Alcohol and Tobacco Tax and Trade Bureau

ANNUAL REPORT

FISCAL YEAR 2011

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Introduction

Supporting the Nation's economic prosperity is at the core of the work performed by the Alcohol and Tobacco Tax and Trade Bureau (TTB). The Bureau's role in permitting and regulating the alcohol and tobacco industries ensures a fair marketplace, enhanced trade opportunities, and a level playing field in the industries we regulate.

Even in these tough economic times, the market sectors TTB regulates have continued to expand, specifically evidenced by growth in the beverage alcohol producer and wholesaler permit applications received by TTB. Annual tax revenue from the alcohol, tobacco, firearms, and ammunition industries is approaching $24 billion, making TTB the third largest tax collection agency in the Federal government. The revenue that TTB collects on these products goes toward funding national priorities.

Across government, as the resources available to agencies to effect their mandates are contracting, it is imperative that every dollar invested in government services produce a return or demonstrate a value. Responsible government means holding one's self accountable to the citizens of this country, which is why TTB combines program performance and financial data within its FY 2011 Annual Report to demonstrate how effectively the Bureau translates its program dollars into quality service, responsible management practices, consumer protection, and increased tax revenue.

As part of the performance and budget cycle, this report grants the Bureau an opportunity to inform stakeholders of its successes and explain any shortfalls. The report defines the Bureau's mission, strategic goals, and major programs, and summarizes its progress in meeting its objectives, as stated in the TTB strategic plan. TTB also presents financial information that depicts how TTB expended its budget on its major programs, and accounted for tax collections from the alcohol, tobacco, firearms, and ammunition industries.

This report presents this information in four parts:

- **Part I – Management's Discussion and Analysis.** This section provides an overview of the Bureau including its mission and programs, highlights of program and financial operations, and a summary of TTB's program performance.
- **Part II – Program Performance Results.** This section provides a summary of results achieved for each performance measure related to the Collect the Revenue and Protect the Public strategic goals and an overview of the Bureau's accomplishments under its Management and Organizational Excellence goal.
- **Part III – Financial Results, Position, Condition and Auditors' Reports.** In this section, TTB presents audited balance sheets, statements of net cost, changes in net position, budgetary resources, and custodial activity as of and for the years ending September 30, 2011, and September 30, 2010. Also included is a report on the Bureau's internal control over financial reporting and a report on TTB's compliance with laws and regulations. This report section also includes a discussion of budget activities for each of the Bureau's seven major programs, and supplemental information, such as a history of Federal excise tax collections for the past decade.
- **Part IV – Appendices.** This section includes a listing of TTB principal officers, an organization chart, and strategic plan information that demonstrates the relationship between TTB's plan and the overall Department of the Treasury's mission and goals.

Message from the Administrator

Finding new and innovative ways to accomplish our respective missions is a shared challenge across the Federal government. The fiscal challenges the Nation faces just add a finer point to a responsibility incumbent upon all public servants to effectively and efficiently administer their jurisdiction. Building a business model that is lean and sustainable, and structured to produce maximum results for the dollars invested, has been a primary focus for TTB in the past fiscal year. The results of our efforts, outlined in part in this annual report, should provide greater assurances that TTB is successful in both its revenue and trade roles.

Already, the TTB business model produces one of the best returns of any tax collection agency, with the Bureau bringing in $468 for every $1 spent on tax collection. In FY 2011, TTB collections on alcohol, tobacco, and firearms products totaled $23.5 billion.

Protecting this important Federal revenue stream requires a vigorous tax enforcement program that, until this year, was handicapped by the lack of law enforcement support to address fraud and other criminal activity in the trade of alcohol and tobacco products. With billions of dollars of tax revenue at stake, TTB pursued an innovative method of using a $3 million earmark from Congress to procure special agent services from the Internal Revenue Service to enforce TTB's criminal jurisdiction. A novelty in government, the agreement between TTB and the IRS embodies this Bureau's longstanding business approach of leveraging available resources before taking on costly and duplicative infrastructure. Contracting for agent services also ensured that the investment made by Congress in this criminal enforcement initiative was used to maximum effect.

The results from this arrangement have exceeded all expectations. In just eight months of active investigations, TTB opened 21 criminal cases that identified more than $20 million in tax liabilities. By outsourcing agent services, TTB expended minimal funding in conducting these cases, and estimates the potential return on investment for this initiative at 10:1. We believe this figure is stunted, both because of the limitations placed on our investigations by the two-year spending authority, and because it does not account for the deterrent impact of our law enforcement presence. Though difficult to quantify, the value of an enforcement presence unquestionably goes beyond any direct collections that may occur to fostering overall tax compliance. The expiration of the two-year earmark ended the reimbursable agreement with the IRS; however, TTB will continue to rely on the partnerships forged in FY 2011 to enforce its criminal jurisdiction in the coming year.

The past year also involved significant progress in the realization of our long-term business vision to move our core services into the online environment. Under tight budget constraints, two e-Gov systems—Permits Online and Formulas Online—were launched in FY 2011. Keeping development costs low by investing in a commercial, Web-based product, TTB released the Permits Online electronic filing solution for permit applications in February 2011. Prior to the system's release, staffing losses and the rising volume of applications had reached a critical point, with the average processing time for original permit applications projected to reach 90 days by the close of FY 2011, an erosion in service of 40 percent compared to just two years ago. Delays in permit processing would have placed TTB in an anti-business posture at a time when small business growth is needed to fuel the economy. Since its release, TTB has achieved a 15 percent reduction in processing times for the eligible application types, issuing original permits to businesses in 48 days compared to 57 days for the same application types submitted on paper. The customer response to Permits Online has been extremely positive, with nearly 60 percent of permit applicants electing to file electronically.

Further, TTB released Formulas Online in January 2011, a Web-based system that members of the alcohol industry can use to draft and submit alcohol product formulas for TTB approval. The review of formulations is both critical in terms of applying the appropriate tax rate and in terms of properly labeling an alcohol beverage product. This e-Gov system also met with customer approval, with more than 500 industry members registering to use Formulas Online within the first weeks of operation. Registrations continue to rise and, to date, more than 30 percent of formulas are received electronically, saving both the industry and TTB time and resources in fulfilling this regulatory requirement.

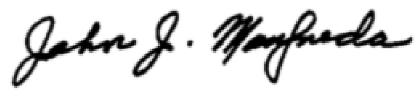
In addition to its tax and regulatory functions, TTB also plays an important role in the facilitation of the global alcohol trade. The trade in alcohol beverages has never been more robust, with the export value of wine and spirits totaling $2.15 billion in FY 2010, a 16 percent increase from 2007. In order to catalyze the vast opportunity for domestic businesses in overseas markets, in FY 2011, TTB advanced our network of regulators through international agreements with Italy, France, and Canada, among others. Targeting the top U.S. trading partners for alcohol beverages supports the Administration's trade policy goal of doubling U.S. exports by the end of 2014.

Ensuring that the commercial trade of alcohol beverages is fair and open to all players is also essential in this economy, and the responsibility for overseeing the integrity of the domestic marketplace falls to TTB. In FY 2011, with a small cadre of investigators, TTB settled a landmark series of cases in which TTB alleged that six major alcohol beverage suppliers were furnishing illegal inducements to a retail casino chain in return for preferential shelf space for their products. Such acts threaten fair competition in the alcohol beverage trade, especially for small companies that cannot afford to pay fees to retailers to do business. TTB negotiated a $1.9 million settlement for these cases, the largest set of offers in compromise ever accepted by TTB for trade practice violations. Looking ahead, vigorous enforcement of these provisions of the Federal Alcohol Administration Act will continue so that all who operate in the alcohol beverage trade have equal opportunity.

In meeting our mandates, we rely on the ingenuity and expertise of a workforce of just 500 employees. In recent years, we have had to make difficult choices in our cost-cutting efforts, the effects of which are felt most acutely by front line staff. The ramifications of reductions in staffing levels manifested in a drastic decline in employee satisfaction in FY 2010, as measured by the Federal human capital survey. As human capital is the backbone of every organization, the TTB leadership team committed extensive resources and time in the last fiscal year to soliciting input from employees on ways to improve the workplace and putting those suggestions into effect. Validation of these efforts came in the shift in TTB's ranking among the Federal government's Best Places to Work, as issued annually by the Partnership for Public Service, from 83rd in FY 2010 to 34th in FY 2011.

Though external pressures are driving change across Federal agencies, TTB has always maintained a focus on keeping a lean and efficient business model. In keeping with our adaptive and flexible work culture, we intend to meet the challenges of the future with continued automation of business processes, increasingly sophisticated risk modeling to target limited enforcement resources, and the expanded application of statistical sampling to extend our enforcement coverage and effectively manage workloads. These strategies will assure that we make the best use of the taxpayer dollars entrusted to us.

The Bureau has validated the accuracy, completeness, and reliability of the performance data contained in this report.



John J. Manfreda

Administrator

Vision, Mission, and Values

Vision

Our vision is to maintain an organization of people who value each other and who treat each other and their customers with the respect that they deserve. We intend to uphold the laws, for which we are responsible, in a fair, equitable, and appropriate manner, affording all an opportunity to have their opinions heard without prejudice. We intend to carry out our mission without imposing inappropriate or undue burden on those from which TTB collects taxes and those TTB regulates.

Mission

Collect the Federal excise taxes on alcohol, tobacco, firearms, and ammunition, and assure compliance with Federal tobacco permitting and alcohol permitting, labeling, and marketing requirements to protect consumers.

Values

We value each other and those we serve. This Bureau:

- Upholds the highest standards of excellence and integrity;
- Provides quality service and promotes strong external partnerships;
- Develops a diverse, innovative, and well-trained workforce in order to achieve our goals; and
- Embraces learning and change in order to meet the challenges of the future.

TTB Strategic Goals and Objectives

Strategic Goal: Collect the Revenue

Industry remits the proper Federal tax on alcohol, tobacco, firearms, and ammunition products

Tax Verification and Validation. Assure voluntary compliance in the timely and accurate remittance of tax payments

Civil and Criminal Enforcement. Detect and address excise tax evasion and other criminal violations of the Internal Revenue Code in the industries TTB regulates

Strategic Goal: Protect the Public

Alcohol and tobacco industry operators meet permit qualifications, and alcohol beverage products comply with Federal production, labeling, and marketing requirements

Business Integrity. Assure that only qualified persons and business entities operate within the industries TTB regulates

Product Integrity. Assure that alcohol beverage products comply with Federal production, labeling, and advertising requirements

Market Integrity. Assure fair trade practices throughout the alcohol beverage marketplace

Strategic Goal: Management and Organizational Excellence

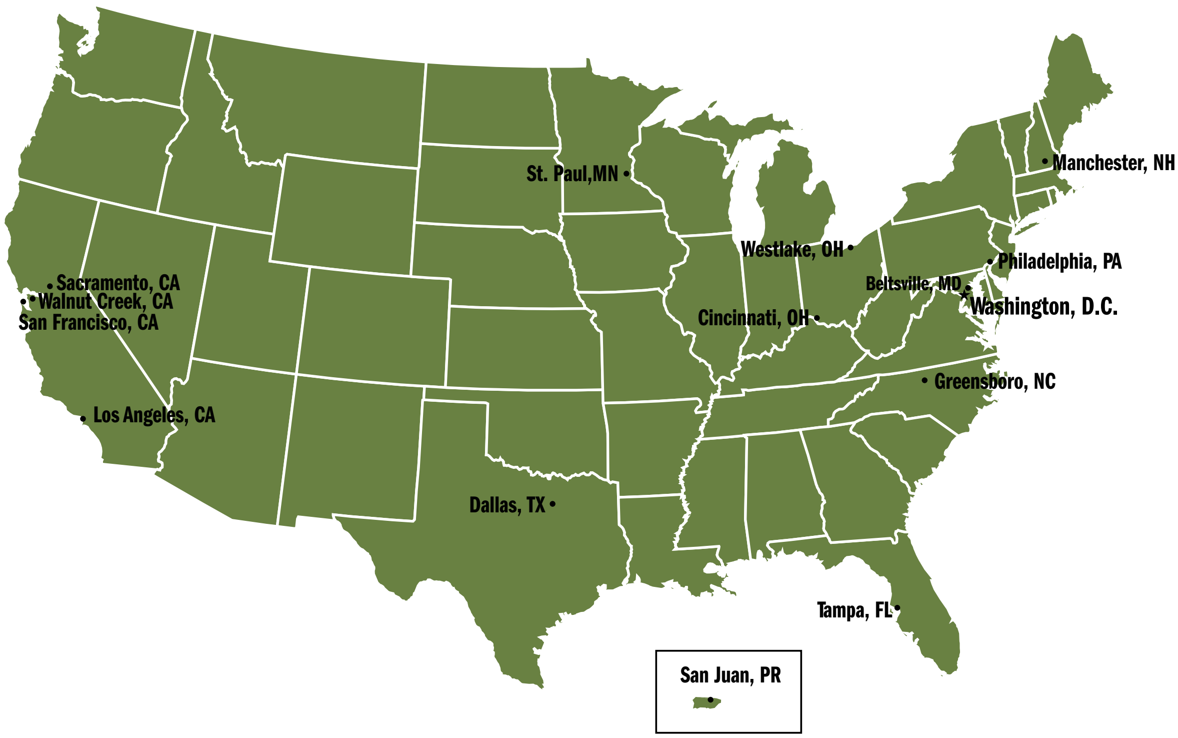
Effectively managed resources and human capital for maximum performance, efficiency, and program results

Human Capital Management. Maintain a qualified, engaged, and satisfied workforce

Technology Solutions. Deliver effective, streamlined, and flexible IT solutions that add value and support program performance

Finance and Performance Results. Facilitate strategic management and financial accountability through the delivery of timely and reliable financial and performance information

TTB Office Locations



TTB at a Glance	
Employees	502
Office Locations *	20
Budget Authority	$100.8 Million
Revenue Collected	$23.5 Billion
Original and Amended Permits Processed	25,679
Certificate of Label Approval Applications Received	145,305

*TTB has some offices co-located in larger cities.

Industry at a Glance	
Total Industry Members	56,217
Industry Members by Permit Type	
Alcohol	96.6%
Tobacco	1.5%
Firearms	1.9%
Industry Members Not Subject to Tax	44,024
Industry Members Subject to Tax	12,193
Those Who Filed and Paid Taxes	7,750

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Part I: Management's Discussion and Analysis

Profile of a Bureau

The mission of the Alcohol and Tobacco Tax and Trade Bureau (TTB) is to collect the Federal taxes on alcohol, tobacco, firearms, and ammunition products and to protect the consumer of alcohol beverages from unsafe or improperly labeled products and from unfair competitive practices in the trade of alcohol. The Bureau's diverse mission, and its position as a bureau of the Department of the Treasury, means that TTB must strike a balance between its tax and regulatory functions and its role in facilitating fair and robust economic activity in the alcohol and tobacco trades.

TTB is staffed with approximately 500 employees, most of whom report to either the headquarters office in Washington, D.C., or the National Revenue Center in Cincinnati, Ohio. For its auditors and investigators to most effectively operate in the field, TTB also has 11 offices in cities across the U.S., as well as Puerto Rico. Additionally, the Bureau has two laboratory facilities in Walnut Creek, California and Beltsville, Maryland. See Part IV of this report for a chart outlining the TTB organization structure.

The Bureau was formed in January 2003, under the Homeland Security Act of 2002, but its history began more than 200 years ago as one of the earliest Federal tax collection agencies. Today, TTB operates under the authorities of the Internal Revenue Code of 1986 (IRC)[1] and the Federal Alcohol Administration Act (FAA Act),[2] including the Alcoholic Beverage Labeling Act of 1988 (ABLA)[3] and the Webb-Kenyon Act.[4] These laws put in place strict requirements and controls related to alcohol and tobacco products and place restrictions on who can make, sell, and distribute these commodities.

In general terms, TTB administers its jurisdiction according to two core mission areas—"Collect the Revenue" and "Protect the Public"—to produce identifiable outcomes in support of the Nation's financial and economic interests.

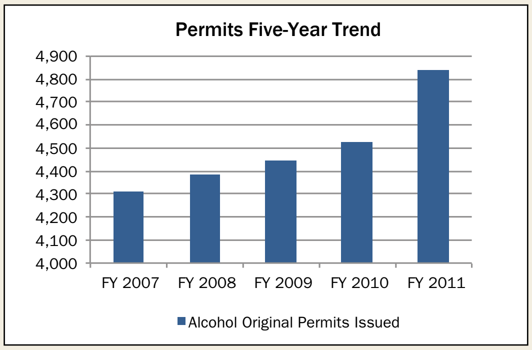
1 Chapters 51 and 52 of the IRC provide for excise taxation and authorize operations of alcohol and tobacco producers and related industries, and IRC sections 4181 and 4182 provide for excise taxes for firearms and ammunition.

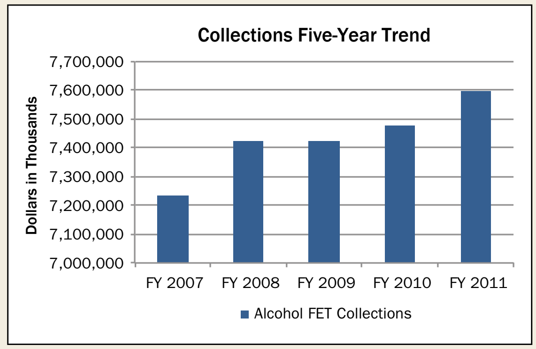
2 The FAA Act provides for regulation of those engaged in the alcohol beverage industry and for protection of consumers through certain requirements regarding the labeling and advertising of alcohol beverages. The FAA Act also includes provisions to preclude unfair trade practices that serve as barriers to competition and trade in the U.S. marketplace.

3 The ABLA mandates that a Government warning statement appear on all alcohol beverages offered for sale or distribution in the United States.

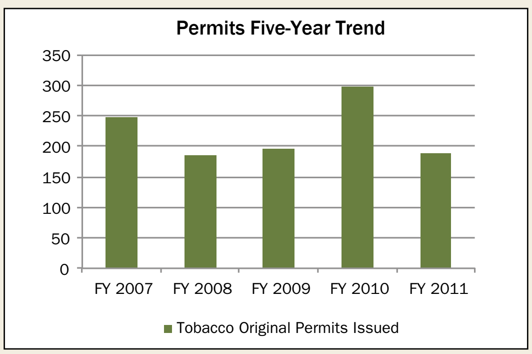
4 The Webb-Kenyon Act prohibits the shipment of alcohol beverages into a State in violation of the receiving State's laws.

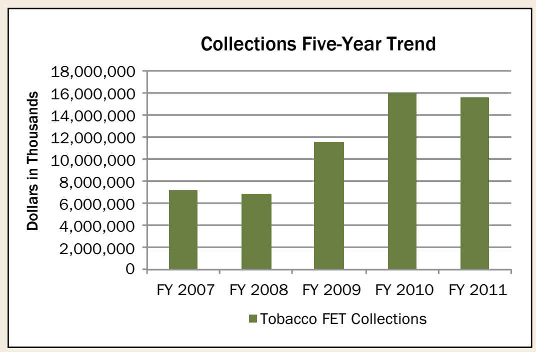
Alcohol Industry Snapshot



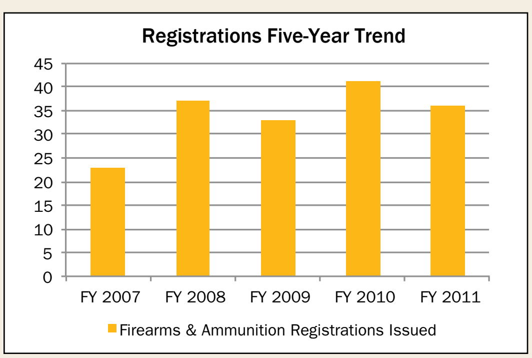


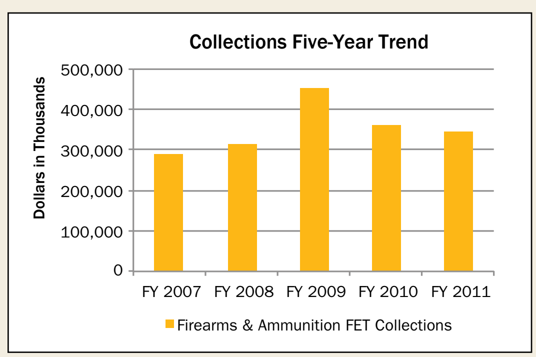
Tobacco Industry Snapshot





Firearms & Ammunitions Industry Snapshot

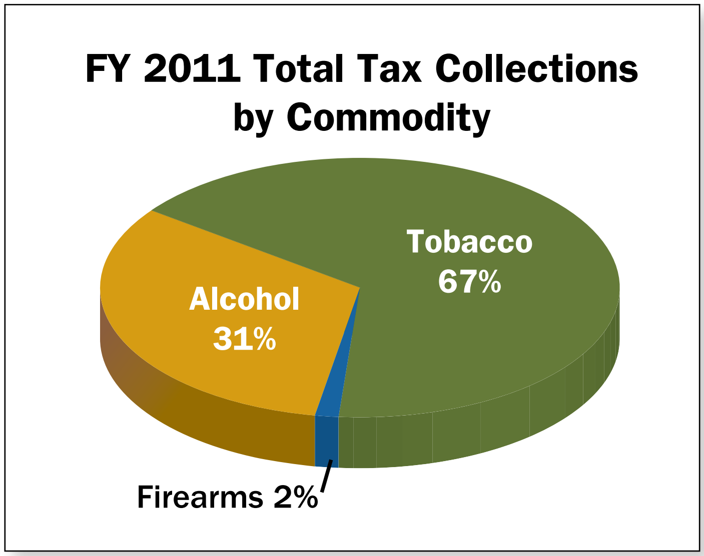




Collect the Revenue

TTB is the third largest tax collection agency in the U.S. Government, behind the Internal Revenue Service (IRS) and U.S. Customs and Border Protection (CBP). TTB's effective administration of its collections duties ensures that the Federal government has the cash resources needed to fund the Nation's priorities.

TTB collected $23.5 billion in taxes in FY 2011—a decrease of 1 percent compared to FY 2010 when excise tax collections on these trade goods reached an historic high. Prior to 2008, TTB and its predecessor—the Bureau of Alcohol, Tobacco and Firearms (ATF)—collected between $14 - $15 billion in excise taxes annually. Now, for the third consecutive year, TTB tax collections have exceeded $23 billion.



The increase in tax revenue is mostly attributable to increased receipts from the tobacco industry. With the passage of the Children's Health Insurance Program Reauthorization Act (CHIPRA) in February 2009, Congress imposed significantly increased tax rates on cigarettes and other tobacco products. This legislation provided for a tax increase on all tobacco products (except large cigars), and cigarette papers and cigarette tubes, effective April 1, 2009. In FY 2011, TTB tobacco excise tax collections reached $15.5 billion. In forecasting tobacco revenues, Federal collections are expected to decline after peaking in FY 2010. Higher prices on tobacco products have historically resulted in decreased consumption and increased illicit trade, which combined would indicate declining tax revenues in the out years.

The alcohol beverage industry in the United States pays $7.6 billion in Federal excise taxes each year and also provides a source of tax revenue for state and local governments. Economic forecasts predict continued modest growth in the alcohol industry, and taxes collected on alcohol beverages are expected to continue to rise throughout the period of FY 2011 – FY 2013. TTB expects that the increase in new alcohol businesses will be most prominent in the number of wineries, craft breweries, and craft distilleries.

Firearms and ammunition excise taxes are remitted to the Fish and Wildlife Restoration Fund under provisions of the Pittman-Robertson Act of 1937. The U.S. Fish and Wildlife Service, which oversees the fund, apportions the money to state governments for wildlife restoration and research, and hunter education programs. Federal excise tax collections on firearms and ammunition have increased from $193 million in FY 2003 to $344 million in FY 2011, an increase of $151 million over the past seven years, or a 78 percent growth in Federal FAET revenues. The increase in reported tax revenue can be attributed to industry growth, effective outreach and collection initiatives at the Bureau, and the field presence of TTB's auditors, which continues to promote voluntary taxpayer compliance.

Civil Tax Enforcement

Tax Classification

The tax rate on alcohol and tobacco products varies according to various characteristics of the products themselves and the production volume of the producers. Therefore, a critical first step in tax enforcement is the assignment of a tax class to alcohol and tobacco products based on Federal regulatory standards.

For alcohol beverages, classification requires that the Bureau review the formula of certain products before they enter the market. For example, if an examination of the formula were to disclose that an imported sake, which is made from fermented rice and is classified and taxed as wine, contains added spirits, then the product is then classified and taxed as a distilled spirit. This type of formula review, known as a pre-import approval, can have significant tax implications, as wine is subject to a lower tax rate than spirits products.

TTB also conducts post-market product evaluations to check for proper tax classification. As an example, TTB evaluates samples of products marketed as large cigars to verify that the products are large cigars rather than cigarettes or small cigars, as the tax rates differ markedly between these products. In classifying such a product under the IRC, TTB evaluates the product's wrapper, the type of tobacco used in the filler the product's packaging and labeling and its weight to verify that the product meets the statutory criteria for a large cigar.

Non-Traditional Tobacco Products

TTB also must determine the tax classification of new forms of tobacco products. Some of these new products are a result of market innovation while others are actually products common in other countries. In FY 2011, TTB evaluated a range of non-traditional products, such as products marketed as "electronic" cigars, cigarettes, or pipes, and products marketed as "tobacco free" tobacco product alternatives. One important initial factor for evaluating these products is determining whether the products contain tobacco. If the products do not contain tobacco, the tax would not apply. To do so, the TTB Tobacco Laboratory developed a method to confirm the presence of tobacco in these unconventional products. The tobacco verification determinations are also relevant to states, which defer to TTB for such determinations, and other Federal agencies, such as the Food and Drug Administration (FDA).

Regulatory Standards for Tobacco Products

As a result of CHIPRA, the tax on small cigars and small cigarettes was made equivalent, at $50.33 per 1,000 sticks. While the tax issue was resolved by this parity, the need for appropriate classification of these products remains, since other laws make a distinction between cigars and cigarettes, and impose more stringent regulatory restrictions over cigarettes but not cigars. For example, the Jenkins Act, recently amended by the Prevent All Cigarette Trafficking (PACT) Act, applies restrictions on delivery and Internet sales of cigarettes and smokeless tobacco products and on mailing such products through the U.S. Postal Service (USPS), but these restrictions do not apply to cigars. In this case, and in all instances where cigarettes are more restrictively regulated than cigars, the incentive for industry to misclassify these products remains.

From an excise tax perspective, since the enactment of CHIPRA issues relating to distinguishing between cigars and cigarettes are less prominent because the tax on cigarettes and small cigars is now the same, while issues relating to verifying that a product is a large rather than a small cigar have become more prominent.

The distinction between small cigars and large cigars is a straightforward one based solely on weight, that is, large cigars weigh over 3 pounds per 1,000 while small cigars weigh 3 pounds per 1,000 sticks or less. However, the tax on large cigars is based on the sale price (the price sold by the manufacturer or importer) while the tax on small cigars is a fixed per-unit tax ($50.33 per 1,000). As a result, the tax on inexpensive large cigars may be quite a bit less than that on small cigars. For manufacturers and importers of inexpensive cigars that are relatively close to the 3-pound per 1,000 dividing line, the incentive is to ensure that these products weigh just enough to meet the weight criteria of large cigars. Hence, after the enactment of CHIPRA, TTB saw that a number of the products that it had evaluated and determined to be small cigars prior to CHIPRA were now just over 3 pounds per 1,000.

An even more significant issue since the enactment of CHIPRA, and one of ongoing concern, is the shift in the pipe tobacco and roll-your-own (RYO) tobacco products. Prior to CHIPRA, the tax rates on pipe tobacco and RYO tobacco were the same at just under $1.10 per pound. As a result of CHIPRA, the tax on pipe tobacco was increased to just over $2.83 per pound, while the tax on RYO tobacco was increased to $24.78 per pound. This significant tax difference resulted in a dramatic shift in the volume of pipe tobacco and RYO tobacco reported as removed by domestic manufacturers from their manufacturing premises for sale in the United States. In short, the amount of pipe tobacco removed greatly increased while the amount of RYO tobacco removed declined.

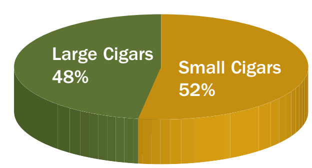
Under the IRC, pipe tobacco is any tobacco which, because of its appearance, type, packaging, or labeling, is suitable for use and likely to be offered to, or purchased by, consumers as tobacco to be smoked in a pipe. RYO tobacco is defined as any tobacco which, because of its appearance, type, packaging, or labeling, is suitable for use and likely to be offered to, or purchased by, consumers as tobacco for making cigarettes or cigars, or for use as wrappers of cigars or cigarettes.

Because of the lack of clear standards in the tax code to differentiate pipe tobacco from RYO tobacco, and the consequent potential for misclassification and erroneous tax payment on these products, TTB published a notice in the Federal Register (75 FR 42659) seeking comment on the types

Effect of CHIPRA on Taxable Removals of Tobacco Products

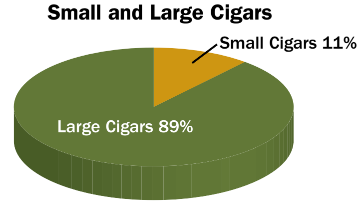
The taxes imposed on tobacco products are determined at the time the product is removed for sale from the manufacturing premises. Since the enactment of CHIPRA, significant shifts in the tobacco products industry have surfaced, particularly in the markets for small and large cigars and RYO and pipe tobacco. The revenue losses just from the shift in RYO and pipe tobacco removals, assuming the market shift is attributable to the tax rate increase, exceed $1 billion since the enactment of CHIPRA.

Pre-CHIPRA Reported Removals of Small and Large Cigars



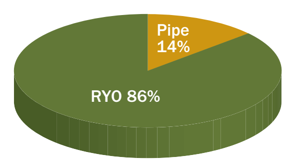
Total Removals between April 1, 2008 - March 31, 2009

Post-CHIPRA Reported Removals of Small and Large Cigars



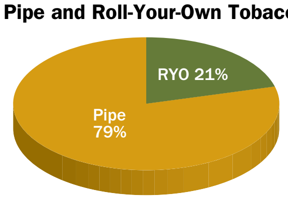
Total Removals between April 1, 2009 - March 31, 2010

Pre-CHIPRA Reported Removals of Pipe and Roll-Your-Own Tobacco



Total Removals of 23.5 Million Pounds in Calendar Year 2008

Post-CHIPRA Reported Removals of Pipe and Roll-Your-Own Tobacco



Total Removals of 28.2 Million Pounds in Calendar Year 2010 of objective standards that would provide a basis for differentiating between these two products for tax purposes. The comment period was reopened to address comments received after the public comment period ended and the extended period closed on October 24, 2011. At the same time, the TTB Tobacco Laboratory has been evaluating proposed methods and standards, and undertaking research to develop methods and standards, in support of this rulemaking. The goal is to set forth a set of objective criteria, based on physical characteristics of the products, that distinguish between pipe tobacco and RYO for tax purposes. TTB intends to publish subsequent rulemaking in this area.

Tax Verification

In effecting its revenue mission, TTB uses a coordinated enforcement approach to verify that industry members remit the excise taxes due on the alcohol, tobacco, firearms, and ammunition products sold to U.S. consumers. The Bureau's auditors, investigators, chemists, and tax and regulatory specialists work in concert to verify and validate that industry members pay the proper amount of tax on these strictly regulated commodities.

The strategic risk-based approach used to deploy limited staff resources enables TTB to leverage its field presence to cover a wide universe of taxpayers. TTB field personnel conduct targeted compliance audits and investigations based on risk and random factors. Working on taxpayer premises, TTB auditors and investigators review the production records and returns of industry members to ensure compliance with Federal tax and regulatory requirements. In FY 2011, these combined efforts resulted in the identification of $35 million in additional tax, penalties, and interest, and the collection of more than $15 million in additional tax revenue.

Floor Stocks Tax Enforcement

In FY 2011, TTB continued to address the significant revenue exposure that remains from the floor stocks tax (FST) levied on tobacco products under the CHIPRA legislation. An FST is a one-time excise tax placed on a commodity undergoing a tax increase, and was imposed on all tobacco products held for sale as of April 1, 2009. The FST is equal to the difference between the new tax rate and the previous rate. As TTB has no regulatory authority over tobacco wholesalers and retailers, the FST represented an enforcement challenge by adding approximately 400,000 new taxpayers to TTB's enforcement responsibility. In two years, TTB has identified $16.3 million in underpaid FST, and collected $8.5 million in additional FST collections.

Since its enactment, TTB has continued its FST enforcement efforts based, in part, on findings that many wholesalers and retailers failed to report or underreported their tobacco inventory and associated tax payments. Field examinations of the largest FST taxpayers have been initiated, and on-site examinations will continue into FY 2012; however, the number of FST non-filers is so great that existing enforcement resources cannot conduct on-site examinations of the entire population of high-risk taxpayers. In FY 2011, TTB developed a procedure to pursue tax liabilities at companies where targeting analysis indicates FST liabilities exist, but where it is not cost effective or otherwise practical to conduct an on-site examination.

The procedure combines field analytics with a risk-based assessment approach to identify tobacco wholesalers and retailers that sourced tobacco product during the month of March 2009, but either did not file an FST return or filed an FST return declaring zero FST liability. TTB auditors use Federal and state databases, as well as third-party commercial data, to target non-filers, and the National Revenue Center uses a "substitute-for-return" process to issue assessments on the estimated tax liabilities en masse. The

IRC permits TTB to create a tax return for a taxpayer where no return has been filed, or the return that was filed is considered false. TTB may use the information collected in the course of FST enforcement, if sufficiently detailed, to create a tax return, in what is commonly called a "substitute-for-return" process. Initial estimates based on this procedure indicate that the FST revenue risk is more than $25 million.

Targeted Tax Enforcement

In FY 2011, TTB used current intelligence on potential vulnerabilities in the distribution chains for tobacco to enhance its risk models and better target its enforcement efforts to protect Federal revenues.

Due to the known revenue risk in the import and export trade in tobacco products, and as the Federal permitting authority for tobacco importers, TTB developed a tobacco importer risk model to identify the highest risk tobacco importers in TTB's portfolio. In FY 2011, the Bureau's audits of these businesses resulted in the identification of more than $10 million in additional excise tax liability. TTB referred these cases to CBP, the authority for collecting the Federal excise tax on imported products.

Additionally, as required by the CHIPRA legislation, tobacco processors now report to TTB on the removal, transfer, or sale of processed tobacco. As processed tobacco is untaxed, there is significant revenue risk if this product is diverted outside the lawful distribution chain for use in the illegal manufacture of tobacco products. In FY 2011, TTB initiated a pilot project, driven by a newly developed risk model, which indicated that processed tobacco was being distributed to non-permitted manufacturers who did not report or file Federal excise taxes. There are 30 domestic tobacco processors and 179 importers of processed tobacco who distribute approximately 1.1 billion pounds of processed tobacco to a myriad of brokers, manufacturers, and other tobacco processors. The TTB risk model developed for the pilot project indicated that many of these businesses warranted a joint investigation/audit to determine compliance with TTB laws and regulations and to validate the amounts of processed tobacco reported in their filings.

TTB conducted field examinations of these manufacturers and importers of processed tobacco, and conducted subsequent audits and forward traces of processed tobacco removals outside of the permitted system. As of the close of FY 2011, this work had identified the potential for approximately $9 million in additional Federal excise tax due on illegally manufactured tobacco products. To date, through its efforts to trace processed tobacco from manufacturers and importers to various points in the distribution system, TTB has collected $1 million from a tobacco importer. Additionally, these efforts found that large quantities of processed tobacco were being reported as shipped to two warehouses that either didn't exist or never received the product. The potential tax liability for these processed tobacco shipments (if made into cigarettes) exceeds $5 million. In terms of criminal activity, this initiative identified several illegal manufacturers, to date, and one criminal case referral to a United States Attorney's office; that office is currently investigating the case for potential prosecution. This pilot project will be rolled out nationwide in FY 2012.

Criminal Enforcement

TTB is the sole agency with jurisdiction over Federal excise tax evasion in relation to alcohol and tobacco products. Under its criminal authority, TTB is charged with identifying any gaps in tax payment from entities and individuals operating outside of the lawful distribution system for alcohol and tobacco products. Using leads from referrals, government databases, and other external sources, as well as internal data, TTB is able to identify trends and schemes used to facilitate tax fraud and diversion.

Tax fraud in the alcohol and tobacco industries, whether through unlawful product diversion or other means, poses a high risk to Federal revenue collection as well as a lucrative funding source for criminal or terrorist organizations.[5] Diversion activity also undermines Federal and state tax interests in promoting fair competition within interstate commerce. Further, the illicit trade of alcohol and tobacco products also undermines public health policy by allowing the introduction of illegally manufactured or distributed products into the marketplace at reduced prices, thereby making them more accessible or affordable, thus directly contravening tax policies aimed at reducing consumption. Consequently, non-taxpaid alcohol and tobacco products offer a cheap alternative to price-sensitive consumers who might otherwise abstain from use.

The recent increases in the Federal and state taxes[6] on tobacco products establish a compelling motivation for unlawful operators to use diversion as a means to achieve enormous profits with relative ease.[7] In addition to Treasury Department estimates regarding the range of potential revenue loss from Federal excise tax on tobacco[8], a September 2009 Department of Justice Inspector General report cites estimates that the diversion of tobacco products costs Federal and state governments over $5 billion in lost tax revenues annually. Diversion of tax is not limited to the tobacco trade. Though TTB has no similar estimates of revenue losses from the diversion of alcohol, criminal case work in FY 2011 indicates that fraud in the alcohol beverage trade poses a serious revenue threat.

Establishment of a TTB Criminal Enforcement Program

Until FY 2011, addressing criminal activity in the alcohol and tobacco industries required that TTB coordinate with other law enforcement agencies to effect the Bureau's criminal jurisdiction. Recognizing the Bureau's lack of resources to hire special agents and its inability to enforce its criminal jurisdiction without its own agents, Congress granted TTB special funding under the Consolidated Appropriations Act of 2010 "for the hiring, training, and equipping of special agents." With this funding, TTB negotiated an agreement with IRS Criminal Investigation (IRS CI) to provide criminal investigative services, effectively allowing TTB to contract out agents to enforce its laws under TTB's own authority. This arrangement allowed TTB to engage in operations quickly and to bypass operational costs associated with standing up a law enforcement arm, both of which were critical considerations given the expiration of the two-year funding at the close of FY 2011. The agreement, which took effect October 1, 2010, provided for both infrastructural support, such as training, vehicles, weapons, and medical testing, and for the provision of special agents themselves.

5 Department of Justice, Office of the Inspector General Report Number I-2009-005, "The Bureau of Alcohol, Tobacco, Firearms and Explosives' Efforts to Prevent the Diversion of Tobacco," September 2009.

6 Between 2005 and 2009, 32 states and the District of Columbia have raised cigarette excise taxes a combined total of 51 times.

7 To illustrate the potential profit margin for those engaged in the illicit tobacco trade, a product that is introduced into New York City without payment of any federal or state taxes or applicable fees presents an illegal profit of $58.60 per carton, based upon the evasion of taxes and fees. This translates into $3,516 per case, or approximately $3.2 million per truckload.

8 A 2010 U.S. Treasury Department report (based on tax rates in effect prior to the enactment of CHIPRA) estimated that for the year 2007, the diversion of tobacco products may have cost the Federal government in the range of $500 million to $1.5 billion, depending on a correction factor applied. Applying the new tax rate, Federal losses could range between $1.5 billion and $4.5 billion.

Pursuant to this agreement, a Special Agent in Charge (SAC) and five special agents were assigned full-time to TTB. The SAC and the special agents were chosen based on their experience with conducting criminal tax fraud investigations and were assigned to geographic areas that had known alcohol and tobacco criminal and diversion related activity. Further, recognizing the expertise required to work these cases effectively, TTB established permanent fraud teams within its audit and investigator workforce; these fraud teams coordinate with TTB's tobacco laboratory, to successfully support special agents in making criminal diversion cases. The complexity of diversion cases requires leveraging all of TTB's enforcement resources to identify, develop, and successfully prosecute offenders.

Criminal Enforcement Program Results

In its one year of operations, the criminal enforcement program at TTB produced significant results. With only six TTB special agents, a total of 21 cases were opened within just eight months, with a total estimated tax liability of over $20 million. These cases were selected, in part, based upon likelihood of completion within the period of the contract authorized under TTB's appropriations. TTB referred 19 of these cases to an Assistant United States Attorney (AUSA), each of which were accepted and are currently under investigation. This unprecedented acceptance rate on criminal referrals demonstrates not only the magnitude of the cases but also the strength of the case on the merits. This success rate reflects the synergy that results from experienced civil fraud auditors and investigators who know the industry and its trade channels working with skilled agents to develop the criminal case.

The types of investigations developed during the short amount of time that the criminal enforcement program was underway were wide ranging and are representative of the extensive type of tax fraud and criminal activity surrounding illegal alcohol and tobacco activities. The schemes employed to evade excise tax payment include:

- Manufacturing of tobacco products without payment of Federal excise tax
- Cigarette distributors evading tobacco FST
- Cigarette distributors selling "exported" cigarettes in the U.S. without payment of Federal excise tax
- Cigarettes smuggled into the U.S. without payment of Federal excise tax
- Failure to pay Federal excise tax on distilled spirits produced
- Importation of misclassified distilled spirits to evade Federal excise tax
- Operating without a permit/wholesaling violations
- Importing alcohol without a permit
- False wine labeling and sales of counterfeit wine

Significantly, though criminal cases often are multi-year endeavors, TTB forwarded for prosecution two criminal investigations in FY 2011 that resulted in guilty pleas by the respective defendants. The first investigation forwarded for prosecution involved an imported distilled spirits product, known as Soju, which was intentionally misclassified as wine upon importation. By falsifying import documentation, the defendant avoided paying the Federal excise tax due on these shipments. The case resulted in a plea agreement of nearly $102,000. The second case referred for prosecution involved a criminal case related to the evasion of FST on cigarettes. TTB special agents and other field staff conducted mass interviews of persons who were falsely reported to be customers of the subject tobacco distributor. This coordinated effort lead to the verification that the subject was evading approximately $92,000 in FST. The subject recently signed a guilty plea.

TTB also continued joint investigations with its partner law enforcement agencies in FY 2011, and reached an historic settlement with a Native American tribe involved in the manufacturing of cigarettes without a Federal permit or payment of excise taxes. Enforcement of Federal excise tax laws on Native American reservations involves the application of Federal revenue laws to activities that occur on tribal lands, and associated issues involving claims of tribal sovereignty in some instances, particularly on the St. Regis Mohawk Indian Reservation in New York. These matters are extremely sensitive and have presented difficult enforcement issues based upon existing law establishing that Federal excise tax laws apply on Native American lands. Over the last several years, TTB has made substantial progress in resolving these cases by working with the Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF) to achieve settlement agreements with the four largest manufacturers on the St. Regis Mohawk reservation. Under these agreements, the parties have resolved past non-compliance issues and agreed to comply with Federal tobacco tax laws in the future. During 2011, TTB, working with ATF, resolved the last of the four largest illegal manufacturing cases there. In this last case, TTB and ATF accepted a $1.25 million forfeiture, paid to ATF, from the unlicensed cigarette manufacturer for prior violations of the IRC, as well as the Contraband Cigarette Trafficking Act (CCTA).[9] The illicit manufacturer agreed to come into compliance with all applicable Federal statutes and regulations, pay all Federal taxes due under the IRC, and cease its operation of a cigarette sales Internet site, which violates the Prevent All Cigarette Trafficking Act. As part of the settlement, TTB agreed to issue a permit to this company to manufacture tobacco products.

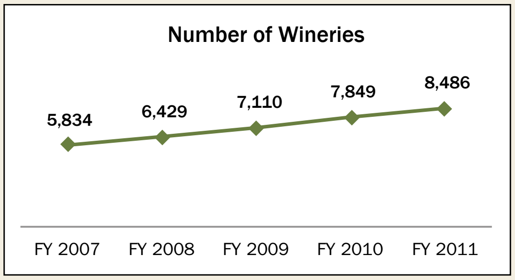
Several unlicensed cigarette manufacturers continue to operate on the St. Regis Mohawk reservation, which straddles the border between the United States and Canada. In FY 2012, TTB will continue to work with the various businesses on the reservation, ATF, and the U.S. Attorney's Office, to either bring all of the illegal operations into compliance or cease their operations.

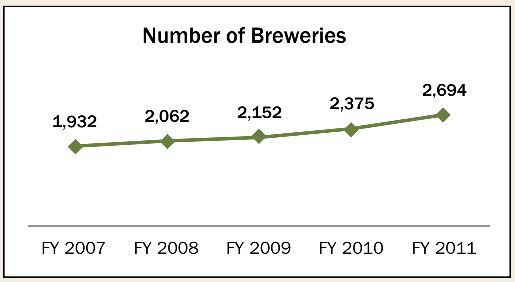
Protect the Public

The TTB Protect the Public strategic goal has broad meaning and is inclusive of activities that directly impact American consumers, such as product safety testing and the verification of labeling claims so that products are safe and are what their labels and advertisements claim them to be, as well as work that directly impacts the U.S. economy by facilitating vigorous trade and fair competition within the alcohol beverage trade. Consumer confidence, both domestically and abroad, in the alcohol beverage products manufactured in the U.S and a fair playing field within the marketplace, are critical to fueling the economy and promoting job growth.

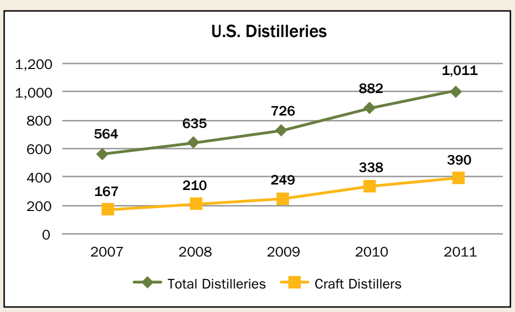
9 The CCTA, 18 U.S.C. chapter 114, prohibits the introduction of cigarettes into a state without the required reporting and payment of that state's taxes. The CCTA makes it a Federal felony for certain persons to traffic in contraband tobacco products or make false representations in records required by the Act.

Alcohol Industry Permit Activity





The number of wineries and breweries in the U.S. continues to trend up even during a period of recession in the global economy. Both the number of wineries and breweries has grown approximately 40 percent since FY 2007. Market data indicates that growth is strong in the craft brewer segment, which includes microbreweries and brewpubs.



The number of U.S. distilleries has increased by 79 percent since 2007. Over the last five years, there has been explosive growth in the number of craft distillers, defined as beverage distilled spirits plants that taxpaid less than 100,000 proof gallons annually. This segment has increased by more than 130 percent since FY 2007.

TTB's work in this mission area aligns under four programs: 1) Permits and Business Assurance; 2) Trade Facilitation; 3) Advertising, Labeling, and Product Safety; and 4) Outreach and Voluntary Compliance. Taken together, these programs ensure the integrity of the businesses that produce and distribute alcohol and tobacco products, the integrity of the products themselves, and the integrity of the market in which these businesses operate.

Business Integrity

The FAA Act includes provisions to require a permit for those who engage in the business as a producer, importer, or wholesaler of alcohol beverages. The IRC includes similar permitting requirements for tobacco manufacturers, importers, and export warehouses, as well as some alcohol industry members.

Under its FAA Act authority, TTB conducts a multi-tiered background evaluation prior to issuing a permit to ensure that only qualified persons obtain a permit to operate within the regulated industries. Through this process, and other activities under its Permits and Business Assurance Program, TTB prevents prohibited persons from commencing operations and potentially diverting products from legitimate commercial channels in order to fund illicit activity. Given the substantial tax revenue associated with the commodities TTB regulates, and the distribution controls associated with them, the incentive to operate under color of law for illegal purpose and illegal profit is substantial and, therefore, an important area of the Bureau's focus.

Given shrinking resources, TTB has to effectively target its regulatory enforcement efforts to ensure results. In reviewing permit applications, certain applications are referred to TTB investigators for a field inspection, based upon various risk factors. TTB investigators also perform field investigations on a statistically random sample of applicants who received a permit to ensure that the proprietor is eligible to operate within the TTB regulated industries and to verify that the business' operations comply with Federal law. If TTB determines that a business is violating the conditions of its Federal permit, TTB may suspend or revoke its permit to operate.

Efficiency in permit processing is equally critical to the Department of the Treasury's goal of improved economic opportunity. In addition to ensuring a lawful marketplace by preventing diversion, improving turnaround time for permit application processing enables those who are qualified to hold a permit in the alcohol and tobacco industries to begin operating businesses sooner, facilitating U.S. economic growth in a fair marketplace.

TTB facilitates growth in the U.S. economy by enabling qualified applicants to enter business as an alcohol producer, wholesaler or importer, or as a tobacco products manufacturer, importer or exporter. The number of applicants filing for an original permit or registration with TTB has grown 11 percent between FY 2007 and FY 2011. Today, the Bureau regulates 56,217 industry members, an increase of 27 percent over the 44,138 permit holders in FY 2007.

Importing Tobacco Products without a Permit

In support of the Bureau's business integrity objectives, TTB monitors compliance with Federal permit requirements among tobacco product importers by comparing the import records in U.S. Customs and Border Protection's International Trade Data System to the permit records on file in the TTB Integrated Revenue Information System (IRIS)—the Bureau's integrated tax and permit database. In FY 2011, TTB intelligence analysts were able to identify 47 entities (14 percent of active tobacco importers in FY 2011) importing product illegally through this comparison, and responded by issuing cease and desist letters to the culpable individuals. These efforts to address compliance violations have proven effective, as all of the importer entities notified by TTB have come into compliance or ceased operations, and the overall rate of non-compliance has declined since FY 2008, based upon this comparison activity. CBP is the Federal agency responsible for collecting taxes and duties due on these imported products. The tax value of these imports as declared to CBP is $375,000. It is important to point out that, while this activity is vital to detect declared importations of tobacco, the fundamental nature of illicit activity is to evade detection. Therefore, while this program addresses non-compliance by known entities, TTB relies upon and is developing other methods to detect undeclared importations and the substantial potential tax value that they entail.

Since the Bureau began this enforcement strategy, the rate of non-permitted tobacco importers that have declared entries of tobacco products to U.S. Customs has declined. Since FY 2008, the level of illegal importers fell from 22 percent to 14 percent in FY 2011. However, as tobacco products are often smuggled into the U.S. through undeclared importations, TTB must continue to supplement these data mining efforts and to monitor importer activity through audits, investigations, and other intelligence efforts in order to truly address the issue of illegal importations and the persons who trade in the illicit market.

Improvements to Permit Application Processing

TTB currently processes application packets for more than 20 types of permits or registrations for the alcohol, tobacco, firearms, and ammunition industries. New or existing alcohol and tobacco industry members file these packets to request permission to commence a new regulated industry operation, or to update critical permit information such as a change in location or partnership changes for an existing business.

Over the past several years, the number of permit applications that TTB receives has increased drastically. The increase in workload volume combined with stagnant resources has made it difficult for the Bureau to maintain service levels. Since 2003, TTB's permit processing workload has increased 56 percent. Between FY 2010 and FY 2011, TTB's permit processing activity has increased 7 percent. Without intervening action, TTB projections estimated reaching 90-day turnaround times for original permit applications at the close of FY 2011, compared to 65 days in FY 2010.

In FY 2011, TTB acted to address these service delivery issues through its successful release of a new electronic permit application processing system, Permits Online. With the first two releases, in February and April 2011, Permits Online currently allows certain industry members—alcohol wholesalers, alcohol importers, wineries, specially denatured alcohol users or dealers, and tax-free alcohol users—to complete and submit permit applications online. These application types account for more than 70 percent of the total number of original permit applications TTB receives. Future phases will allow all types of industry members to submit applications electronically through Permits Online.

Significant system features include online self-registration, self-monitoring of an application's status, and electronically guided assistance through the application process. The built-in prompts and self-help instructions at each step of the application process also assure that the applications that reach TTB specialists are completed correctly and contain all the required documentation.

Permits Online also has created workflow efficiencies that allow TTB to process electronic applications nine days faster than paper applications that the Bureau receives at the same time. Industry members who use Permits Online also save approximately six days on mailing delays from the time they submit their applications to the time they receive their approval documents.

The impact of Permits Online has been substantial. Prior to the system release, projections for average annual processing times for FY 2011 were 90 days, an increase of nearly 40 percent compared to the prior year, given the increase in applications received and the staffing reductions as part of government-wide efficiency efforts. TTB expects the Permits Online system to enable TTB to exceed this projected processing time, and target an average of 75 days to process an original permit application.

The strategic investment that TTB made in the Permits Online system was critical to improving business results for this TTB program, which has real value in terms of supporting the Nation's economic recovery. Not acting on delays in permit issuance would have placed TTB in an anti-business posture at a time when job creation and United States competitiveness abroad are national priorities. The new businesses permitted by TTB are predominantly small businesses, and contribute to job opportunities locally and to America's competitiveness in the global market.

Market Integrity

TTB is charged with assuring that the alcohol marketplace is free from practices that would stifle competition and act as a barrier to trade. TTB, under its Trade Facilitation program, meets this mandate through a variety of activities, ranging from investigations of the commercial trade of alcohol beverages to liasing with foreign counterpart agencies to keep the channels of commerce open and operating in compliance with U.S. and international laws.

TTB works with industry, foreign and state governments, and other interested parties to maintain the appropriate level of industry and market oversight to ensure compliance with Federal product and trade requirements. An effective Trade Facilitation program keeps the domestic market operating on a level playing field, opens new markets to domestic alcohol producers, and positively influences the balance of trade with respect to alcohol beverages.

TTB's work in this area has direct influence on the Nation's economic recovery. A 2007 industry trade association report shows that the alcohol beverage industry contributes directly or indirectly to the U.S. economy by providing nearly 4 million jobs and roughly $400 billion in economic activity. Overseas demand for the products TTB regulates continues to grow, with U.S. exports of all alcohol beverages totaling $2.3 billion in 2010. The majority of these exports are spirits and wine products. In just examining the wine sector, 81 percent of world wine consumption is outside of the U.S., indicating that these industries may contribute significantly to the U.S. trade policy goal to double all exports in 5 years, as stated in the President's National Export Initiative.

Promoting Fair Competition in the U.S. Marketplace

As part of its Trade Facilitation Program, TTB has reinvigorated FAA Act trade practices activities to investigate acts that violate Federal law relating to alcohol beverage marketing practices. The FAA Act provisions that TTB enforces require TTB to ensure fair competition in the alcohol beverage trade by ensuring that persons who engage in the trade are qualified to do so within the meaning of the statute and by regulating the trade practices, labeling, and advertising concerning the sale of alcohol beverages. Regulated trade practices entail restrictions involving exclusive outlets, tied house arrangements, commercial bribery, and consignment sales. Unlawful trade practices threaten fair competition because such practices undermine equal access to the marketplace, precluding healthy small business activity, and limit consumer choices by allowing influential producers to unlawfully interfere with the supply chain.

In FY 2011, TTB concluded a nationwide trade practice investigation of some of the largest alcohol beverage suppliers in the United States. The suppliers were alleged to have violated the tied house "slotting fee" provisions of the FAA Act by offering inducements to a large casino chain in order to receive preferred shelf and warehouse space. TTB accepted offers in compromise totaling approximately $1.9 million from six companies—Diageo North America, Inc.; Period Ricardo USA, LLC; Moet Hennessey USA, Inc.; Bacardi USA; Future Brands; and E. & J. Gallo Winery. This case marked the largest set of offers in compromise ever accepted by TTB for trade practice violations.

The allegations of tied house violations stem from the companies' participation in the 2008-2009 Harrah's Nationwide Beverage Program. The TTB investigation, which focused on activities in the Las Vegas area, alleges that the companies collectively furnished nearly $2 million in inducements through a third party to Harrah's Entertainment's hotel and casino subsidiary corporations during the two year period of the program. TTB alleges that the purpose of these inducements was to obtain preferential product display and shelf space (also known as slotting fees) at Harrah's Hotels and Casinos

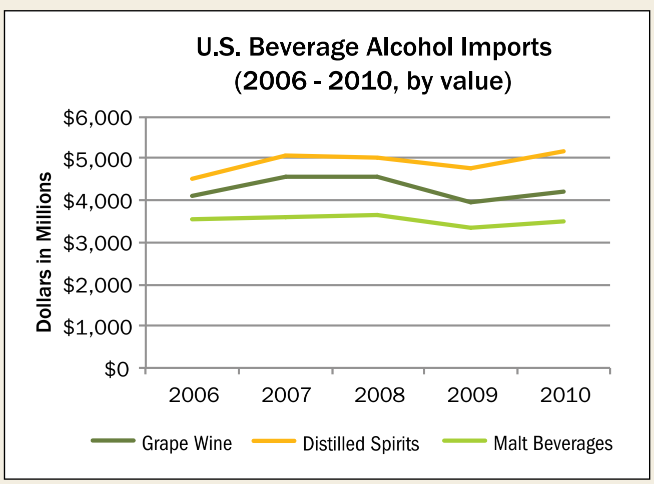
Payment of slotting fees by an alcohol beverage supplier to an alcohol beverage retailer is an unlawful marketing inducement which creates an artificial barrier to open and fair competition especially for small to medium-sized companies that cannot afford to pay such fees, and to other companies that refuse to pay them.

Facilitating U.S. Penetration into Foreign Markets

TTB has been actively engaged in program activity to promote fair and open trade supports the Nation's economic recovery. U.S. exports of alcohol beverages totaled $2.3 billion in 2010. As the technical expert in these commodities, TTB seeks to promote U.S. exports by facilitating industry compliance with foreign requirements and by working with foreign regulators to address barriers that block market access for U.S. products. Through its international outreach, TTB has arranged for the elimination or reduction of certification requirements for wine exported to the European Union, Argentina, Australia, Canada, Chile, Georgia, New Zealand, and South Africa.

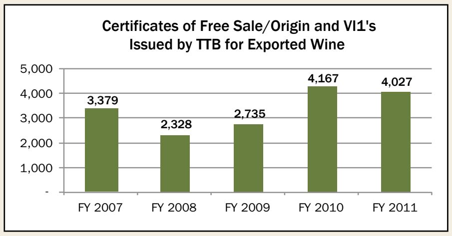
Trends in the Import and Export of Alcohol Beverages

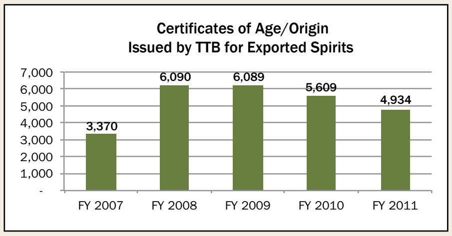
The value of the commodities that TTB regulates has increased, particularly in regard to wine products. In 2010, for example, global exports of U.S. wine totaled more than $1 billion, which represents a 23 percent increase from 2009. With the exception of the 2009 calendar year, exports of wine (by value) have increased each year since 2006. Distilled spirits exports reflect a similar trend, though at a more moderate level. Global exports of U.S. spirits totaled more than $1.15 billion, representing a 12 percent increase over the same period in 2010. Malt beverage exports also indicate a positive trend, with a consistent increase in exports since 2006.



Imports of beverage alcohol products (by value) in 2010 increased from previous years. From 2009 to 2010, there was a 9 percent increase in wine, a 13 percent increase in distilled spirits, and a 2 percent increase in malt beverages. Statistics indicate a slight decrease in imports from 2008 to 2009, which was also a trend with exports. Aside from distilled spirits imports, which totaled more than $5.18 billion in 2010, no other commodities have reached their 2008 peaks.

Trade Certificate Processing





In FY 2011, TTB issued almost 9,000 export certificates for wine and distilled spirits products. Without these certificates, U.S. alcohol beverage producers and exporters cannot register or sell their products in many key markets abroad, such as China, the European Union (EU), and Japan. TTB's workload in processing export certificates increased by 45 percent between FY 2007 and FY 2010, reflecting both an increase in exports – wine and spirits exports in 2010 totaled $2.15 billion, a 16 percent increase from 2007 – as well as the establishment of new certification requirements in emerging markets such as Brazil.

These developments have emphasized the importance of working with trading partners to eliminate unnecessary or burdensome certification requirements. In recent years, through its international efforts, TTB has arranged for the elimination or reduction of certification requirements for wine exported to the 27 countries of the EU, as well as to members of the World Wine Trade Group (Argentina, Australia, Canada, Chile, Georgia, New Zealand, and South Africa). Export certifications as a whole declined 8 percent between FY 2010 and FY 2011, principally in the VI1 forms required for wine exported to the EU.

For those countries that maintain a certification requirement, in FY 2011, TTB issued nearly 9,000 export certificates for beer, wine, and distilled spirits. Without these certificates, which are only issued by TTB, U.S. producers of alcohol beverages cannot sell their products in major markets abroad. TTB must process certificates for U.S. producers in order for the producers to be able to make export sales, because many foreign countries require that an appropriate authority from the exporting government certify exports of alcohol beverages to that country. This activity furthers TTB's goal of ensuring product integrity of domestically produced alcohol beverages, but more importantly facilitates the export trade in alcohol beverages, which in turn creates jobs and helps economic growth.

In calendar year 2010, TTB's certification of export documents allowed almost $275,000,000 worth of domestic alcohol beverages to be sold to foreign customers. TTB expects FY 2011 figures, once available, to be similar. In FY 2012, TTB will continue certifying documents required for U.S. exports, and will track the dollar value of the program in terms of U.S. exports.

Preventing and Addressing Barriers to Trade

The TTB Trade Facilitation Program also involves identifying and addressing barriers to trade in the international marketplace. TTB is the principal advisor and technical expert for the Office of the United States Trade Representative (USTR) and other Federal agencies in the administration of U.S. alcohol laws, regulations, and policies, and coordinates with these agencies as appropriate in responding to alcohol beverage and tobacco trade issues. TTB provides expert reviews of foreign regulatory proposals impacting the alcohol and tobacco trade to identify and assess the impact of potential trade barriers for U.S. alcohol and tobacco exporters. The USTR estimates that between 10 percent and 20 percent of new barriers to trade relate to alcohol beverages, and TTB plays a crucial role in the early identification and resolution of these issues.

TTB also works to address barriers in the international marketplace by participating with other Federal agencies in the negotiation of international trade agreements related to alcohol and tobacco products on behalf of the U.S. Government. In FY 2011, TTB took an active role in an interagency project with the USTR, the USDA-Foreign Agricultural Service, the U.S. Department of Commerce, and the U.S. Department of State to establish an Asia-Pacific Economic Cooperation (APEC) Wine Regulatory Forum (WRF) in support of expanding markets for U.S. exports.

Co-sponsored by Australia, New Zealand, and the United States, the WRF provides a forum to support open and free trade and eliminate technical barriers to trade issues.

APEC is the premier forum for facilitating economic growth, cooperation, trade, and investment in the Asia-Pacific region. It is the only inter-governmental grouping in the world operating on the basis of non-binding commitments and open dialogue. Unlike the World Trade Organization (WTO) or other multilateral trade bodies, APEC has no treaty obligations required of its participants. Decisions are reached by consensus and commitments are undertaken on a voluntary basis. The 21 APEC members include: Australia, Brunei Darussalam, Canada, Chile, the People's Republic of China, Hong Kong, Indonesia, Japan, the Republic of Korea, Malaysia, Mexico, New Zealand, Papua New Guinea, Peru, the Republic of the Philippines, Russia, Singapore, Chinese Taipei, the United States, Thailand, and Vietnam. Many of the APEC member economies are emerging export markets for the U.S. wine industry.

The WRF, which took place in September 2011, focused on differences and similarities in the countries various wine regulatory structures and examined options to simplify, harmonize, or institute mutual acceptance of wine regulations across the APEC region. Eighteen of the 21 APEC member economies sent representatives to this inaugural session. Moving forward, TTB will continue to work with APEC members to help those economies develop reasonable and responsible regulatory activity that does not impede trade in alcohol beverages because, currently, emerging markets are creating increasing numbers of technical barriers to trade in alcohol beverages.

Coordinating with Foreign Counterparts to Extend Regulatory Controls

The global trade in alcohol beverages is active and increasing and, to be an effective regulator, TTB must seek innovative and efficient ways to achieve its consumer protection and revenue collection mission. One principle strategy to assure that U.S. businesses remain competitive on a global scale is through improved communication with our trading partners. TTB's expansion of international agreements has fostered a global network of regulators in the alcohol and tobacco industries that ensure markets remain open and that illegal activity in the global trade is addressed promptly.

In FY 2011, TTB made significant progress on international agreements with multiple counterpart agencies in Canada, Italy, France, the People's Republic of China, Australia, and the Republic of Georgia. Each of these agreements facilitate trade by increasing mutual understanding of each country's alcohol and tobacco production, labeling, and licensing requirements, and by providing a process for the exchange of regulatory information that has the potential to impact trade, compliance, and product safety. TTB, working with its trade partners in the World Wine Trade Group (WWTG), also established an agreement regarding certification requirements on wine products to assure the WWTG parties do not encounter compositional certification requirements from other member countries in the export trade of their products that would obstruct free flowing trade.

Canada

Canada is among the top five exporters of malt beverages, wine, or distilled spirits to the United States. Canada also shares a long border with the United States across which alcohol and tobacco products and counterfeit products might be smuggled or otherwise diverted, resulting in a loss of Federal excise tax revenue. Accordingly, a cooperative relationship with the appropriate Canadian authorities is necessary to reduce the impact of diversion activities on the Federal revenue.

In FY 2011, TTB met with officials from the Canadian Border Services Agency (CBSA) to discuss several issues of mutual interest, including ongoing collaboration on the analysis of tobacco products. On March 23, 2011, TTB's Scientific Services Division and CBSA's Laboratory and Scientific Services Directorate signed a memorandum of understanding (MOU) that lays the groundwork for technical collaboration and partnership on methodology, such as a DNA technique for tobacco analysis necessary to appropriately classify tobacco products for tax purposes. As part of the MOU, CBSA scientists will visit TTB to give a seminar on their applications of the DNA technique for tobacco analysis and receive training on nonbeverage product evaluation.

On March 23, 2011, TTB Assistant Administrator for Headquarters Operations, Bill Foster, signed an MOU between the TTB Scientific Services Division and the Laboratory and Scientific Services Directorate of the CBSA in Ottawa, Canada.

France

France, along with Italy, is typically the largest or second-largest source of imported wine in the United States, and in 2010, large quantities of French wine were sold to U.S. importers by French merchants as pinot noir while the wine was not entitled to that varietal designation. As a result, it is important that TTB develop effective partnerships with the French authorities that have jurisdiction over the production, sale, and labeling of wine so that U.S. businesses and consumers are not affected by cases of fraud that originate in France. In FY 2011, TTB negotiated the text of an MOU with France's General Directorate for Competition Policy, Consumer Affairs, and Fraud Control (DGCCRF), which TTB signed on September 1, 2011.

China

The People's Republic of China is an important emerging market for U.S. alcohol beverage exporters and represents the single largest destination country for export certifications that TTB processes. China is also a potential source of counterfeit goods in the global marketplace. Thus, the MOU that TTB established with China's General Administration of Quality Supervision, Inspection and Quarantine (AQSIQ) in 2007 is an important tool by which TTB can help ensure a stable export market for U.S. alcohol beverages and a U.S. market that is free of counterfeit goods. In FY 2011, TTB continued its cooperation with its

Chinese counterpart and, in January 2011, TTB met with Minister Baoquing Zhao, of the Embassy of the People's Republic of China, to discuss several issues, including counterfeit wine in China and potential partnering between TTB and Chinese laboratories. TTB invited AQSIQ laboratories to participate as partners in collaborative projects, initiated by TTB, for the multi-laboratory validation of a number of analytical methods that TTB uses for regulatory compliance of beverage alcohol products. TTB also began a coordinated effort with the AQSIQ regarding proposed changes to China's Ministry of Health's regulations related to approved additives for alcohol beverage products.

Russia

Russia is an important emerging market for U.S. exporters, but is not a member of the WTO and, therefore, is not subject to WTO rules, which means that U.S. exports may experience exceptional difficulties in exporting to Russia. A functional relationship between TTB and Russia's regulatory authorities on alcohol can prevent or mitigate a number of potential trade problems.

In August 2011, TTB joined the United States Department of Agriculture's Foreign Agriculture Service (FAS) in Moscow to meet with representatives of Russia's Federal Service for Alcohol Market Regulation (FSR) to discuss the FSR's draft technical regulation on alcohol product safety. If finalized, the FSR regulations would create significant barriers to trade for U.S. alcohol beverage exports entering the Russian market. TTB alerted the FSR to several issues in the draft technical regulation pertaining to labeling, certification, standards of identity, wine additives and processing aids, geographic indicators, and traceability. FSR informed TTB that it would consider the United States' concerns and publish a new draft of the technical regulations for comment in September 2011. In addition, FSR expressed interest in developing a close, regulator-to-regulator relationship with TTB within the framework of an MOU. TTB plans to pursue an MOU in FY 2012 in order to promote effective regulation of the alcohol market and facilitate compliant trade in alcohol between the United States and Russia.

Italy

Italy is currently the largest source of imported wine in the United States. Consequently, effective relationships with Italian government authorities with jurisdiction over the production and labeling of wine are important to ensuring that all imported alcohol beverages are properly labeled and classified. In furtherance of this objective, in April 2011, TTB signed an MOU with the Central Inspectorate for Food Quality and Fraud Repression (ICQRF) of the Italian Ministry of Agriculture and Forestry. The ICQRF regulates the production of wine and malt beverages and has authority to conduct investigations into improper production.

The ICQRF played a significant role in a recent investigation of Brunello di Montalcino producers who illegally blended grapes other than Sangiovese into the wine. TTB met with a Guardia di Finanza official from the Embassy of Italy in October 2010, to discuss the resolution of the Italian court cases against individuals involved in the mislabeling of Brunello di Montalcino wine. TTB

TTB Deputy Administrator Mary Ryan signs MOU with ICQRF received confirmation that the court cases have concluded and that the culpable individuals, including officials of the Brunello di Montalcino producers' consortium, have paid the imposed fines.

To ensure that mislabeled product is not exported to the United States, TTB has asked the ICQRF to continue to certify each vintage of Brunello di Montalcino, which is aged for 5 years before being bottled, annually through the release of the 2008 vintage.

The MOU between TTB and the ICQRF establishes a consistent channel for cooperation and exchange of information for the purpose of combating fraud in the production of and trade in alcohol beverages; establishes a consistent point of contact on issues of mutual interest in the regulation of wine, distilled spirits, and malt beverages issues; and provides a cooperative framework for working together to resolve future issues before they negatively impact either party's market.

In FY 2011, TTB solidified its cooperation with its Italian counterparts by signing an MOU on April 12, 2011, with the ICQRF of the Italian Ministry of Agriculture and Forestry.

Pictured at left is the TTB and ICQRF team responsible for negotiating the MOU.

The Republic of Georgia

TTB established an MOU with the Ministry of Agriculture's Department of Vine and Wine (SAMTREST) of Georgia in June 2009. Georgia has a long history of wine production, but has only been expanding its export market in recent years. TTB's cooperation with Georgia helps ensure that Georgian wine imported into the United States complies with U.S. laws and regulations.

This cooperative relationship has helped assure the integrity of products offered to consumers, with TTB investigating products sold in the U.S. that SAMTREST had identified to TTB as falsely labeled as Georgian.

In addition, in November 2010, TTB met with the Georgian Minister of Agriculture to discuss wine issues within the framework of TTB's MOU with SAMTREST. In particular, TTB welcomed Georgia's becoming a full participant of the WWTG in October 2010. TTB is also working with SAMTREST on the recognition of Georgia's 18 viticultural appellations of origin.

World Wine Trade Group

The United States is a participant in the WWTG, an informal grouping of government and industry representatives from the wine-producing countries of Argentina, Australia, Canada, Chile, Georgia, New Zealand, the United States, and South Africa.

The WWTG, founded in 1998, aims to share information and collaborate on a variety of international issues and endeavors to create new opportunities for wine trade. Since its inception, the WWTG has completed a mutual acceptance agreement on oenological practices and an agreement on labeling practices for wine, both of which seek to minimize trade barriers, and thereby facilitate international trade.

In calendar year 2010, trade in wine and wine products between the United States and other WWTG countries totaled $1.7 billion, including $300 million in U.S. exports and $1.4 billion in U.S. imports. That same year, wine produced by WWTG countries increased its share of the global wine export market from 15 percent in 2000 to 30 percent in 2010. On average, each year, the wine industry contributes $121.8 billion in U.S. economic impact and supports 820,000 American jobs.

Early in FY 2011, TTB participated in the WWTG Annual Meeting in Mendoza, Argentina. The meeting included discussion of ways forward in concluding a second stage labeling agreement, including the possibility of pursuing mutual acceptance of countries' requirements for vintage date, variety, and appellation of origin labeling; sustainability and carbon footprint labeling; regulatory developments of non-members like the European Union and Brazil that create significant trade barriers for countries exporting wine to those non-member countries; efforts to establish a seminar on key issues relating to wine, which would target representatives from countries that are members of the Asia-Pacific Economic Cooperation forum; and an MOU on Certification Requirements, which facilitate trade in wine by eliminating the requirement for routine certification of wine composition, certificates of free sale, or analytical reports on wine constituents for imported wine.

In October 2011, the United States, along with representatives from Argentina, Australia, Chile, Georgia, and New Zealand, signed an MOU on Certification Requirements, which aims to reduce barriers to international wine trade and support exporters of wine in each participating country by encouraging the elimination of burdensome requirements and routine certifications of wine products and ingredients. A key goal of the WWTG is to gain the participation of Asian economies in this MOU in order to reduce the burden of exporting wine to those countries.

In FY 2012, TTB and its WWTG trade partners will continue its outreach to other wine producing countries, such as Brazil, Uruguay, and China, to facilitate import and export markets for the wine trade.

Product Integrity

Consumer confidence is essential to ensuring that U.S. and world economies perform at their full economic potential. TTB is the Federal agency responsible for carrying out provisions of the FAA Act that ensure that labeling and advertising of alcohol beverages provide adequate information to the consumer concerning the identity and quality of the product and to prevent misleading labeling or advertising that may result in consumer deception regarding the product.

This consumer protection function falls under TTB's Advertising, Labeling, and Product Safety Program. Before an alcohol beverage product can be sold in the United States, TTB completes a review of the product label to ensure the label contains all mandatory information and does not mislead the consumer. In addition, labels are reviewed for compliance with the Alcohol Beverage Labeling Act, the Federal law which mandates that a Government health warning statement appear on all alcohol beverages offered for sale and distribution in the United States. The approved label application is called a Certificate of Label Approval (COLA).

TTB also conducts post-market sampling of alcohol beverages after they enter the marketplace for container content and label compliance through its Alcohol Beverage Sampling Program (ABSP). This involves examining a statistical sample of domestic and imported wine, spirits, and malt beverage products to determine if the labels meet Federal requirements, and the contents of the bottle match the label description. This process also includes a chemical analysis of selected products by the TTB Laboratory for identification and product safety purposes. TTB also reviews advertisements for alcohol beverage products from television, radio, the Internet, and other ad sources for compliance with Federal regulations.

As part of the Bureau's Advertising, Labeling, and Product Safety Program, TTB also works to ensure that alcohol beverages meet the standards of identity that their labels reflect and that all ingredients and treating materials are authorized and within the limits set forth under applicable law and regulations. In the event that a food safety or other product integrity issue occurs, the Bureau shares its findings with other regulatory and enforcement agencies, as appropriate, and works in partnership to timely resolve the issue.

Streamlining the Alcohol Beverage Label Approval Process

TTB reviews alcohol beverage label applications to fulfill the statutory requirement that bottlers and importers of alcohol beverages have an approved COLA or an exemption certificate before the product enters domestic commerce. The number of applications for label approval that TTB received between fiscal years 2007 and 2011 increased 16 percent. After a drop off in FY 2009, which may be attributable to the economic downturn, the number of label filings trended up again in fiscal years 2010 and 2011, with a year-to-year increase in applications of 10 percent. Again in FY 2011, the significant majority of label applications received were for wine products. The wine industry submitted 82 percent of the label applications processed by TTB in FY 2011.

Due to resource and workload challenges, the Bureau began evaluating its COLA pre-approval process and regulations related to alcohol beverage product labeling to focus on ways to streamline operations. These changes will reduce costs to the Bureau and industry, encourage the use of automated processes, help industry to get products to the marketplace faster, and improve service.

TTB began the process of modernizing its alcohol beverage labeling program in FY 2011. At the beginning of FY 2011, a TTB working group identified three initiatives for this effort: 1) provide clear guidance to industry, 2) provide industry with an automated database which meets TTB's statutory requirements and decreases industry burden, and 3) use a stratified random sampling which will enhance enforcement efforts and put into place a tool for tracking compliance. The goal of this initiative is to shift TTB's focus in the labeling area from pre-market approvals to a marketplace review.

Under this three-pronged approach, TTB dedicated resources in FY 2011 to reviewing the labeling regulations (27 CFR parts 4, 5, 7, 13, and 16) issued under the FAA Act. This process included identifying regulations that are obsolete, need expansion, or otherwise need updates or revisions to keep up with industry trends. By modernizing the regulations to remove ambiguity and to remain current with market conditions, TTB anticipates that industry will gain greater understanding of Federal requirements and be more compliant.

TTB also evaluated its current published labeling policies and internal processes to determine if the Bureau can improve and streamline the process and reduce workload. To date, TTB has streamlined qualification guidelines and modernized the list of rejection reasons for COLAs. The Bureau also is looking at increasing the list of allowable changes that industry members may make to labels without resubmitting a COLA application. TTB anticipates that, over time, these changes will reduce the number of resubmitted and new label applications.

Further, TTB made changes to its process and reduced burden on industry through issuing TTB Industry Circular 2011–4, Streamlining the Certificate of Label Approval Review Process. Recognizing that TTB returned many electronically-submitted label applications to industry members multiple times for corrections due to image-related problems that occurred during the upload of the label image, the Bureau relaxed these requirements to reduce industry burden and to help industry get their products to the marketplace faster.

TTB is continuing to review each practice associated with the label approval process to identify areas that the Bureau may streamline, cease or enhance.

Expansion of the Alcohol Beverage Sampling Program

Once alcohol beverages enter the marketplace, TTB monitors labeling compliance through the Alcohol Beverage Sampling Program (ABSP). In FY 2011, TTB expanded the ABSP to include all three alcohol beverage commodities (wine, distilled spirits, and malt beverages) and added investigative support from TTB investigators. In the past TTB has monitored only one commodity per year.

The purpose of the ABSP is to determine the compliance rate of alcohol beverage labels for all products found in the marketplace in a determined period of time. Specifically, TTB seeks to determine the percentage of products that are fully labeled, i.e., the label accurately reflects the contents of the bottle. The Bureau accomplishes this by examining a statistically valid sample of alcohol beverages in the marketplace and reviewing the labels and contents. TTB reviews the label of each product purchased for the ABSP to ensure that it contains all legally required information and matches it to a COLA. Additionally, TTB determines if there is a valid COLA for the product. TTB also chemically tests each product to ensure that label information is accurate and ensures that what is described on the label is what is actually inside the container. Then TTB projects the results across all products available in the marketplace during the specific time selected.

In FY 2011, the expansion of the ABSP included an investigative component. For the first time, TID provided "content" compliance information for domestic wine. TID performed limited Product Integrity (PI) investigations on all domestic wines that were selected for the ABSP. The PI investigations include reviews of proprietors' records to verify label claims that cannot be assessed through laboratory analysis, such as vintage and varietal statements. When TTB combines the results from ABSP testing and the PI investigations, the Bureau gets a more comprehensive picture of domestic wine label compliance. The Bureau's monitoring of product and label compliance through the ABSP forms the basis to ensure the integrity of U.S. alcohol beverage products, both in the view of U.S. consumers and TTB's international counterparts, which is critical to gaining foreign market access for U.S. exporters. The results of the ABSP for FY 2011 can be found on TTB.gov.

TTB Launches Online Filing Solution for Formulas

TTB reviews domestic and imported alcohol beverage formulations and issues formulas, statements of process, laboratory analyses and pre-import letters. In the last 5 years, the number of formula applications that TTB has received has grown by about 880 applications per year, an increase of 118 percent over the five years. Similarly, the number of pre-import requests has increased by about 141 percent since FY 2007.

As part of TTB's strategy to move the services it provides to businesses into the online environment, TTB developed an electronic filing solution for industry to submit their formulas to TTB for review for regulatory and tax compliance. TTB deployed Formulas Online on January 10, 2011. Formulas Online is a Web-based system that allows external users to draft, submit, and track formula applications for domestic and imported alcohol beverages. Whether TTB receives paper or electronic formula applications, all submissions are captured in Formulas Online, providing a streamlined process for TTB specialists to view, evaluate, request additional information or corrections, and approve or reject applications.

With the initial release, this new e-Gov filing system also streamlines the formula approval process for the alcohol beverage producers and importers. The system has built-in validations of the data entered to assist industry in complying with Federal regulations. In efforts to reduce the regulatory compliance burden, TTB integrated the Formulas Online system with its electronic filing system for label applications, COLAs Online, offering users a single logon ID and password for both custom applications. At year-end, TTB received 32 percent of alcohol beverage formula submissions electronically through Formulas Online.

Monitoring Fraudulent Activity

The improper labeling of alcohol beverages has economic consequences. Domestic alcohol label fraud represents a serious threat to the Bureau's public protection mission, as it degrades the economic stability of the legitimate alcohol beverage trade. Counterfeit alcohol beverages bearing legitimate domestic brand or trade names jeopardize domestic alcohol beverage commerce by trading on the brand reputation of authentic domestic producers. Likewise, label fraud deceives consumers as to the true identity of products being sold.

TTB monitors fraudulent activity by tracking product integrity issues and tasking policy and enforcement staff, as appropriate, to address issues. TTB's coordinated response to each incident includes liasing with the foreign government to ensure that no counterfeit or fake product was exported to the United States. Examples of fraudulent activity that TTB discovered in FY 2011 include:

- *Wine Fraud Investigation in Czech Republic.* TTB received a report of large quantities of improperly labeled wine from the Czech Republic. Police in that country are investigating a major winery for selling over a million liters of wine as 2009 Chardonnay, Sauvignon Blanc, and Riesling, when the grapes were of unknown origin. TTB reached out to the U.S. Department of Agriculture's Foreign Agricultural Service (FAS) posts in Brussels and Prague for more information. TTB verified that the winery in question is not currently exporting wine to the United States, and has not done so in recent years.

- *Counterfeit Vodka Produced in the United Kingdom.* TTB received a news report of the discovery of a large illicit vodka production scheme near Manchester, United Kingdom (UK). Her Majesty's (HM) Revenue and Customs seized over 25,000 liters of counterfeit "Smirnoff" vodka. Tests showed that the vodka was not toxic, but illicit alcohol products always carry health risks and frequently contain lethal levels of methanol. TTB immediately contacted the FAS post in London. HM Revenue and Customs verified that the counterfeit vodka was sold only in the Manchester, UK area and was not exported to the United States.

Addressing Alcohol Beverages Containing Added Caffeine

In November 2010, following coordination with the FDA, TTB issued industry guidance on alcohol beverages containing added caffeine. This action followed a year-long investigation by the FDA into the safety and legality of alcohol beverages containing added caffeine, and their subsequent warning to four companies that the caffeine added to their alcohol malt beverages is an "unsafe food additive."

The guidance issued by TTB in FY 2011 advised alcohol beverage industry members that the FDA's determination that a product is adulterated under the Federal Food, Drug, and Cosmetic Act (FFDCA) could not be marketed under the FAA Act, since adulterated products may not be labeled as alcohol beverages or introduced or received in interstate or foreign commerce, under the FAA Act.

In response to the specific products determined to be adulterated, the FDA provided 15 days for the four companies to develop specific actions to address the violation, and if these actions were not to be completed within the 15-day timeframe, to advise of the date of completion. TTB also notified the companies that, due to the FDA's determination, their products were considered mislabeled under the FAA Act, and provided the companies with a 15-day window to address the violations before taking any enforcement action. The coordinated enforcement action resulted in the adulterated products removal from the market.

Participating in Pesticides, Adulterants, and Contaminants Taskforce

In administering the Advertising, Labeling, and Product Safety Program, TTB also conducts routine analysis of sampled alcohol beverages for ingredients or materials whose presence is prohibited or limited. Examples include thujone, methanol, and toxic heavy metals. In addition, wines are analyzed to ensure safe levels of pesticides and ochratoxin-A, and malt beverages are tested for mycotoxins.

TTB has established an intra-agency Pesticides, Adulterants, and Contaminants (PAC) Task Force to clearly define the steps and procedures TTB will take in response to unsafe ingredients, pesticides, or hazards in any beverage product that TTB regulates. As marketplace findings dictate, TTB coordinates with CBP, foreign governments, and foreign alcohol beverage producers to address the consumer health hazard. In FY 2011, TTB and task force agencies worked on two cases identified by the Alcohol Beverage Sampling Program.

In one case, TTB identified 11 imported Italian wines that were being sold in the U.S. marketplace that contained the unauthorized pesticide oxadixyl. Oxadixyl functions as a fungicide; however it is not, and never has been, approved for use on grapes in the United States, and there is no prescribed tolerance for oxadixyl on grapes. Wines that contain oxadixyl are adulterated within the meaning of the FFDCA. TTB communicated the issue to the Italian Ministry of Agriculture and Italian embassy, and worked with CBP to initiate a customs hold on attempted imports of the adulterated wine. CBP has removed the hold on five of the products following TTB's confirmation that the adulterated vintage is not being shipped to the United States and that subsequent vintages are not adulterated. CBP holds remain in place for six products. TTB has also notified the U.S. importer that the wine is mislabeled and should not be introduced into the marketplace. TTB continues to work with CBP regarding adulterated alcohol beverages and customs holds on imports.

In a second case, the ABSP found that a rum product imported in bulk from the U.S. Virgin Islands and bottled in the U.S. was adulterated with lead, a poisonous or deleterious substance, as ruled by the FDA. In its analysis of the sample product, the TTB Laboratory found the rum contained lead at a level determined by the FDA to be unsafe for consumption. TTB compliance specialists and investigators coordinated with the U.S. Virigin Island authorities to determine the source of the lead. The source of the lead was traced to storage tanks at the facility of the U.S. bottler, and these tanks are no longer in use for processing. TTB is coordinating with the FDA to address the issue and assure that U.S. consumers are not at risk of exposure to a health hazard.

Voluntary Compliance

In all of the Collect the Revenue and Protect the Public program areas, TTB emphasizes voluntary compliance from the industry through its outreach efforts. TTB employs a dedicated staff of industry analysts and liaisons to provide industry members and the States with direct assistance on specific needs or guidance on broader issues affecting the regulated commodities.

The Advertising, Labeling and Formulation Division coordinated with the Knowledge Management Staff to host a series of complimentary Webinars for those who are interested in discovering new ways to work smarter and more effectively with Formulas Online.

The Bureau also sponsors seminars and workshops to educate the industry on Federal requirements in the areas of manufacturing, marketing, importing and exporting, and paying tax on alcohol and tobacco products, and firearms and ammunition. In FY 2011, TTB held three Formulas Online Webinars for industry. The training covered topics such as system registration; the basics of drafting, submitting, and tracking formula applications for domestic and imported alcohol beverages; and common pitfalls to avoid when submitting electronic formula applications. In FY 2012, TTB plans to hold additional Webinars focusing on formula submissions by commodity. In the years ahead, TTB intends to continue to leverage the TTB.gov site and other Web-based capabilities to provide online seminars and tutorials so that industry members will have additional on-demand resources and options to answer questions related to tax and regulatory compliance.

Further, to support transparency in government and customer access to information, TTB implemented several initiatives that should facilitate industry compliance. TTB created a portal on its Web site to its existing online tools for filing applications with TTB. In FY 2011, as part of the TTB Open Government plan, TTB also published on its Web site guidance expressed in private letter rulings, petitions for rulemaking, and other high-value information so that it is readily available to industry and members of the public. Additionally, TTB provided to Treasury data sets relating to wine treating materials, alcohol fuel plants, and wine grape varieties, for inclusion on the Government-wide Data.gov site.

TTB also strives to reduce the burden of compliance on industry by providing clear regulatory guidance. The statutes and regulations that the Bureau administers have not kept up with the changes in the industries that TTB regulates, and in FY 2011 TTB made significant progress on modernizing its regulations to reflect current practices and conditions.

In February 2011, TTB published a final rule that completely revised and reorganized the distilled spirits plant regulations to improve the clarity and ease compliance. Many previous alternate methods or procedures that were applicable industry-wide were incorporated into the regulations. The new regulations also provide for the use of modern technology such as mass flow meters. Additionally, the revision will reduce the regulatory burden by increasing the use of letterhead notices and log books in lieu of certain reporting forms. The revised regulations should improve efficiency of plant operations.

TTB also published a final rule in January 2011 revising its American Viticultural Area (AVA) regulations to provide clearer regulatory standards for the establishment of AVAs and clarifying the rules for preparing, submitting, and processing AVA petitions. TTB regulations define a viticultural area for American wine as "a delimited grape-growing region distinguishable by geographic features, the boundaries of which have been recognized and defined in part 9 of the TTB regulations." These AVA designations allow vintners and consumers to attribute a given quality, reputation, or other characteristic of a wine made from grapes grown in an area to its geographic origin. This final rule addresses the effect that the approval of an AVA may have on established brand names; provides clearer regulatory standards for the establishment of AVAs within AVAs; and clarifies the rules for preparing, submitting, and processing viticultural area petitions. The revised regulations should lead industry members to submit better-evidenced petitions and allow TTB to more quickly process perfected petitions or deny poorly-evidenced petitions.

In FY 2011, TTB also undertook a rulemaking project to revise the specially denatured alcohol (SDA) and completely denatured alcohol (CDA) formulas regulations. TTB is acting to update its regulations because SDA and CDA are very widely used in the American fuel, medical, and manufacturing sectors. The industrial alcohol industry is far larger than the beverage alcohol industry in both size and scope, and it continues to grow rapidly in the United States. The current regulations may cause significant roadblocks for industry members in getting their products to the marketplace quickly and efficiently. TTB is proposing to reclassify some SDA formulas as CDA and to issue new general use formulas for articles made with SDA so industry members would not need to seek formula approval from TTB as frequently. TTB estimates that this effort will decrease the number of formula submissions required from industry by an estimated 80 percent. Changes would also remove unnecessary regulatory burdens and update the regulations to align them with current industry practice.

Moving forward, TTB will continue to work to modernize its regulations to make positive changes to the regulatory framework and significantly influence how well TTB accomplishes its "collect the revenue" and "protect the public" mission.

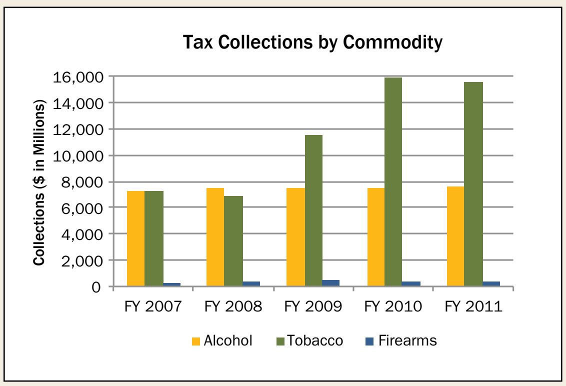
Performance Summary

Collect the Revenue

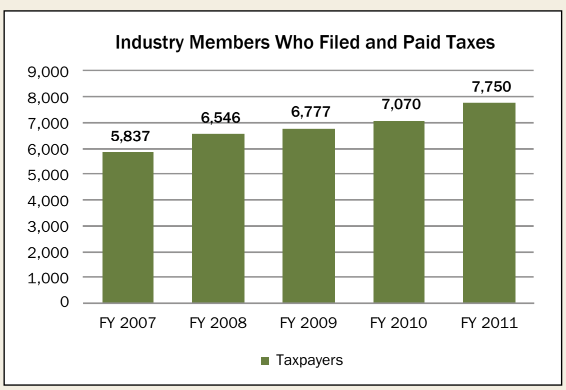
TTB met all of its performance measures under the ***Collect the Revenue*** activity. A detailed summary of TTB performance is discussed in Part II of this report, Program Performance Results.

Investments in the Collect the Revenue mission resulted in the following accomplishments in FY 2011:

- TTB collected $23.5 billion in excise taxes and other revenues from 7,750[10] taxpayers in the alcohol, tobacco, firearms, and ammunition industries. In all, TTB returned $468 for every $1 expended on tax collection activities. Since the tax rate increase on tobacco products took effect, the return on TTB tax collection activities has increased by approximately 50 percent.
- TTB expanded its e-filing capability to allow all excise taxpayers to file and pay taxes, and file monthly operational reports, electronically through the Pay.gov system. The total number of Pay.gov registrants increased by 12 percent in FY 2011, bringing the total to nearly 7,200.



TTB collected $23.5 billion in tax revenue in FY 2011, a year-to-year decrease of 1 percent. Declines to tobacco revenues offset increased alcohol tax collections. TTB tobacco revenue collections reached an historic high in FY 2010, and this downward trend was predicted, as price increases on tobacco products are closely correlated to consumption patterns. Even with this decline, since 2008, tobacco revenues collected by TTB have increased 126 percent.



TTB regulates more than 56,000 permittees, but only a small percentage file a return and pay taxes in a given fiscal year. The largest segment of TTB permit holders—alcohol importers and wholesalers—do not pay taxes to TTB. Following two years of modest growth, the TTB tax base grew 10 percent between FY 2010 and FY 2011. Since FY 2007, the number of taxpayers has increased 33 percent.

10 About 12,190 TTB permittees were subject to file a tax return and pay excise taxes this fiscal year; however, many operations do not result in the taxable removal of product from bonded premises. Therefore, in FY 2011, a total of 7,750 permittees had operations that required them to file a tax return and pay excise tax.

- In measuring voluntary compliance, TTB reported a compliance rate of 95 percent in filing timely tax payments among its taxpayers who pay $50,000 or more annually. TTB's educational outreach efforts at industry seminars and on manufacturer's premises, as well as enhanced online training tools and guidance, proved successful in helping TTB exceed the compliance rate achieved in fiscal years 2009 and 2010. TTB continues to leverage its Web site and other technologies to educate industry as to the most frequent compliance errors and complex areas of TTB's jurisdiction so that education efforts have the broadest and most lasting reach at the least expense for all involved.

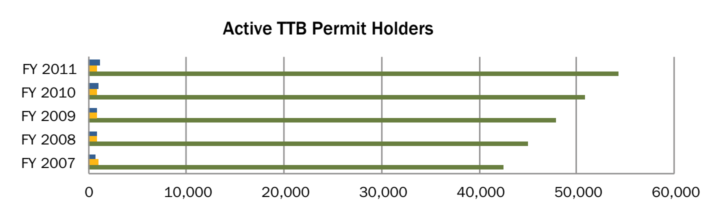
- TTB processed cover-over payments of $462 million to Puerto Rico and the Virgin Islands. Cover-over payments to the Virgin Islands increased 8 percent, while payments to Puerto Rico increased nearly 20 percent. Federal excise taxes collected on rum produced in Puerto Rico and the Virgin Islands and subsequently imported into the United States are "covered over" (or paid into) the treasuries of Puerto Rico and the Virgin Islands. Year-to-year, cover-over payments can vary.

- TTB processed approximately $307 million in drawback claims, an increase of 3 percent in refunded tax money compared to FY 2010. Under current law, persons who use nonbeverage alcohol in the manufacture of medicines, food products, flavors, extracts, or perfume and other non-potable products may be eligible to claim drawback of excise taxes paid on distilled spirits used in their products. To assess drawback claims, the TTB Laboratory analyzed approximately 10,000 formulas and samples in FY 2011.

- TTB also analyzes nonbeverage and beverage alcohol samples to assign or verify a tax classification. For this purpose, TTB chemists processed approximately 2,100 nonbeverage product specially denatured alcohol formulas and samples to support tax-free alcohol claims. TTB analyzed another 1,200 beverage alcohol samples associated with pre-import evaluation, the 5010 tax credit, and enforcement activities, as compared to 1,060 samples in FY 2010. Pre-import evaluations also serve to protect consumers, as the analytical tests also analyze products for limited or prohibited ingredients.

- The Tobacco Laboratory analyzed 350 tobacco samples in support of tobacco tax classification, regulatory projects, audits, investigations, criminal diversion cases, and in the development of protocols for counterfeit tobacco product authentication. Year-to-year, the workload remained relatively constant.

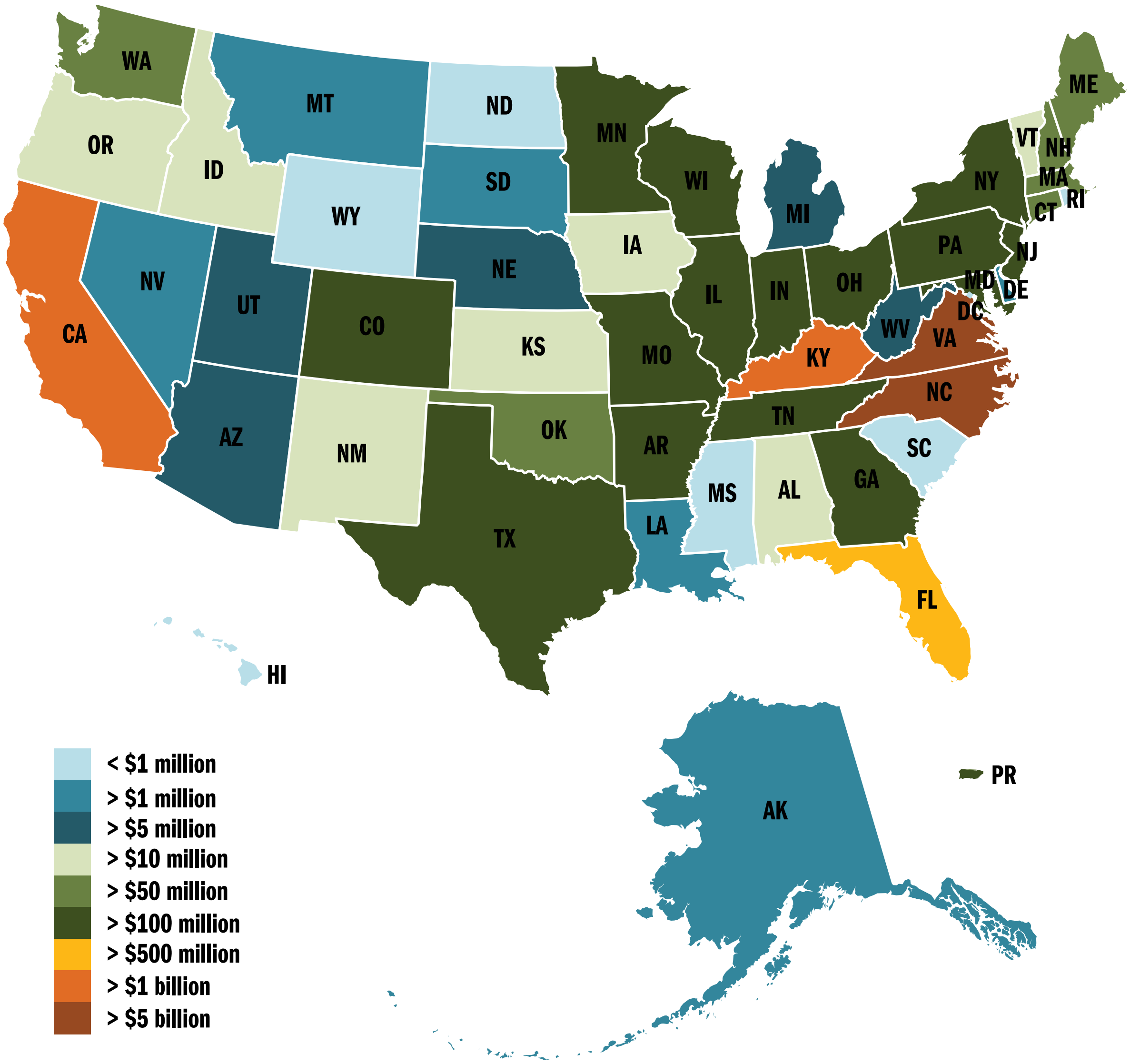
- During FY 2011, TTB completed approximately 540 audits, examinations, and revenue investigations resulting in $35 million in identified tax, penalty, and interest being due, with $15.3 million collected to date. An additional $428,000 was collected from audit findings outstanding from the previous fiscal years.



	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
Firearms	724	784	855	1,012	1,071
Tobacco	931	883	886	835	857
Alcohol	42,483	45,018	47,818	50,823	54,289

The total number of active TTB permit holders in the alcohol, tobacco, and firearms industries has increased 27 percent since FY 2007. The average annual increase in permit holders is 6 percent. Alcohol and firearms permittees have displayed a steady rising trend, while the number of tobacco permittees dipped in FY 2010. Active tobacco permit holders have fallen by 8 percent in 5 years.

FY 2011 Tax Collections by State



States with the Largest Percentage Increase in Federal Excise Tax Collections (FY 2007 - FY 2011)			
State	**FY 2007**	**FY 2011**	**% Increase**
Delaware	$435,027	$2,027,173	366%
Virginia	$1,605,223,492	$7,122,003,832	344%
Arizona	$1,748,835	$7,694,146	340%
Alabama	$11,513,760	$46,516,747	304%
Oklahoma	$24,964,698	$96,931,731	288%

- TTB continued to enforce the collection of the tobacco FST from the manufacturers, importers, wholesalers, and retailers who held tobacco products for sale at the time of the tax rate increase imposed by CHIPRA. In FY 2011, TTB continued its FST examination program by conducting 175 FST examinations. These examinations identified approximately $5.6 million of potential tax, penalties, and interest, and collections to date are $4.8 million. Since TTB began its FST examination program in FY 2010, the Bureau has completed more than 465 examinations. This field work by TTB auditors and investigators resulted in the identification of $16.3 million in potential tax, penalties and interest, of which $8.5 million has been collected to date. Total FST collections to date are well over $1.2 billion.

- TTB has criminal enforcement authority over the commodities it taxes and regulates. Tax fraud in these industries, whether through unlawful product diversion or other means, poses a high risk to Federal revenue collection. Diversion includes tax evasion, theft, distribution of counterfeit products, and distribution in the United States of products marked for export or for use outside the U.S. TTB contracted out its criminal enforcement function with IRS CI in FY 2011, to operate a law enforcement program to counteract illicit trade in the alcohol and tobacco industries. In just eight months, TTB agents opened 21 cases for investigation, with 19 of those cases accepted by an AUSA for prosecutorial investigation. Two cases have reached the prosecution stage, and three others have been closed. As of the close of FY 2011, the total estimated tax liability on these cases totaled more than $20 million. The combined value of the seizures and forfeitures made by other agencies in partnership with TTB total approximately $1.7 million.

- TTB collaborated with several Federal agencies, international organizations, and other stakeholders in ensuring that the revenue due on imported alcohol and tobacco products is collected. Through its partnership with CBP, and by effectively leveraging data available to TTB from CBP's International Trade Data System, TTB identified 47 entities (14 percent of those who imported cigarettes or other tobacco products in FY 2011) as having imported tobacco products without a Federal permit. Though the year-to-year non-compliance rate has remained relatively constant for the third consecutive year, the total number of entities identified as importing without a permit has decreased significantly, from 190 in FY 2010 and 260 in FY 2009. In this fiscal year, TTB continued to notify each entity to cease their illegal operations, and all either stopped importing or obtained a permit to import tobacco products. CBP is the Federal agency responsible for collecting the taxes and duties due on imported products, and TTB referred these cases to CBP for follow up action. The tax value of these imports as declared to CBP is $375,000. This effort is an important aspect of TTB's overall program to detect unlawful distribution of non-taxpaid tobacco products into the domestic marketplace.

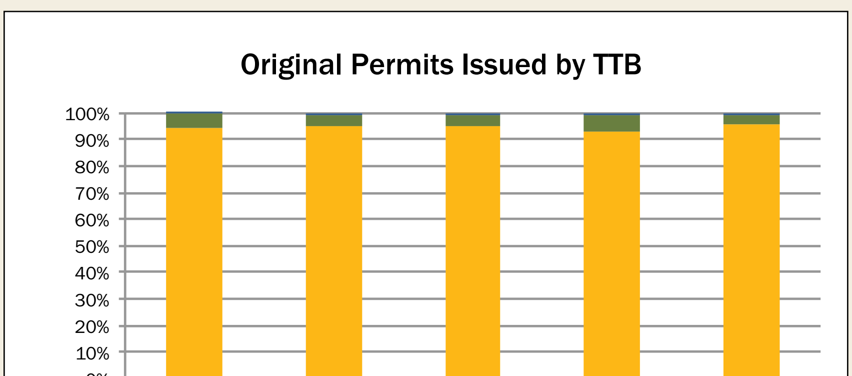
- TTB participated with CBP and Immigration and Customs Enforcement on the Fraud Investigative Strike Team (FIST). The FIST initiative addresses smuggling and fraud activity along United States' borders. The purpose is to determine compliance with laws and regulations at Foreign Trade Zones and Customs bonded warehouses and, where violations are found, to investigate and prosecute illegal operators. TTB field personnel participated in FIST operations in seven U.S. cities with ports or international borders. Through these efforts, TTB identified regulated industry members for comprehensive audits in FY 2012. Further, participation in these operations helped to identify vulnerabilities in the movement of TTB-regulated commodities from bonded premises to Customs bond that are prone to diversion activity. TTB's audit and shipment tracing procedures were modified based on this important intelligence.

Protect the Public

TTB met all of its performance measures under the ***Protect the Public*** activity. A detailed summary of TTB performance is discussed in Part II of this report, Program Performance Results.

Investments in the Protect the Public mission resulted in several achievements during FY 2011:

- TTB issues original and amended permits to persons who are engaged in the alcohol and tobacco industries. TTB processed 5,977 original and 19,702 amended permits, or approximately 4 percent and 8 percent more than in FY 2010, respectively. In FY 2011, TTB processed original applications in an average of 74 days, which resulted in the issuance of 5,063 original permits to qualified applicants.
- As illicit activity in the alcohol and tobacco industries has the potential to be highly lucrative, it is crucial that TTB prevent criminal operatives from obtaining a permit to engage in the alcohol and tobacco trade through its permit investigation process. In support of this objective, TTB initiated approximately 250 permit investigations to verify that applicants were qualified and not prohibited from engaging in business activity in the alcohol and tobacco industries, and that those operating in these industries were properly permitted and operating in compliance with Federal regulations. As a result of TTB's application investigations, 8 applications were withdrawn or abandoned by the applicant and 6 applicants were found by investigators to be unqualified to hold a Federal permit. Of the total permit investigations, TTB conducted 48 investigations into businesses suspected of operating without a permit, and 65 investigations into recently permitted entities as part of its post-application verification program. The post-application investigations involve the random selection of permit applications that were approved in the previous year for an in-depth review of the permittees' activities to determine if the information supplied on their application was accurate and if they are conducting compliant operations. In total, TTB permit and revenue investigations resulted in the voluntary surrender of 9 permits and the surrender of 11 permits in-lieu of adverse action.

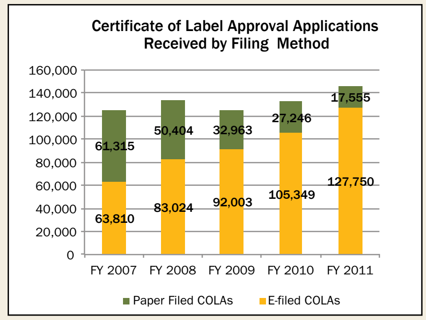


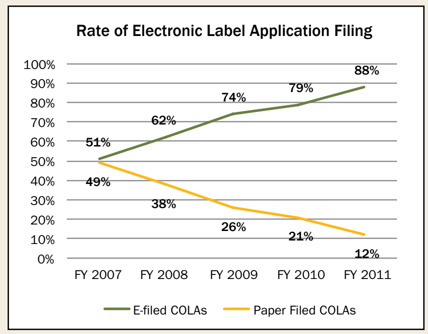
	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
Firearms	23	37	33	41	36
Tobacco	248	185	197	297	188
Alcohol	4,308	4,381	4,442	4,529	4,839

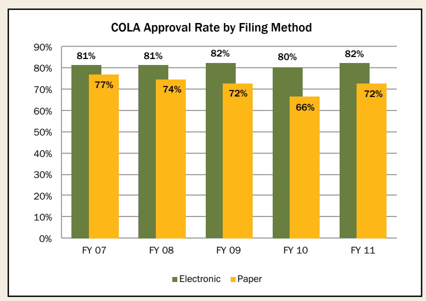
In five years, the total number of original permits and registrations approved by TTB has grown 11 percent. Between fiscal years 2010 and 2011, the total number of original permits issued increased by 4 percent. Firearms registrations approved by TTB decreased 12 percent compared to the prior year, and the number of tobacco permits issued decreased 37 percent.

- TTB approved 117,079 (81 percent) of the 145,305 COLA applications received; the remaining 28,226(19 percent) were either rejected, returned for correction, withdrawn, expired, or surrendered. The number of COLA applications received increased by 10 percent from 2010. Of those label applications, 88 percent were submitted through COLAs Online, the Bureau's system for the electronic filing of label applications. TTB was successful in increasing the rate of e-filing by 9 percent over the previous fiscal year, which corresponds to a 21 percent increase in the number of e-filed applications. The increase in online applications is due in large part to outreach efforts by TTB through educational workshops, improvements to online information, and one-on-one demonstrations to those industry members who are the highest volume paper filers.
- TTB deployed Formulas Online on January 10, 2011. Formulas Online is a Web-based system that allows external users to draft, submit, and track formula applications for domestic and imported alcohol beverages. In FY 2011, TTB received nearly 7,200 paper and electronic formulas for domestic and imported alcohol beverages. TTB received more than 2,300 of those applications electronically. In just eight full months of operation, TTB achieved an electronic filing rate of 32 percent for formula applications. The success of the system is due, in part, to outreach efforts. TTB held three Formulas Online Webinars to offer new users training in topics such as system registration; the basics of drafting, submitting, and tracking formula applications for domestic and imported alcohol beverages; and common pitfalls to avoid when submitting electronic formula applications.
- In FY 2011, TTB investigators closed more than 350 field investigations into the integrity of alcohol beverage products. Total product integrity investigations closed by TTB increased 18 percent compared to FY 2010, as a result of revisions TTB made to its enforcement approach as reflected in its investigation operating plan in FY 2011. The plan includes a combination of targeted and random investigations, and supports the expansion of the Bureau's Alcohol Beverage Sampling Program.

Alcohol Beverage Label Processing Stats







Between fiscal years 2007 and 2011, the number of alcohol beverage label applications submitted to TTB increased 16 percent. After a decline in total COLA applications in FY 2009, the number of Certificate of Label Approval (COLA) applications submitted by the alcohol beverage industry and processed by TTB has steadily increased.

Through targeted education efforts, the Bureau was successful in increasing usage rates for the electronic label filing system by 10 percent in just one year. The promotion and education strategy employed over the last five years has resulted in the COLAs Online usage rate increasing from 51 percent in FY 2007 to 88 percent in FY 2011.

- In assuring the integrity of alcohol beverage products offered for sale to U.S. consumers, TTB analyzed and reviewed for compliance 650 alcohol beverage products as part of the Alcohol Beverage Sampling Program (ABSP). The ABSP uses statistically valid sampling of products in the marketplace to validate that they are properly labeled to protect consumers. This program enables TTB to be proactive rather than reactive to potential labeling issues or threats to the food supply. In FY 2011, the ABSP was expanded to include all three beverage alcohol commodities in order to produce more timely compliance information. The program was also augmented with a field investigation component in order to verify alcohol beverage label claims, such as grape varietal and vintage focused on wine, which cannot be established through laboratory testing. Preliminary data indicates that overall compliance for distilled spirits increased due to an increase in content compliance; the compliance rate for malt beverages remained constant; and the compliance rate for wine decreased due to a decrease in label compliance. As in prior years, there was no statistically significant difference between the estimated overall compliance rates for domestic versus imported alcohol beverage products in FY 2011. Significant findings that required TTB intervention included high lead content in a distilled spirit product, an unauthorized pesticide in wine, and wines that were misclassified for tax purposes. The ABSP results add important data to the TTB risk model, which is used to most effectively direct enforcement resources and address non-compliance issues. For a full report on the ABSP, please visit TTB.gov.
- In FY 2011, the TTB laboratories analyzed nearly 2,000 product samples for product integrity, tax compliance, and the Alcohol Beverage Sampling Program. Of these products, 408 (approximately 20 percent) were non-compliant with Federal standards. Further, of the 17 complaints submitted to TTB by consumers regarding alcohol beverages they had purchased, TTB found that none posed serious health risks to consumers after collecting samples and testing the suspect products.
- As part of its active program to ensure the safety of alcohol beverages, TTB evaluates alcohol beverages for a number of potentially harmful adulterants or contaminants, including heavy metals and pesticide residues. In FY 2011, TTB continued its pesticide residue program that involves sampling wine in the marketplace for analytical testing to determine the presence of unauthorized pesticides and to ensure that authorized pesticides that are present are within the limits prescribed by the Food and Drug Administration and Environmental Protection Agency. In FY 2011, in support of these efforts, the TTB Laboratory successfully completed a multi-laboratory validation to test for the pesticide oxadixyl. Twelve laboratories in the U.S., Italy, China, and New Zealand representing academia, government, and commercial organizations agreed to participate in the collaborative effort. Multi-laboratory validation and method harmonization collaborations promote additional mutual acceptance of the methods of analysis, protect consumer health, and facilitate fair practices in the food and alcohol beverage trade.
- TTB's Trade Facilitation program helps to strengthen the U.S. economy by facilitating import and export trade in alcohol and tobacco products, while administering the consumer protection standards under its jurisdiction. TTB has made progress on international agreements with multiple counterpart agencies in Canada, Italy, France, the People's Republic of China, Australia, and the Republic of Georgia. These agreements are designed to facilitate trade by increasing mutual understanding of each country's alcohol and tobacco production requirements and labeling and licensing standards, and provide a process for the exchange of regulatory information that has the potential to enhance protection of the

revenue or impact product trade, compliance, and safety. TTB also provides technical support to Federal agencies, including the Office of the United States Trade Representative (USTR), in their development of international agreements that promote U.S. exports. TTB partnered with the USTR in a project to establish an Asia-Pacific Economic Cooperation (APEC) Wine Regulatory Forum (WRF). APEC is the premier forum for facilitating economic growth, cooperation, trade, and investment in the Asia-Pacific region, and member countries are emerging export markets for the U.S. wine industry. The purpose of the WRF is to provide a venue for open dialogue to support open and free trade and eliminate technical barriers to trade. TTB coordinated a September seminar in San Francisco, California, with representatives from 18 of the 21 APEC nations.

- The TTB Trade Facilitation program also assures fair competition within the domestic marketplace. In FY 2011, to support this TTB objective, TTB concluded a nationwide trade practice investigation of some of the largest alcohol beverage suppliers in the United States that were found to have violated the FAA Act by paying a major casino chain for preferential shelf space for their products. The negotiated settlements with six companies totaled approximately $2 million and, most importantly, broadcast TTB's active enforcement efforts in this area. TTB is following up on this case by issuing specific guidance to industry on the restrictions placed on the alcohol trade.

Financial Summary

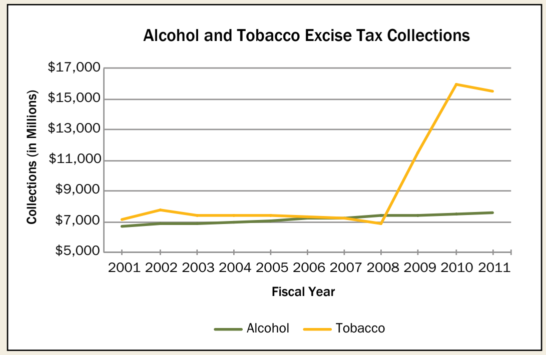
Federal Excise Tax Collections

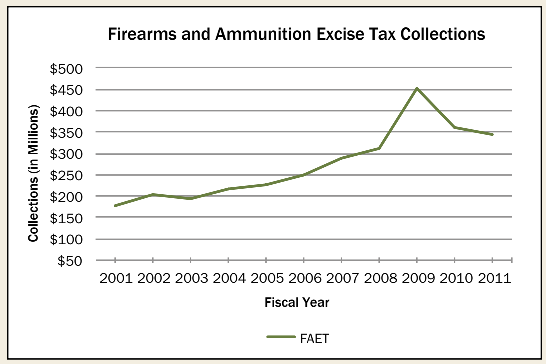
TTB collects excise taxes from the alcohol, tobacco, firearms, and ammunition industries. In addition, the Bureau collects Special Occupational Tax (SOT) from certain tobacco businesses. During FY 2011, TTB collected $23.5 billion in taxes, interest, and other revenues.

Substantially all of the taxes collected by TTB are remitted to the Department of the Treasury General Fund. The firearms and ammunition excise taxes (FAET) are an exception. This revenue is remitted to the Fish and Wildlife Restoration Fund under provisions of the Pittman-Robertson Act of 1937. The U.S. Fish and Wildlife Service, which oversees the fund, apportions the money to State governments for wildlife restoration and research, and hunter education programs.

FY 2011 Excise Tax Collections:

Alcohol	$7,594,330,000
Tobacco	$15,515,073,000
FAET	$344,262,000
SOT	$268,000
FST	$5,220,000
Other	$2,257,000
TOTAL	**$23,461,410,000**





TTB's tax collections for domestic alcohol beverages have shown a relatively stable rising trend for several years. The tax for imported alcohol beverages is collected by U.S. Customs and Border Protection.

Tobacco tax revenues in FY 2011 decreased by 3 percent from the prior year. This trend tracks with Congressional Budget Office projections for tobacco tax revenue following the passage of the CHIPRA legislation.

Since TTB assumed the responsibility for administering the FAET in 2003, collections have increased 78 percent. After reaching a high in FY 2009, revenue collections trended down in fiscal years 2010 and 2011.

Refunds and Other Payments

During FY 2011, TTB issued $802,048,000 in tax refunds and cover-over payments, and drawback payments on taxes paid by Manufacturers of Nonbeverage Products (MNBPs).

Cover-over Payments

Federal excise taxes are collected under the Internal Revenue Code of 1986, 26 U.S.C., on certain articles produced in Puerto Rico and the Virgin Islands, and brought in or imported into the United States. In accordance with 26 U.S.C. 7652, such taxes collected on rum imported into the U.S. are "covered over," or paid into the treasuries of Puerto Rico and the Virgin Islands, less the collection expenses incurred by TTB. During FY 2011, cover-over payments totaled $462 million.

Drawback Payments

Under current law, 26 U.S.C. 5134, MNBPs may be eligible to claim a refund of tax paid on distilled spirits used in their products.

During FY 2011, drawback payments totaled $307 million. In the case of distilled spirits on which the tax has been paid or determined, a drawback is allowed on each proof gallon at the rate of $1 less than the rate at which the distilled spirits tax had been paid or determined. The refund is due upon the claimant providing evidence that the distilled spirits on which the tax has been paid or determined is unfit for beverage purposes, or was used in the manufacture of medicines, medicinal preparations, food products, flavors, flavoring extracts, or perfume. The claimant must submit a product formula to the TTB laboratory for analysis and approval of the nonbeverage claim.

FY 2011 Excise Tax Refunds:	
Alcohol and Tobacco Excise Tax Refunds	$33,414,000
Cover-over Payments, Puerto Rico	$452,040,000
Cover-over Payments, Virgin Islands	$9,592,000
Drawbacks on MNBP Claims	$306,584,000
Interest and Other Payments	$418,000
Total	**$802,048,000**

FY 2011 Bureau Budget

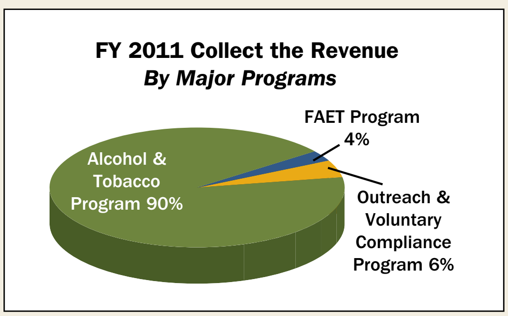
Direct Appropriations (Salaries & Expense Account)

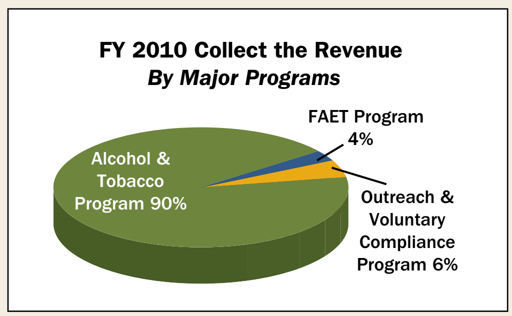
The FY 2011 TTB budget for salaries and expenses was $100,798,000. The authorized full-time equivalent (FTE) staffing level for direct positions was 535, which included 10 FTE for special agents provided under two-year funding made available in FY 2010 for the hiring, training and equipping of special agents. However, TTB elected not to hire the agents directly, but to enter into an interagency agreement with the Internal Revenue Service Criminal Investigation office to conduct criminal investigations into violations of the tax laws TTB enforces.

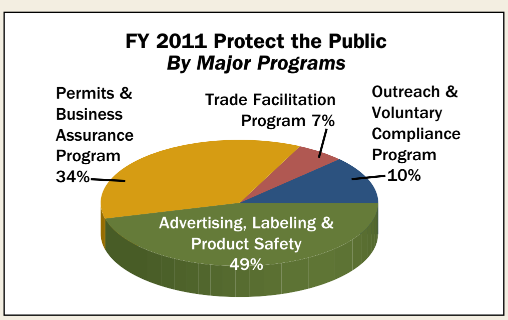
Offsetting Collections and Reimbursable Accounts

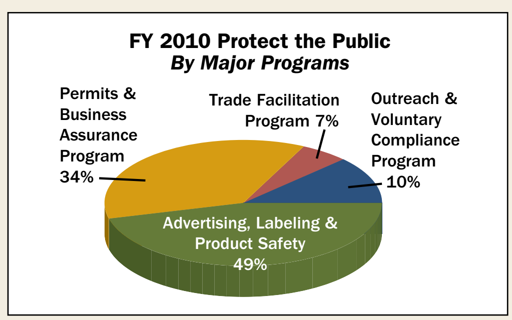
During FY 2011, the Bureau realized offsetting collections in the amount of $3.8 million. Those funds originated from multiple sources including recoveries from the operation of the cover-over program and other enforcement activities in Puerto Rico, and funding from the Department of the Treasury's Executive Office of Asset Forfeiture to cover investigative expenses; and funding from the Community Development Financial Institutions Fund (CDFI) for reimbursement of information technology support services.

Obligations and Expenditures by TTB Program









The Bureau's expenditures by its major programs remained constant between FY 2010 and FY 2011.

Audit of TTB's FY 2011 Financial Statements

The Department of the Treasury is one of 23 Federal agencies that are required by law to produce annual audited financial statements. TTB's financial activities are an integral part of the information reported on by the Treasury Department.

TTB's Annual Report includes audited FY 2011 and FY 2010 financial statements, as well as reports on the Bureau's internal control over financial reporting and compliance with laws and regulations.

Management Assurances

An independent, full-scope financial statement audit was conducted for FY 2011 and TTB received an unqualified audit opinion. However, the audit identified a material weakness in internal control over financial reporting related to the computation of allowances for uncollectible tax receivables.

For FY 2011, except for the noted weakness related to the allowance for doubtful accounts computation, TTB provides reasonable assurance that the objectives of the Federal Managers' Financial Integrity Act have been achieved, and the Bureau's financial management systems are in substantial compliance with the Federal Financial Management Improvement Act. This overall determination is based on past and current practices, an improved controls environment, scrutiny by external audit sources, internal evaluations, and administrative and fiscal accounting system enhancements.

During the year TTB implemented corrective actions to improve internal controls that were designed to ensure the accurate recording of financial transactions into the capital accounts of the general ledger and accurate reporting of capital assets in the financial statements. These changes were made to address prior year audit findings.

Also during FY 2011, TTB applied its custom risk management tools to its Revenue Accounting Section to identify risks in the accounting and tracking of TTB's annual Federal excise tax collections, and to the National Revenue Center, with a focus on its key business processes. Those tools disclosed that TTB has adequate internal controls in place to mitigate risk to operations, and that the overall risk of fraud, waste, and abuse is characterized as "LOW."

Bureau Challenges

TTB is planning improvements designed to address the deficiency identified in the audit regarding the computation of allowances for uncollectible tax receivables. The corrective actions should be completed during the second quarter of FY 2012. Further, TTB plans to revisit the vulnerability and risk management tools that are used each year to monitor the internal controls over tax collections to ensure these documents reflect the key business processes in operation at the National Revenue Center and fully support our internal control program at the Bureau. As systems and business processes change it is important that TTB update the tools that are being used to monitor its tax processing activities.

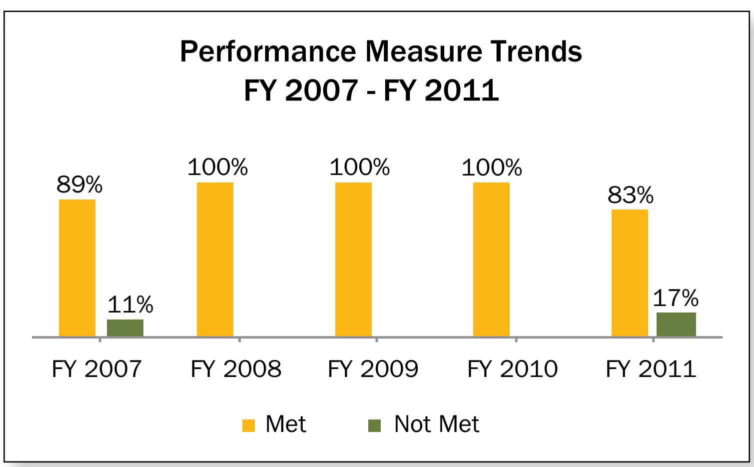
Part II: Program Performance Results

Performance Overview

TTB reports its performance in terms of six metrics that represent its ability to supply satisfactory service to its customers in the industry, foster compliance from taxpayers, employ technology to meet its public protection mission, and return value to the Nation for its investment in TTB programs.

TTB exceeded the performance targets for five of the measures reported to its stakeholders in FY 2011. Based on external factors and the results achieved this fiscal year, TTB reviewed its FY 2012 performance targets and updated those in which TTB significantly exceeded its intended performance. To meet its performance goals in FY 2012, TTB will implement an aggressive strategic agenda that integrates new technology, human capital management techniques, and targeted efforts in both outreach and enforcement. All performance results are subject to management review and periodic audit by the Department of the Treasury.

FY 2011 Performance Measure Status	
Performance Targets Met	5
Performance Targets Not Met	1
Baseline	0
Total Performance Measures	**6**



Summary of Collect the Revenue Performance

Table 1.1

Performance Measure	FY 07 Actual	FY 08 Actual	FY 09 Actual	FY 10 Actual	FY 11		FY 12 Target	FY 11 Target Met?	% of Target Reached
					Target	Actual			
Amount of revenue collected per program dollar	–	$313	$427	$478	$400	**$468**	$410	Y	117%
Percentage of voluntary compliance from large taxpayers in filing timely tax payments (in terms of revenue)	–	94%	94%	94%	92%	**95%**	94%	Y	103%

Performance Discussion

In FY 2011, TTB met all of its targets for the performance measures under the Collect the Revenue budget activity, demonstrating the effectiveness and efficiency with which TTB operates its revenue collection mission.

Efficiency of Tax Collection

The amount of revenue collected per program dollar measure uses annual collections figures and the actual expenditures and obligations for collection activities to quantify the efficiency of the TTB tax collection program. In FY 2011, TTB reported a return on investment of $468 for every dollar spent on collection activities. Due to ongoing and successful compliance audit and investigation efforts, TTB exceeded the performance target for FY 2011 by 17 percent.

Each year, TTB collects approximately $23.5 billion in excise taxes, interest, and other revenues from alcohol, tobacco, firearms, and ammunition industries. In determining its performance targets for this measure, TTB examines historical collections trends across each of its regulated commodities, as well as other predictors that influence consumer behaviors.

In just three years, the return on investment for the Collect the Revenue program increased by 50 percent, principally because of the higher Federal excise tax rate imposed on tobacco products under the February 2009 CHIPRA legislation. This legislation nearly tripled the Federal tax rate on certain tobacco products and, as a result, TTB's return on investment reached an historic high in FY 2010 of 478:1. However, shifts in consumption patterns, product manufacturing, and trade will impact federal revenues in the years ahead. In accounting for these types of marketplace shifts, TTB used Congressional Budget Office revenue projections for tobacco excise tax collections to determine its targeted performance levels for fiscal years 2011 – 2013.

The performance target of $400 for FY 2013 reflects TTB's analysis of collections data, and will be met through continued efficiencies gained in TTB's costs to operate its Collect the Revenue activities, specifically, savings achieved in the processing of operational reports filed by distillers. In FY 2011, TTB drafted rulemaking that proposes to streamline the reporting requirement for distilled spirits plants (DSP).

The proposal calls for replacing the four current report forms that DSPs use to report to TTB on their production and operations each month with two new report forms. Further, plants with small excise tax liabilities will be able to submit quarterly reports instead of monthly reports. Additionally, the reporting forms have been updated to eliminate unnecessary information and improve TTB's ability to identify transfers of spirits that do not comply with the regulations. This initiative will significantly reduce the filing burden for industry members, and reduce processing costs for TTB. TTB estimates that this project will result in additional savings of $300,000 annually based on the more efficient and effective processing of reports and the use of report data to reconcile industry member tax accounts.

Increase Voluntary Tax Compliance

Fostering voluntary compliance among excise taxpayers is another primary tax administration strategy for TTB and supports the priority goal of the Department of the Treasury. A key performance metric shows that 95 percent of large taxpayers (i.e., those that pay more than $50,000 in annual taxes) voluntarily file their tax payments on or before the scheduled due date. During an economic downturn, this compliance rate from business is especially notable, and is a function of the service and outreach TTB provides to its industry members and its effective enforcement presence.

Improved Access to TTB Services

Through targeted investments in technology, TTB aims to improve voluntary compliance by working toward allowing TTB permittees and taxpayers to file all payments, returns, and applications online with the National Revenue Center. In FY 2011, TTB expanded the e-filing program to allow all excise taxpayers to file and pay taxes and file monthly operational reports electronically through the Pay.gov system. The total number of Pay.gov registrants increased over the prior year by 12 percent in FY 2011, bringing the total to nearly 7,200.

Tax Enforcement Audits and Investigations

An identifiable enforcement presence is a well-established driver of compliance rates. In FY 2011, to meet its performance target of 92 percent for the voluntary compliance measure, TTB used increasingly sophisticated risk models and audit targeting techniques to complete field work for approximately 175 targeted audits and 190 revenue investigations. These audits and investigations resulted in the identification of approximately $29.4 million in additional tax, penalties, and interest from industry members, and $10.6 million in additional collections. Further, in a continuation of efforts to enforce the CHIPRA legislation enacted in 2009, TTB continued its Floor Stocks Tax (FST) examination program by conducting 175 FST examinations of tobacco manufacturers, importers, wholesalers, and retailers, which this year identified $5.6 million of potential tax, penalties, and interest, and resulted in $4.8 million in additional collections. In just over two years, TTB auditors have completed approximately 465 FST examinations, identifying $16.3 million and collecting $8.5 million of potential tax, penalties and interest.

Additionally, in FY 2011, TTB developed an automated system to identify FST non-filers at a national level, using minimal TTB resources. This involves a special operating procedure for targeting, referring, assessing, and collecting FST revenue from non-filers. In using this database solution, to date, TTB has identified the potential for an additional $25 million of estimated FST due, to be verified through FST examinations in

FY 2012. The actual revenue risk is likely higher, as TTB continues to collect tobacco data from a variety of sources and to complete its database of all FST non-filers. Since enacted in 2009, total FST collections are well over $1.2 billion.

In FY 2011, TTB made significant adjustments to its operating plans by targeting tobacco importers and tobacco processors, two points in the distribution chain that present a revenue risk.

Using a tobacco importer risk model developed in FY 2010 to isolate the highest risk tobacco importers in TTB's portfolio, TTB completed more than 20 tobacco importer audits, which led to the identification of more than $10 million in additional excise tax liability. These matters were referred to CBP for collection, as the authority for collecting excise tax on imports resides with Customs.

Also during FY 2011, TTB piloted an initiative that involved joint teams of auditors and investigators employing forensic audit techniques to investigate the activities of tobacco processors. CHIPRA imposed new permit requirements on these businesses, which source processed tobacco to manufacturers for the production of cigarettes and other taxable tobacco products. These joint investigations resulted in approximately $2 million in additional Federal excise tax. The forensic audits, which involve forward tracing processed tobacco through various points in the distribution chain, uncovered a number of suspicious removals of processed tobacco outside of the permitted system, and several illegal manufacturers. One cased involved the shipment of processed tobacco to two warehouses that didn't exist or never received the product. The potential tax liability of these shipments (if the processed tobacco was made into cigarettes) exceeds $5 million. These TTB investigations also resulted in criminal case referrals.

Criminal Enforcement

Further, in its efforts to maintain tax compliance within the industries it regulates and the collection of all revenue due on alcohol and tobacco products, the Bureau worked to address the illicit activity in the marketplace. TTB has criminal enforcement authority under the IRC, which includes penalties for illicit tobacco product manufacturing and evasion of excise tax. Until this past fiscal year, however, TTB did not have the resources to effectuate this authority. Instead, TTB had to rely on the availability and interest of other Federal and state law enforcement agencies, agencies with separate and distinct missions, to either initiate joint investigations that would include violations of IRC provisions enforced by TTB or accept a criminal investigation referral.

TTB entered into an interagency agreement in FY 2011 to reimburse the IRS for agent services to enforce the criminal provisions of TTB's jurisdiction. In FY 2011, a Special Agent in Charge and five special agents were assigned full-time to TTB. In its 10 months of operations, this program has resulted in the initiation of 21 cases with a total estimated potential Federal excise tax liability of over $20 million, and combined seizures and forfeitures by partnering agencies totaling approximately $1.7 million. Of the 21 cases, 11 related to illicit tobacco trade (52 percent) and 10 relate to the illegal alcohol trade (48 percent), demonstrating that criminal activity is present across the industries TTB regulates. Of the 21 open criminal cases, 18 (86 percent) are currently under investigation and have been accepted by an Assistant U.S. Attorney for prosecution. TTB has closed three cases, one of which involved the misclassification of imported distilled spirits to evade Federal excise tax and resulted in a plea agreement of nearly $102,000. TTB is working with IRS CI to close the cases opened under this contract agreement.

Moving Forward

Looking ahead, TTB will continue its enforcement strategies to achieve the target of 94 percent established for the voluntary compliance performance measure. Strategies that TTB will employ to meet this target focus on developing a balanced field approach of audits and investigations that targets non-compliant industry members, establishing an identifiable presence within the industry that encourages voluntary compliance, and identifying any gaps in tax payment from illegal entities and individuals operating outside of the lawful distribution system for alcohol and tobacco products.

TTB's revenue collection activities will focus both on legitimate industry members, and those operating outside of legal distribution chains. TTB will continue to include in its audit plan a mix of comprehensive audits, limited scope audits, and examinations in order to maximize TTB's audit resources and provide broad industry coverage. TTB also plans to address revenue risk areas in FY 2012 through enhanced risk modeling and audit programs developed for specific industry member types determined to be at high risk for non-payment or underpayment of taxes. The fraud units comprised of TTB auditors and investigators will also be deployed to work on complex fraud and diversion cases and cases with national scope.

To assure compliance in the importer community that TTB regulates, TTB will continue to participate in joint Federal agency initiatives designed to trace alcohol and tobacco product through the Customs bonded warehouse system to ensure alcohol and tobacco products moving into domestic commerce are properly taxpaid and meet packaging and marking requirements. TTB also is involved in multiple ongoing criminal investigations of illegal activity in the industries TTB regulates. Using an integrated enforcement approach, auditors will follow up on referrals provided by the TTB Intelligence Division to address suspected illegal activity. TTB auditors and investigators will use partnerships cultivated with AUSA's and other law enforcement agencies, including IRS CI, to effectuate TTB's criminal enforcement operations.

In FY 2012, TTB will complement its enforcement efforts with education strategies to obtain tax compliance from TTB permittees. Sustaining or increasing the rate of compliance achieved will depend, in part, on continued efforts to promote industry member use of the online tax return and payment filing system, Pay.gov. Efforts to maintain voluntary industry compliance also will focus on educating industry of Federal requirements related to operating in the alcohol, tobacco, and firearms industries, both on premises through guidance provided by TTB auditors and investigators and through Web-based industry seminars. Going forward, online seminars will enable TTB staff to reach broad groups of users and provide advanced instruction on the reporting and payment of excise taxes and other regulatory requirements.

TTB also will further enhance its tax verification program by building on the Error Tracking Database (ETD) to identify discrepancies in operational reports and tax returns. In development since FY 2010, the ETD now identifies more than 70 different types of errors on certain industry operational reports, and generates compliance letters to notify industry of the compliance issues. In FY 2012, the ETD will be expanded to include operational reports for additional TTB-regulated commodity types. TTB also will expand the module in the ETD that identifies missing and late excise tax returns.

Summary of Protect the Public Performance

Table 1.2

Performance Measure	FY 07 Actual	FY 08 Actual	FY 09 Actual	FY 10 Actual	FY 11		FY 12 Target	FY 11 Target Met?	% of Target Reached
					Target	Actual			
Percent of electronically filed Certificate of Label Approval (COLA) applications	51%	62%	74%	79%	81%	**88%**	88%	Y	109%
National Revenue Center (NRC) customer service survey results	–	90%	89%	89%	85%	**90%**	85%	Y	105%
Average number of days to process an original permit application at the NRC	–	64	64	65	72	**74**	75	N	97%
Percentage of importers identified by TTB as illegally operating without a Federal permit	–	22%	15%	15%	19%	**14%**	14%	Y	126%

Performance Discussion

In FY 2011, TTB met three of its targets for the performance measures under the Protect the Public budget activity. TTB tracks its success in meeting its trade and consumer protection goals through four principal performance measures that indicate how timely the Bureau is in issuing permits to qualified alcohol and tobacco businesses, how satisfied businesses are with TTB's permitting process, how effective TTB is in deterring illicit importation of tobacco products by non-permitted entities, and the efficiency of the Bureau's alcohol beverage label application processing activity. Taken together, these measures reflect the priorities of a service-oriented organization, which applies technology to the greatest extent in order to perform its consumer protection role and in order to assure that commerce is fair, lawful, and open.

Increase Efficiency in Permitting Qualified Businesses

TTB protects consumers by screening permit applicants to ensure only qualified persons engage in operations in the alcohol, tobacco, firearms, and ammunition industries. For this purpose, in FY 2011, TTB processed 6,000 original and 19,700 amended permits, and performed 200 investigations into high-risk applicants to meet TTB's business integrity objective. TTB also monitors its timeliness in processing permit applications through its measure of average processing times for original permit applications. Undue delays in providing businesses a permit to commence operations impacts small business growth and federal revenues, as taxable commodities cannot be lawfully produced without a TTB permit. TTB targeted a 72-day turnaround time for original permit applications in FY 2011; however, the Bureau averaged 74 days to process these applications.

TTB launched Permits Online in FY 2011 to expedite permit processing times and increase the number of paperless transactions with the community TTB services. Permits Online provides a secure, Web-based solution that allows members of the alcohol and tobacco industries to electronically submit applications for permits to operate. Applicants who plan to produce finished distilled spirits, wines, malt beverages, and tobacco products, and persons wishing to operate businesses such as alcohol wholesalers, alcohol importers, tobacco importers, specially denatured spirits users and dealers, tax-free alcohol users, alcohol fuel plants, tobacco processors, and tobacco export warehouses, must submit original and amended permit applications. TTB's National Revenue Center currently processes original application packets for 23 types of permits/ registrations.

Over the past several years, however, the volume of paper applications has increased making it difficult to maintain current service levels. On average, TTB has experienced a 6 percent annual increase in original permit applications. Recognizing this trend, and the loss of processing resources, TTB purchased a commercial off-the-shelf software package to serve as the core of the electronic system to automate the submission process for all permit applications. TTB is deploying the system in stages, with the initial release implemented in FY 2011, and subsequent releases scheduled through FY 2012. The initial release, which came online in February 2011, included the highest volume permit application filers—alcohol importers, alcohol wholesalers, and wineries. A second release of the system in May 2011 enabled electronic filing by specially denatured alcohol users and dealers and tax-free alcohol users. Processing times in the second and third quarters of the year suffered as staff was redirected for these initial system releases, but showed improvement in the fourth quarter as applicants and employees gained experience using the system. Also, with these initial releases, TTB focused its resources on processing e-filed permit applications in an effort to incentivize businesses to file their application in Permits Online. During this period, the backlog of paper applications grew, and increased the average processing time.

With full system functionality for Permits Online slated for deployment in FY 2012, and considering the requisite transition and training period for industry members, TTB does not anticipate achieving reductions to turnaround time until the latter quarters of FY 2013. The FY 2012 President's Budgets include staff reductions as a result of the efficiencies gained by the introduction of this technology. These reductions in staffing will produce budget savings, but will impede improvements in processing times, which TTB projects to average 75 days at the close of FY 2013. Sustained performance during a period of declining staff and increasing workloads will demonstrate TTB's effectiveness, and the success of the new e-filing system, without which processing times would exceed 90 days.

Improved Customer Satisfaction Results

TTB also measures its performance in its permit processing function through surveying the businesses that apply for a TTB permit. The NRC customer survey solicits feedback on the level of service provided to applicants for an original or amended permit, and those industry members who file a claim to recover taxes paid on nonbeverage alcohol or overpayments of tax. TTB exceeded its target of a sustained score of 85 percent on customer satisfaction for permit application and claims processing, and achieved a composite score of 90 percent in FY 2011. Planned service enhancements, including the scheduled enhancements to the online filing solution for original and amended permit applications in FY 2012, will contribute to the Bureau continuing to meet its targeted performance level. The FY 2012 target for performance of 85 percent will be met through efforts to increase applicant adoption rates for the Permits Online system, as well as other improvements to business processes and TTB call centers that directly impact the business community that TTB services.

Sustained Permit Compliance by Regulated Importers

Maintaining lawful operations in the trade of alcohol and tobacco commodities is a principal TTB objective. TTB continues its enforcement of Federal permit requirements, targeting entities identified as importing cigarettes and other tobacco products without a TTB permit. By monitoring the CBP's International Trade Data System, and comparing import data against the permitees on file with TTB, the Bureau is able to identify and take action against those entities engaging in unlawful operations. In FY 2011, through this data comparison, TTB determined that 14 percent of entities reporting importations of tobacco products had done so without a permit. TTB improved upon its prior year result of 15 percent for this measure and, through its vigilant oversight, produced a result 5 percent below its target for performance. In all, TTB identified only 13 entities importing commercial quantities of tobacco products (10,000 KG or more). TTB's issuance of cease and desist letters, and appropriate follow up activities, ensured that the responsible parties ended operations or obtained a permit.

Efficiency in Alcohol Beverage Label Processing

TTB protects U.S. consumers by assuring that the alcohol beverage products offered at retail outlets are properly labeled and comply with federal production standards. In FY 2011, TTB met this objective and facilitated U.S. commerce through the approval of 117,100 of the 145,300 COLA applications received; the remaining 28,200 (19 percent) were rejected, returned for correction, withdrawn, or expired. In furtherance of the Department-wide priority goal of increasing paperless transactions, the Bureau reported increases in the percent of electronically filed COLA applications, which in FY 2011 reached 88 percent of all applications. The ongoing rise in electronic filing is due to system improvements that track with customer feedback and which simplify the filing process for industry members. TTB has set a target of 88 percent for FY 2013 and, to meet this performance goal, will use targeted outreach to reach the segments of the industry that have not migrated to the online filing environment.

Moving Forward

TTB will continue working to improve processing times for all services provided to its regulated businesses through the automation of its paper-based application processes and to encourage use of online filing systems already in place. Usage rates for its electronic filing system for alcohol beverage label applications have continuously increased due to outreach efforts and in response to faster turnaround times for e-applications versus paper applications. In FY 2011, TTB will continue to inform industry members of the benefits of electronic filing, and will continue to provide system demonstrations and publish online guidance, including a revamped e-newsletter, to the businesses that comprise the user community. Further, with the introduction of Formulas Online, the new e-filing system that enables the online submission of alcohol beverage formulas, TTB also expects increased user rates for COLAs Online. The integration of Formulas Online with the existing COLAs Online system will streamline the process of obtaining both formula and label approval for those in the alcohol beverage trade. The integrated systems use a single user ID and password to allow access to both systems. Currently, 794 active users are registered for both COLAs Online and Formulas Online.

Even during the economic contraction, applications to open new businesses in the alcohol industries continued a steady rising trend. As resources contract, TTB intends to meet the growing demands of its customers, by continuing to promote use of the Permits Online system by all permit applicants, and by updating the risk model and processes used by the NRC to conduct permit applicant interviews. These business process improvements will help TTB meet its 75 day performance target, despite projected growth in workload.

Additionally, with the phased rollout of Permits Online scheduled through FY 2012, TTB anticipates increased customer satisfaction, as applicants experience faster response times and the ease of using the electronic filing system. Additionally, customers should benefit from other efforts to streamline the permit application process, such as planned improvements to TTB bond forms and instructions, a prerequisite for operations for many permitees.

Finally, in its monitoring of Customs data to assure that tobacco importers are properly permitted, TTB intends to meet its FY 2013 performance target of 14 percent for this measure by placing special emphasis on enforcing the Prevent All Cigarette Trafficking (PACT) Act, a law enacted in 2010 to prevent tobacco smuggling and to ensure the collection of all tobacco taxes. Under the PACT Act, shipments of tobacco products via the U.S. Postal Service (USPS) are prohibited. The vast majority of the illegal imports are individuals purchasing tobacco products in small quantities for personal consumption through online tobacco outlets via the USPS and FedEx. TTB continues to coordinate with the USPS and other ground carriers to provide enforcement assistance. TTB also will focus on monitoring the importation of processed tobacco, which is subject to new regulation and oversight under CHIPRA, to ensure the fidelity of the importers. Processed tobacco is the subject of intense TTB enforcement scrutiny, as it is a non-taxpaid tobacco product that may be diverted for illegal manufacturing of cigarettes.

Summary of Management and Organizational Excellence Performance

In order to effectuate the Bureau's revenue collection and public protection mission, TTB must create the conditions necessary for programs to reach and sustain excellence. In all aspects of performing its mission, TTB aims to ensure that its programs operate efficiently and effectively, and with full accountability. TTB accomplishes this by ensuring that program offices receive the high-quality management and administrative support needed to achieve the Bureau's goals.

The Bureau's objectives in the area of Management and Organizational Excellence align with the Administration's emphasis on automating processes to improve services and enhancing internal operations to be more efficient and effective. In FY 2011, the Bureau demonstrated its ability to enhance efficiency and reduce costs through its strategic management of human capital, IT enhancements to improve operations, and rigorous financial management practices.

Human Capital Management

TTB continues to implement the strategic goals, strategies, and measures of results outlined in the current Human Capital Strategic Plan. As the majority of TTB's human resource functions are operated through the Bureau of Public Debt Administrative Resource Center (BPD ARC), TTB establishes and updates, as appropriate, performance benchmarks and measures to monitor these outsourced functions. In FY 2012, TTB will continue its efforts to revise its Human Capital Strategic Plan to align with the strategic direction of the Bureau. The new plan will take into account the overall business and cultural vision for TTB, to include:

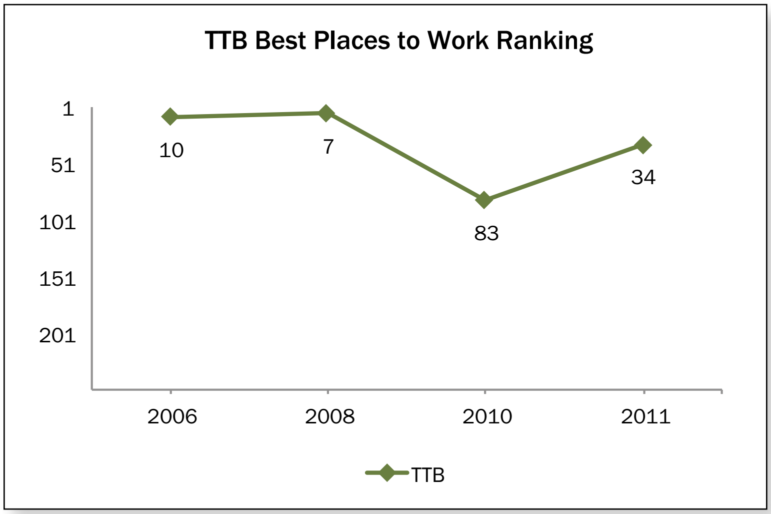
- addressing retirement trends by identifying and closing competency gaps and creating a succession plan, enhancing our recruitment and retention plan, and identifying targeted skills sets;
- providing an employee friendly culture that strikes a work/life balance through employee recognition, performance management, flexible schedules, and teleworking;
- incorporating organizational needs based on the 2011 OPM Employee Viewpoint Survey results; and
- streamlining human resources functions through various human resources information systems, including a new electronic employee official personnel file, performance management system, and enhanced self-service personnel actions available online.

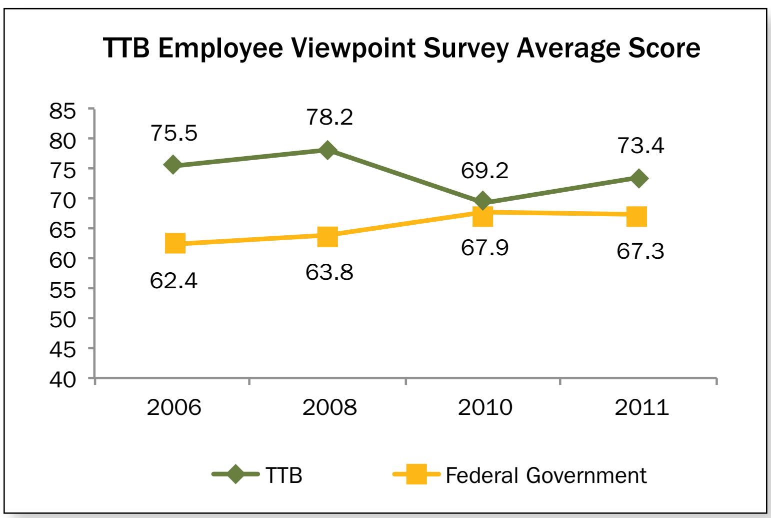
In FY 2011, TTB held Labor/Management Partnership Council meetings with the National Treasury Employees Union (NTEU) under the provisions of the Collective Bargaining Agreement. These meetings have been instrumental in fostering the Bureau's labor management relations. In furtherance of improved labor management relations, TTB and the NTEU collaborated on several pre-decisional projects, including the reorganization of several field offices to best support the mission and the expansion of the Bureau's telework policy.

TTB also conducted impact and implementation bargaining with the NTEU, and revised orders prior to publication, for a number of significant human resources policies during FY 2011. These included the TTB orders related to Performance Rating Calculations; Recruitment, Relocation, and Retention Incentive Plans; Merit Promotion; and Mission, Organization, and Responsibilities.

Employee satisfaction is critical to a productive workplace. Each year, the Office of Personnel Management administers the Employee Viewpoint Survey (EVS) to measure the satisfaction of the Federal workforce. The TTB EVS average score for FY 2011 trended up to a 73.4 percent positive response rate from employees. In response to the scores TTB received on this Government-wide survey, TTB developed an FY 2012 Employee Viewpoint Survey (EVS) Action Plan to address areas that showed a decline from the prior year.

Based on this survey data, the Partnership for Public Service determines rankings for Federal agencies. TTB ranked 34th out of 240 sub-component agencies on the FY 2011 Best Places to Work in the Federal Government rankings, an increase from its 2010 ranking of 83 out of 224.





In its efforts to improve upon the 2010 ranking, throughout FY 2011, TTB worked to implement the actions identified in its FY 2011 EVS Action Plan. This involved, in part, conducting a series of focus group meetings at the Bureau's two primary locations—the National Revenue Center and TTB Headquarters—in an effort to solicit feedback from both employees and managers. The purpose of these sessions was to offer a forum where employees could freely share information, express concerns, and to offer suggestions on how to improve the work environment for all TTB employees. The focus group sessions were supported and facilitated by EEO and human resources personnel.

During FY 2012, under the revised EVS Action Plan, TTB has targeted the areas of effective hiring practices, an inclusive workplace, and workforce engagement to build upon the improvements in employee satisfaction realized in FY 2011. Specifically, TTB will:

- Provide recruitment lifecycle and interviewing training to hiring managers;
- Establish an on-boarding and mentoring program customized for veterans and individuals with disabilities;
- Implement recommendations and act on the results of the Recognition Survey, an internally administered survey of TTB employees, to transform the awards and recognition program;
- Develop an action plan to support Job Satisfaction, Talent Management, Results-Oriented Performance Management, Leadership and Knowledge Management, and Employee Retention;
- Develop an action plan for building an inclusive workplace (i.e., veterans (disabled and non-disabled) and individuals with disabilities); and
- Develop an action plan to effectively promote and support the Department-wide objectives to hire the best talent by decreasing time to hire.

Implementing these and other initiatives on the FY 2012 EVS Action Plan will increase communication to employees, ensure a highly talented and well-developed staff, and enhance employee engagement.

As a knowledge-intensive organization, TTB requires a highly trained workforce to fulfill its responsibility to protect the public and collect the revenue within a dynamic and global environment. During FY 2011, TTB used a variety of human capital policies and programs for recruiting and attracting talent to ensure qualified people with the necessary skills are in the right positions, and to continue to retain those professionals in the future. Successful strategies included partnerships with a diverse range of universities across the country, use of the Treasury Veterans Program, and the Presidential Management Fellows (PMF) Program.

In FY 2011, TTB expanded its use of the PMF Program, with several TTB offices participating in the annual PMF recruitment and job fair hosted by OPM. As a result, several PMF were hired to support the regulatory area.

Succession planning is also a strategic priority for the Bureau, especially as it relates to TTB's mission-critical positions. One in five TTB employees is eligible to retire in FY 2012. To mitigate the loss of expertise and close skill gaps in mission-critical occupations, TTB continues to use the personnel interventions identified in the Pay Demonstration Program—a successful pay-for-performance pilot project established in 1999—to enable the Bureau to improve its capacity to recruit, develop, and retain high-caliber employees. TTB uses tailored approaches designed and implemented specifically for the Bureau's continuing and evolving needs in order to meet mission requirements and remain competitive for highly skilled talent.

Finally, in FY 2011, TTB continued its Emerging Leader's Program (ELP), established in FY 2009, and selected its fourth class of the ELP. This leadership development initiative offers three unique certificate programs for non-supervisors, first-level supervisors, and second-level managers at TTB. The three-year program series supports TTB's succession planning strategies, and prepares participants with the competencies critical for higher levels of leadership responsibility. With the FY 2011 participants, 45 employees are enrolled in the ELP (8 percent of the TTB workforce), all of whom are up to date on certificate requirements. Based on participant feedback, TTB is working on expanding the programs offerings to include mentoring opportunities and detail assignments to tax or regulatory counterpart agencies to broaden the exposure of program participants.

Financial Management

TTB established and monitored key performance standards to ensure that its business activities covering financial accounting and reporting operate in a highly effective and efficient manner. In FY 2011, TTB, in collaboration with its shared service provider at BPD ARC, achieved all of its financial management performance metrics.

This joint effort in providing financial management services has allowed the Bureau to meet its financial goals and deliver quality accounting and budget services to program staff, including:

- Paying vendor invoices on time (Prompt Payment Rate) greater than 98 percent;
- Incurring interest on late payments less than 0.02 percent;
- Achieving an Electronic Fund Transfer Compliance Rate of greater than 96 percent;
- Completing timely and accurate Cash/Fund Balance reconciliations within 15 days after the end of the accounting period;
- Reconciling Cash/Fund Balance to 100 percent of the proper balance;
- Clearing suspense accounts within 60 days;
- Ensuring prompt deposits and recording of tax collections;
- Providing timely and useful financial management data;
- Providing excellent customer service; and
- Maintaining an account code structure that captures and measures costs of TTB programs.

The Bureau also met established due dates to ensure timely submission of required Financial Management Service (FMS) reports. Monthly closing of financial data was completed within three business days, and payroll information was downloaded into the Oracle core accounting system within three working days of receipt of payroll tapes from the National Finance Center.

Joint reviews of payroll activity were conducted to obtain reliable projections of payroll costs relative to continuously changing on-board staffing levels. The payroll projection system has proven to be a valuable tool and its use has led to better financial information for decision making on the budget and has helped the Bureau avoid Anti-Deficiency Act violations. The ability to extract information from both the core accounting system, and make sound payroll projections, continues to provide reliable and accurate financial information for management use in executing the budget.

In FY 2011, the Bureau was able to conduct timely reviews of financial information so that program offices were afforded the data necessary to make efficient use of the Bureau's annual appropriation, and fulfill TTB's tax collection and regulatory responsibilities as outlined under the budget plan. By closely monitoring the Bureau's financial status, TTB was successful in making a number of key investments in support of its mission. These financial reviews were not limited to the current year's appropriation. TTB also conducted a review of prior year obligations. This endeavor led to the close out of accounts that no longer legally obligated TTB. As a result of this comprehensive effort, the Bureau was able to increase its FY 2010 unobligated balance, of which 50 percent, or $236,000, was reapportioned for use in FY 2011 for a one-time investment in information technology (IT) infrastructure equipment to replace obsolete network equipment and its IT network intrusion detection system (IDS).

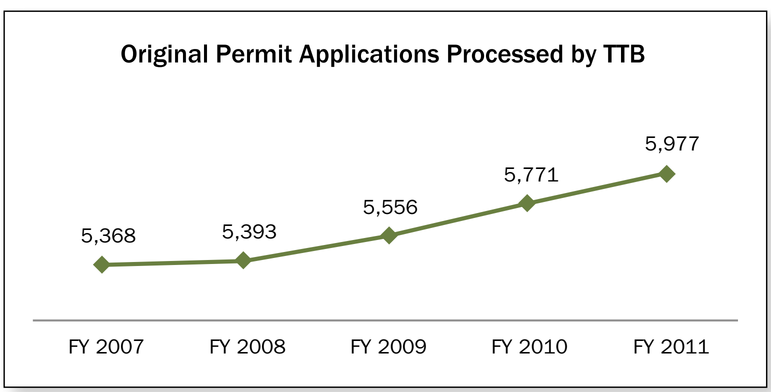
In support of Treasury's OMB Circular A-123 requirements over financial reporting controls, the TTB Office of Finance and Performance Budgeting tested internal controls related to the financial reporting of tax collections. The review identified no control weaknesses over TTB's collection activity and the reporting of those collections.

Expansion of Technology Solutions

TTB made significant progress in achieving its strategic vision of using technology to streamline the delivery of its core business services. In FY 2011, TTB continued with business application development to improve internal operational efficiency and to reduce the regulatory burden on industry members. Two major business applications went into production that added essential automation to paper-intensive processes.

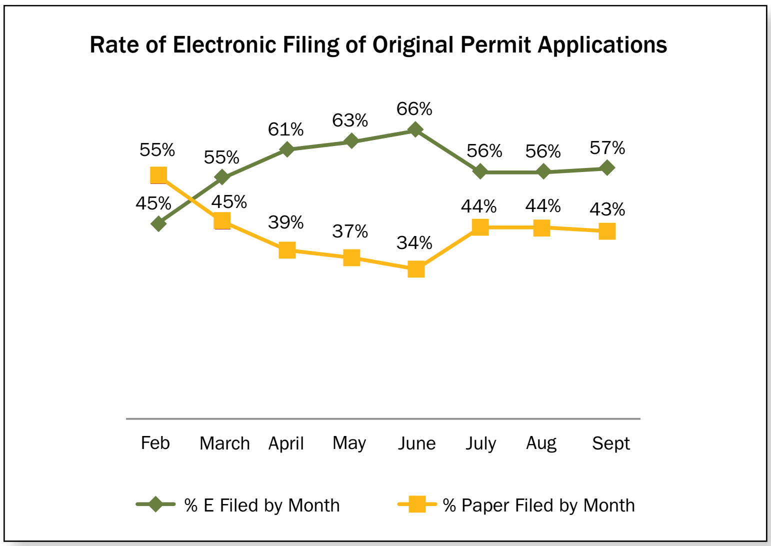
The Permits Online initiative, a major software development project that began in earnest in FY 2010, came online in FY 2011, enabling industry members to electronically submit new and amended permit applications to TTB for approval. The secure, Web-based system supports the online submission, routing, and processing of original and amended permit applications.

TTB currently processes application packets for 23 types of permits or registrations for the alcohol, tobacco, firearms, and ammunition industries. New or existing alcohol and tobacco industry members file these applications to request permission to commence a new regulated industry operation, or to update critical industry member information such as trade names on an existing business. Over the past several years, the volume of paper applications has increased, making it difficult to maintain current service levels. Without Permits Online, TTB projected processing times to increase to nearly 90 days by the end of FY 2011. This IT initiative helped TTB achieve its performance goal of expeditiously processing permit applications, which allows qualified persons to commence operations sooner, and contributes to the overall growth and health of the U.S. and global economy.



This e-Gov system will be released in phases. The first phase, which went online in February 2011, included the three highest volume permit types—wineries, alcohol importers, and alcohol wholesalers. A second system release in April 2011 enabled electronic filing of applications for specially denatured spirits (SDS) users and dealers, tax-free alcohol users and dealers, and Government users. The third release in September 2011 enabled the electronic filing of applications for breweries, distilled spirits plants, and alcohol fuel plants. The final major release planned in FY 2012 will expand the permit types that can be filed electronically, including firearms and tobacco permit and registrations.

The response from industry has far exceeded TTB's targeted adoption rate of 20 percent for those permit types available in the system. For the approximate eight months of operating, TTB received 57 percent of these permit applications electronically. Further, in demonstrating the processing efficiencies of the system since the system came online, TTB was able to process the electronic applications 15 percent faster than the same permit types submitted by paper application.



Improving service options to customers is a priority of the Administration, and one supported by the Department of the Treasury through its various initiatives in support of the priority performance goal of increasing paperless transactions. The Permits Online project was selected by the Department as one of three initiatives for the Treasury Customer Service Plan, developed in response to Executive Order 12862, "Streamlining Service Delivery and Improving Customer Service."

The second core business service brought online in FY 2011 was Formulas Online. This system, released in January 2011, allows industry members to submit beverage and nonbeverage alcohol formula forms and documentation via the Web. Some alcohol beverages require formula approval prior to the issuance of a Certificate of Label Approval and, to simplify this process, TTB integrated Formulas Online with the label filing system, COLAs Online. COLA applications and approved labels are linked to formulas and related data stored in Formulas Online. This development effort also enables industry members to register for both Formulas Online and COLAs Online via the Web, and use a single user ID to access both systems. Industry also gets the benefit of step-by-step guidance to filing an application, with validation checks built in to the system to ensure that the application submitted is accurate and complete. Another self-service feature is the ability to receive current information on the status of a formula application via e-mail.

The system also benefits TTB by providing an electronic system that tracks formula applications and streamlines their workflow. Whether TTB receives paper or electronic formula applications, all submissions are captured in Formulas Online, providing internal users with the ability to view, evaluate, request additional information or corrections, and approve or reject applications. Between January 10, 2011, when TTB launched Formulas Online, and the end of the fiscal year, TTB received 7,189 paper and electronic formulas for domestic and imported alcohol beverages. TTB received 2,316, or 32 percent, of those applications electronically.

Development of the next major system release concluded in September 2011 and will include nonbeverage formula submissions. It is scheduled for production deployment in the first half of FY 2012. TTB plans to continue this software development effort into the Spring of 2012, when the final major system release will implement the functionality required by the Alcohol Beverage Sampling Program and the Consumer Complaints activity.

In FY 2012, TTB will also complete the conversion of historically filed nonbeverage formulas from a legacy system into the new system. With this project phase, and the capture of all formula submissions in the system regardless of filing method, TTB anticipates that once Formulas Online is fully functional, the formulas within the system will become the official record, eliminating the need for additional file space for paper application storage. Future enhancements to Formulas Online also include increased system compatibility with additional Internet browsers, advanced search functionality, and reporting options.

TTB also examined and deployed IT solutions for several manual processes that were creating internal inefficiencies. One such project involved the elimination of manually imaging tax returns filed through the commercial lockbox provider. In March 2011, TTB deployed the Lockbox Imaging System at the National Revenue Center. This system replaced a manual process for scanning paper Federal Excise Tax (FET) and Floor Stocks Tax (FST) returns filed by industry taxpayers. Prior to implementing this solution, the U.S. Bank mailed the paper returns to TTB. Now, images of paper filed FET and FST returns are transmitted electronically on a nightly basis. The electronically processed paper returns are available to TTB Tax Specialists much sooner and the contractors who previously scanned and indexed the paper returns have been redeployed to work on other critical scanning efforts.

As part of TTB's effort to modernize its laboratory environment, TTB initiated a project to replace the existing Laboratory Information Management System (LIMS), a platform for consolidating sample analysis data for the four laboratories that comprise the Bureau's Scientific Services Division. In FY 2011, TTB began the development and testing of a new system based on a commercial software package that allows for integration with applicable laboratory instruments. The LIMS 2.0 project will provide a secure and robust electronic submission process that facilitates the online collection and processing of sample analyses. The system is also crucial to maintaining the laboratory's international accreditation status, as LIMS 2.0 will streamline the process, review, and disposition of sample analyses to ensure compliance with ISO 17025 accreditation. Other benefits include chemical inventory management for the disposal or destruction of reagents and chemicals, and robust reporting capabilities to support the effective management of laboratory process workflows. The system is expected to go into production in the Spring of 2012.

TTB also worked toward improving program results and reducing overall operating costs in FY 2011 through a series of "cloud computing" initiatives. Cloud computing is a model for enabling convenient, on-demand network access to a shared pool of configurable computing resources (e.g., networks, servers, storage, applications, and services) that can be rapidly provisioned and released with minimal management effort or service provider interaction. TTB is developing both TTB's private cloud by building its virtualized infrastructure and cloud software service and a community cloud by hosting and providing cloud infrastructure as a service to the Community Development Financial Institutions (CDFI) Fund.

In enhancing its private cloud infrastructure, TTB continued its use of a commercial product to virtualize its server environment. This process involves applying a software application to maximize use of server capability by dividing a single physical server into multiple isolated virtual environments. To date, TTB has virtualized nearly 70 percent of its Windows server environment and about 40 percent if it's other server environment.

TTB also piloted a "virtual desktop" with about 120 TTB users. The virtual desktop allows the TTB user community to securely conduct their business over the Internet from anywhere, and teleworkers no longer need dedicated office space, workstations, phones, or fax lines. Virtual desktop also enhances IT security by eliminating the need to have information stored locally on the user's machine and helps TTB to reduce data loss, and increase centralization of information. TTB will see a large return on investment from this cloud initiative as low-cost thin client devices are deployed to access virtual desktop, rather than costly personal computers. The refresh of laptops and desktops cost TTB about $1.2 million in the past; the deployment of virtual desktop with thin clients will save TTB about $800,000 in hardware costs.

In FY 2011, in support of the Government-wide move toward cloud computing, TTB became a provider of IT infrastructure services for another Treasury entity, CDFI. TTB began this project in FY 2010 by providing CDFI with wide area network services, remote access services, and disaster recovery capabilities. In April 2011, CDFI's legacy hardware was completely transitioned to the TTB environment, giving CDFI a virtualized server environment to host all of its mission-critical services. In May 2011, TTB started the third phase of the CDFI transition, which involves the migration of CDFI users to TTB's infrastructure, providing them with office automation services such as account logon, e-mail, and network file storage.

These cloud computing initiatives have resulted in significant savings. For TTB, the server virtualization and virtual desktop projects have resulted in a $2.7 million decrease of IT infrastructure requirements for FY 2013 compared to the FY 2009 requirements. Further, the CDFI "cloud" initiative has resulted in $3.5 million of cost avoidance for infrastructure refresh requirements over fiscal years 2010 - 2012, as CDFI did not have IT refresh costs funded in its base budget. Although these savings are not represented in the TTB budget, it represents a savings to the Treasury Department and to the American taxpayers.

TTB also acted in FY 2011 in support of the Government-wide data center consolidation program, prompted in part by the growth in the number of such facilities over the past decade. The number of Federal data centers has grown from 432 in 1998 to more than 2,000 today. In February 2010, OMB launched the Federal Data Center Consolidation Initiative, which required that agencies review their data center requirements and energy consumption at these facilities, with the goal of closing 800 centers by 2015. The intent of this initiative is to reduce the energy and real estate footprint of Government data centers and cut the cost of data center hardware, software, and operations. In its efforts to increase efficiencies and reduce IT operating costs, TTB migrated its custom applications production environment from a commercial data center to TTB's existing data center in Washington, D.C. The migration of this data center saves nearly $30,000 a month in data hosting services. The second phase of this effort involves moving the custom application test and development environments from a commercial data center to TTB's existing data center in Cincinnati, Ohio. This migration will save nearly $60,000 in monthly hosting fees. Upon the completion of both data center migrations, TTB will realize over $1 million in annual cost savings and avoidance.

Message from the Chief Financial Officer

With today's technology, the pace of business is faster and expectations for service are higher. At the same time, the economic downturn has ushered in mandates to cut costs and find areas of savings in government programs. To meet the needs of the businesses we regulate in such a resource constrained environment, and to instill public confidence in TTB, we must continually ask ourselves, "Are we making the best use of every dollar entrusted to us?"

We know that to advance the mission, we must make strategic investments in the foundational elements that support a healthy organization: new technologies, human capital management, and sound fiscal and strategic planning.

Implementing new technology is central to TTB's plan to create efficiencies and realize savings. TTB has made strategic IT investments in order to provide long-term solutions to current operational challenges. First, because the industries we regulate are expanding, TTB must enable improved access to the services we provide in order to avoid lengthy processing delays. To meet this challenge, TTB released two new online business applications in FY 2011 that will improve our permitting and formula approval services. These applications have transformed the way industry conducts its business with our Bureau, and will result in material cost savings for both sides.

Technology improvements are also helping TTB meet the changing expectations and attitudes about where and how we accomplish our work. TTB has served as the model for telework within the Department of the Treasury, with more than 80 percent of our workforce participating in telework. In FY 2011, TTB deployed a leading edge IT infrastructure that allows employees to access the TTB network via a "virtual desktop" connection. With this improvement, employees are seamlessly connected to TTB resources, giving maximum access and flexibility in performing their job duties. These enhancements to our telework offerings have also resulted in real savings, as we have been able to reduce the Bureau's physical footprint by closing office space as employees opt to transition to full-time telework.

In addition to outfitting our employees with the tools they need to succeed, TTB must also meet its financial management, acquisition, and human capital goals to produce agency performance results that are relevant and valuable to American taxpayers. From the financial perspective, in FY 2011, TTB again received an unqualified audit opinion on its financial statements from an independent public accounting firm. Our support of this annual audit affirms our commitment to a vigorous internal control environment and financial reporting excellence. Further evidence of this commitment lies in our management practices, which include routine evaluations of our tax collection and revenue accounting operations at the National Revenue Center to validate that sound internal and administrative controls are in place for our key business processes that support the collection and tracking of nearly $24 billion in annual Federal excise tax collections from alcohol and tobacco industry members.

Reforming Federal acquisitions is a priority of this Administration, and TTB excels in managing its contract costs and achieving the goals established by the Office of Management and Budget (OMB) in the area of acquisitions and procurement. TTB met all goals established for the OMB acquisition improvement mandate, and was one of three Treasury bureaus to meet or exceed their FY 2011 small business goals. Due to our performance, TTB was the recipient of numerous small business accolades, including the

Secretary's "Shining Star" Award, the HUB Zone Small Business Advocacy Award, and the Service Disabled Veteran-Owned "Eternal Flame" Award.

The accomplishments of this Bureau would not be possible without the dedicated staff we employ. We encourage active participation and open dialogue from employees, and take steps to solicit earnest feedback through a multitude of venues. We rely on the annual Employee Viewpoint Survey (EVS), distributed to the Federal workforce by the Office of Personnel Management, to gauge the satisfaction of our employees. Our scores indicated that we are making strides in creating a productive and engaging work environment. TTB's Best Places to Work ranking, which use the EVS scores to rank Federal agencies, also showed dramatic improvement, with TTB ranking 34 of 240 comparative agencies.

Even as resources shrink, we will continue to aim high and put improved processes and tools in place to meet our mission. In the years ahead, strategic fiscal planning and targeted investments in technology and the TTB workforce will support the Bureau in improving the management and performance of this organization.

Cheri D. Mitchell

Assistant Administrator, Management/CFO

Part III: Financial Results, Position, Condition, and Auditors' Reports

Budget Highlights by Fund Account

The FY 2011 TTB budget of $100,798,000 consists of direct appropriations. The budget authorized the full-time equivalent (FTE) staffing level of 535 direct FTE, of which 10 FTE were to be special agents. TTB did not directly hire agents, but instead entered into a reimbursable agreement with the Internal Revenue Service Criminal Investigation unit (IRS CI) to provide agent services to TTB.

The budgeted amount maintains a program level consistent with the current level of effort necessary to support TTB's responsibility for revenue collection and the enforcement of laws and regulations governing alcohol and tobacco commodities.

The Bureau obligated or expended 99.5 percent of the $100,798,000 in FY 2011 direct funding from its one-year Salaries and Expenses appropriation.

In FY 2010, TTB received two-year appropriations in the amount of $3 million that remained available until September 30, 2011. These funds were restricted to expenses associated with the criminal enforcement activity. In FY 2011, the Bureau entered into an interagency agreement with the IRS CI to conduct criminal investigations into tax fraud in the TTB regulated industries.

FY 2011 Salaries and Expenses

Fund Source:		
Salaries & Expenses FY 2011 (P.L. 112-10, Department of Defense and Full-Year Continuing Appropriations Act, 2011)		**$100,798,000**
Amount Spent in FY 2011	$100,333,704	
Salaries & Expenses FY 2010/11 (Funds restricted for the hiring, training and equipping of special agents)		**$3,000,000**
Amount Spent in FY 2010	$10,000	
Amount Spent in FY 2011	$1,674,089	
Salaries & Expenses FY 2010/11 (50% Prior Year Recovery) [1/]		**$236,000**
Amount Spent in FY 2011	$236,000	

[1/] General Provisions of the appropriations bill provide that 50 percent of the unobligated balances remaining available at the end of Fiscal Year 2010 shall remain available through September 30, 2011.

Also during FY 2011, Congress authorized an additional $236,000 from the prior year account of unobligated available balances (often referred to as the 50 percent account) to cover a one-time investment in IT infrastructure to replace obsolete network equipment and its IT network intrusion detection system (IDS).

Offsetting Collections and Reimbursable Accounts from Puerto Rico Cover Over/ Enforcement Activities

The Bureau collected $3.9 million in offsetting collections during FY 2011. The primary source of reimbursable funding was collections from the cover over program and enforcement activity in Puerto Rico, which amounted to $3 million (79 percent) of the offsetting collections.

Puerto Rico Cover Over and Enforcement Activities

All costs associated with the functioning and support of the Puerto Rico office are paid from the cover over program, which is offset from cover-over taxes collected in the United States on products originating in Puerto Rico ($452 million) and the Virgin Islands ($10 million).

In Puerto Rico, TTB conducts annual audits and investigations of industry members regarding the collection of revenue, application processing, and product integrity. Revenue inspections are used to conduct tax examinations on major producers of alcohol and tobacco. This is critical due to the requirements of verifying tax payments under the Internal Revenue Code (IRC), as well as TTB's subsequent accountability for all cover-over amounts due to the government of Puerto Rico.

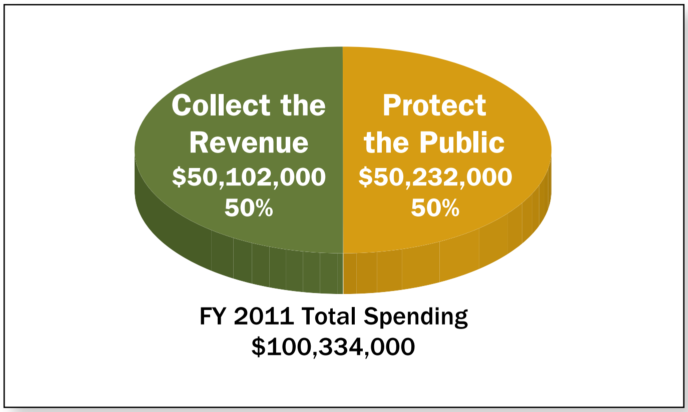
All distilled spirits producers and processors, wineries, wholesalers, importers, Manufacturer of Nonbeverage Products claimants, and specially denatured alcohol permit applicants are subject to a qualification inspection under the IRC.

Additionally, major producers of distilled spirits, wine, and malt beverages are subject to inspection and audits in Puerto Rico.

Linking Budget and Program Spending

TTB has two primary budget activities: collecting all the Federal tax revenue due on alcohol, tobacco, firearms, and ammunition products and protecting consumers of alcohol beverages. Assisting industry members to understand and comply with the Federal laws and regulations regarding the commodities TTB regulates is an integral part of both activities.

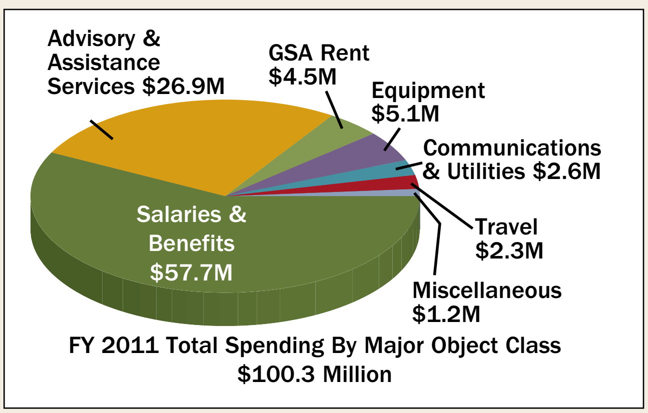
In FY 2011, TTB used an account code structure which provides a direct link from the Bureau budget to specific programs and project activities. An analysis of the data stemming from the account code structure shows that, in FY 2011, TTB spent $100,334,000 of its annual appropriation equally under these two budget activities.



The Total Spending amount includes obligations and expenditures from the FY 2011 TTB appropriation.

In order to ascertain the full costs of each of these budget activities, the overhead costs were allocated and combined with the direct program costs. TTB arrived at the overhead allocation by applying the pro rata share of the number of direct program dollars to each overhead cost category. The overhead is comprised of three major cost components: 1) general and administrative costs; 2) legal costs; and 3) information technology costs. The general and administrative category consists of costs related to operating the human resources, finance, procurement, training, facilities management, and other support-type functions.

Spending by Major Object Class



In this report, TTB presents its spending by budget activity and program to explain the cost of delivering the services that support the mission. The Bureau also presents specific data regarding the purchase of goods and services by major object class that support its program activities. The majority of TTB's spending (84 percent) falls into two principal major object classes: Salaries and Benefits and Advisory and Assistance Services (Contracts). Salaries and Benefits comprise 57 percent of total spending by object class, and cover the cost of the Bureau's roughly 500 FTE positions in FY 2011. The Advisory and Assistance Services object class constitutes 27 percent of FY 2011 spending, and covers the cost of both commercial and intragovernmental services.

The commercial contracts category is predominantly IT contracts in support of engineering, infrastructure, and support services. Also, it includes other commercial contracts for services such as the scanning and imaging of label applications and tax forms, lab maintenance, and Web site development.

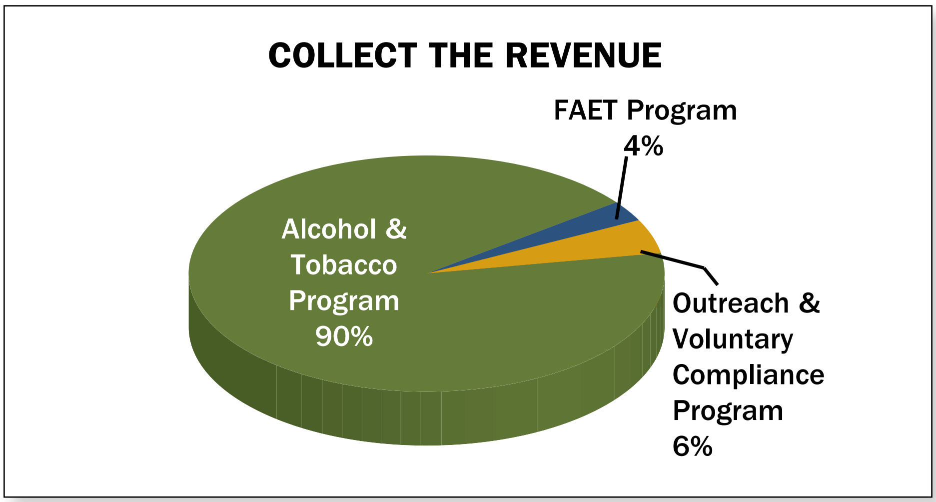
Intragovernmental services include spending related to administrative support services provided by our shared service provider for human resources, accounting, travel, and procurement. Other intragovernmental contract services include the costs for background investigations, publications in the Federal Register, administrative support services, and Federal protective services. In FY 2011, the Bureau's travel costs were primarily related to its audits and investigations, and special agent travel. The remaining object classes that cover the FY 2011 spending activity include those cost categories for rent, communications, equipment, and other miscellaneous categories.

Spending by Budget Activity to Achieve TTB Mission Goals

Collect the Revenue..... $50,102,000

The Collect the Revenue budget activity encompasses TTB's revenue strategy and goal to provide the most effective and efficient system for the collection of all revenue that is rightfully due. It is also designed to prevent or eliminate tax evasion and other criminal conduct and provide high-quality service while imposing the least regulatory burden.

Under the Collect the Revenue activity, TTB administers three programs: 1) Alcohol and Tobacco Tax; 2) Firearms and Ammunitions Excise Tax (FAET); and 3) Outreach and Voluntary Compliance.



In FY 2011, TTB expended 90 percent of its Collect the Revenue resources in collecting Federal excise taxes from the alcohol and tobacco industries and 4 percent in collecting FAET. The specific projects that comprise these costs include the processing of tax returns and operational reports at the National Revenue Center and the audits and investigations conducted on industry.

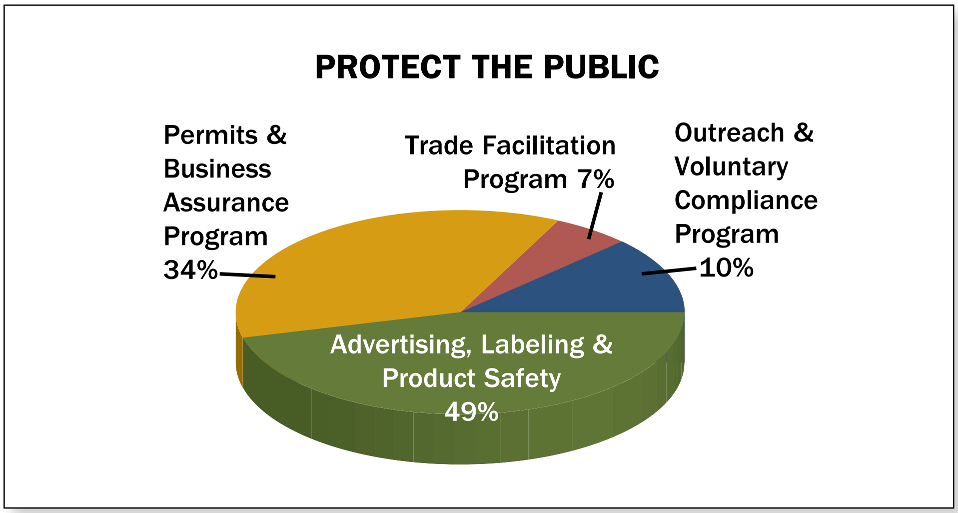
Costs for the Outreach Program reached 6 percent of our Collect the Revenue resources. These resources went toward efforts to educate and train industry members regarding their obligations in the areas of tax calculations and remittance.

Protect the Public..... $50,232,000

The Protect the Public budget activity encompasses TTB's strategy and goal to ensure industry compliance with laws and regulations designed to protect the consumers of alcohol beverages.

TTB does this by assuring the integrity of the people who operate these businesses, of the products themselves, and of the marketplace in which they are traded.

TTB administers four programs under the Protect the Public budget activity: 1) Permits and Business Assurance; 2) Advertising, Labeling, and Product Safety; 3) Trade Facilitation; and 4) Outreach and Voluntary Compliance.



An analysis of the financial data from FY 2011 reveals that TTB spent the preponderance of its Protect the Public resources on two programs: Labeling, Advertising, and Product Safety at 49 percent, and Permits and Business Assurance at 34 percent.

The Labeling, Advertising, and Product Safety Program includes activities designed to assure that beverage alcohol labels fully and accurately describe the products upon which they appear and are not misleading. It also encompasses activities to verify that alcohol advertisements contain all mandatory information and do not mislead consumers. The Product Safety component involves all investigative and laboratory activities performed as part of the Alcohol Beverage Safety and Verification Program, including work related to domestic and imported product analysis.

The Permits and Business Assurance Program is designed to determine the eligibility of persons wishing to enter any of the businesses TTB regulates and to process applications for changes to the original permit. These activities may include a field investigation. The permit is necessary in order to conduct operations in the regulated industries.

The remainder of the Protect the Public resources were divided between the Trade Facilitation Program (7 percent) and the Outreach and Voluntary Compliance Program (10 percent).

Systems and Controls

Introduction

During FY 2011, TTB contracted with BPD ARC to handle its administrative, human resources, procurement, travel and, financial functions.

Accounting Systems and Controls

The BPD ARC accounting system, known as Oracle Federal Financials, is certified by the Financial Systems Integration Office (FSIO) requirements and is in full compliance with Treasury reporting requirements; it also meets requirements under the Federal Financial Management Improvement Act (FFMIA).

The audit of the FY 2011 financial statements disclosed no instances of noncompliance on FFMIA matters, and showed that the Bureau's financial management systems are in compliance with 1) Federal financial management systems requirements, 2) applicable Federal accounting standards, and 3) the United States Government Standard General Ledger at the transaction level.

The Bureau successfully met the Department of the Treasury's reporting requirements and has maintained accurate and reliable financial information on TTB's program activities. The various administrative modules integrated with the TTB financial system have proven to accurately capture Bureau financial data and provide reliable information to management to inform decision making. Only two TTB databases operate outside the BPD ARC environment—the TTB property management system and the tax administration database, IRIS.

Federal Managers' Financial Integrity Act of 1982 (FMFIA)

The FMFIA requires Federal agencies to conduct ongoing evaluations of the systems of internal accounting and administrative control. Annually, TTB must report to Treasury all material weaknesses found through these evaluations. Treasury submits a consolidated report on the Department's controls to the President.

The FMFIA also requires the heads of agencies to provide the President with yearly assurance that obligations and costs are in compliance with applicable laws; that funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and revenues and expenditures are properly recorded and accounted for.

To provide this report and assurance to the President, the Secretary of the Treasury depends upon information from component heads regarding their management controls. The FMFIA program places reliance on each office at TTB to maintain a cost-effective system of controls to provide reasonable assurance that Government resources are protected against fraud, waste, abuse, mismanagement, or misappropriation.

Responsibilities of the Bureau's executive staff include ensuring that programs and administrative support activities are managed efficiently and effectively. Managers must conform to specific management accountability and improvement policies when designing, planning, organizing, and carrying out their responsibilities in order to ensure the most efficient and effective operation of their programs.

These policies address:

- Delegation of authority and responsibility;
- Hierarchical reporting of emerging management problems;
- Personal integrity;
- Quality data;
- Separation of key duties and responsibilities;
- Periodic comparisons of actual with recorded accountability of resources;
- Routine assessment of programs with a high potential for risk;
- Systematic review strategy to assess the effectiveness of program operations; and
- Prompt management actions to correct significant problems or improve operations.

Since its inception, TTB has gradually developed its own Bureau-specific policies.

Management accountability systems must assure basic compliance with the objectives of the FMFIA and the management control standards set by the Government Accountability Office. In addition, any inspection, audit, evaluation, peer or program review process, self-assessment, or the equivalent, used by TTB management to keep informed about needs and opportunities for improvement must incorporate these same standards into its methodology.

Furthermore, the Bureau completed an annual risk assessment for improper payments on all of its programs and activities. This process disclosed low risk susceptibility for improper payments, and documented that sound internal management and controls were in place at the Bureau to cover its disbursements.

The Bureau continues to strengthen and improve the execution of its mission through the application of sound internal controls over financial reporting. In response to OMB Circular A-123, Management's Responsibility for Internal Controls, the Bureau, in concert with the Department, developed and implemented an extensive testing and assessment methodology that identified and documented internal controls over financial reporting on our revenue accounting activities.

This increased emphasis on management controls has had a positive impact on programs and enabled the Bureau to achieve the intended results. The process also ensures that the utilization of resources is consistent with mission priorities and that program and resources are being used without waste, fraud, or mismanagement. Also, in addition to the A-123 review, TTB conducted a series of office reviews during FY 2011 that included an extensive review of administrative and internal controls. However, the audit of the FY 2011 financial statements identified a deficiency related to the computation of allowances for uncollectible tax receivables. Corrective actions will be developed during the second quarter of FY 2012.

Financial Statement Highlights

The following overview of the TTB financial statements highlights certain aspects of the financial statements for the fiscal year ended September 30, 2011.

- The Balance Sheet shows the assets, liabilities, and net position as of a point in time, in this case, as of September 30, 2011.
    - The total assets were reported as $66.3 million at the close of the fiscal year. Of this amount, $37.9 million is classified as the fund balance with Treasury. That fund balance account is the undisbursed account balance with the Treasury, primarily resulting from undisbursed appropriations.
    - The total liabilities amount reported is $40.1 million, of which total intragovernmental liabilities amounts to $11.7 million. The other liabilities are classified by type, such as accrued tax refunds, payables, and other liabilities.
- The Statement of Net Cost shows the total net cost of operations at $104.7 million for the Bureau to administer its two budget activities.
    - The total net cost reported as program costs under the Collect the Revenue program was $52.0 million.
    - The total net cost reported as program costs under the Protect the Public program was $52.7 million.
- The Statement of Change in Net Position shows a total net position balance of $32.4 million, and that amount represents the unexpended appropriations from both prior periods and from the current operating cycle in addition to Net Position from Operations.
- The Statement of Budgetary Resources shows the budgetary resources received and the status of those resources. For TTB, the resources are primarily annual appropriations received from the Omnibus Appropriations Act in the amount of $101.0 million (less a recission of $202,000), in addition to spending authority from collections. The offsetting collections amount was $3.9 million. Of that amount, $3.0 million is from the recovery of costs for maintaining enforcement operations in Puerto Rico.
- The Statement of Custodial Activity shows the amount of revenue received during FY 2011 compared with FY 2010, along with tax refunds, drawback on Manufacturer of Nonbeverage Products claims, and cover-over payments. The amount displayed shows that the total Federal excise tax revenues collected from alcohol, tobacco, firearms, and ammunition amounted to $23.5 billion. Within this total, the Bureau processed tax refunds, drawback claims, and cover-over payments in the amount of $802.0 million.

- **Drawback claims** of $306.6 million were processed based on claims filed from MNBPs. Under current law, a drawback claim is allowed when distilled spirits on which the tax has been paid were unfit for beverage purposes and used in the production of medicines, medicinal preparations, food products, flavors, flavoring extracts, or perfumes.
- **Tax refunds** and other adjustments (e.g., interest) were processed in the amount of $33.4 million.
- **Cover-over payments** were returned to Puerto Rico and the Virgin Islands in the amount of $461.6 million. Such taxes collected on rum imported in the United States are "covered over," or paid into, the treasuries of Puerto Rico and the Virgin Islands.
- **The disposition of the custodial revenue**, after refunds, claims, and cover-over payments, nets to $23.1 billion, and that amount was deposited to the U.S. Treasury to fund the Federal Government, with the exception of the Federal firearms and ammunition Federal excise taxes. Those revenues, in the amount of $344.3 million, were remitted to the Fish and Wildlife Restoration Fund under provisions of the Pittman Robertson Act of 1937.

Notes to the Basic Financial Statements

The notes to the basic financial statements provide additional information that is essential to a full understanding of the financial information provided in the statements.

Supplementary Information

In addition to the basic financial statements and accompanying notes, this report presents other supplementary information. For instance, TTB includes a table that outlines the tax collections for the past 10 years for each of the key revenue sources. Also, a table has been included to show the refunds, cover-over payments, and drawback payments for the past 10 years.

Financial Statements, Accompanying Notes, and Supplemental Information

Limitations of Financial Statements

The principal statements have been prepared to report the financial position and results of operations of the entity, pursuant to the requirements of 31 U.S.C. 3515(b). While the statements have been prepared from the books and records of the entity in accordance with GAAP for federal entities and the formats prescribed by the Office of Management and Budget (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. For fiscal years 2011 and 2010, all financial statements and notes have been audited.

Management Responsibilities

Bureau management is responsible for the fair presentation of information contained in the principal financial statements, in conformity with generally accepted accounting principles (GAAP), and the form and content for entity financial statements specified by OMB in Circular A-136.

Management is also responsible for the fair representation of TTB's performance measures in accordance with OMB requirements. The quality of the Bureau's internal control structure rests with management, as does the responsibility for identification of and compliance with pertinent laws and regulations.

TTB in Relation to Treasury's Annual Financial Statements

The Department of the Treasury received an unqualified audit opinion on its FY 2011 financial statements. The financial activities of the Bureau are an integral part of the information reported by the Department of the Treasury.

This unqualified audit opinion means that the financial information presented by the Treasury, which includes TTB's financial activities, was presented fairly and in conformity with generally accepted accounting principles (GAAP) of the United States.

KPMG LLP
Suite 12000
1801 K Street, NW
Washington, DC 20006

Independent Auditors' Report

Inspector General
United States Department of the Treasury

Administrator
Alcohol and Tobacco Tax and Trade Bureau:

We have audited the accompanying balance sheets of the Alcohol and Tobacco Tax and Trade Bureau as of September 30, 2011 and 2010, and the related statements of net cost, changes in net position, budgetary resources, and custodial activity (hereinafter referred to as "financial statements") for the years then ended. These financial statements are the responsibility of the Alcohol and Tobacco Tax and Trade Bureau's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America; 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. 07-04, *Audit Requirements for Federal Financial Statements*, as amended. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Alcohol and Tobacco Tax and Trade Bureau's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Alcohol and Tobacco Tax and Trade Bureau as of September 30, 2011 and 2010, and its net costs, changes in net position, budgetary resources, and custodial activity for the years then ended in conformity with U.S. generally accepted accounting principles.

The information in *Part 1: Management's Discussion and Analysis* and the *Required Supplementary Information* section of *Part III: Financial Results, Position, Condition and Auditors' Reports* is not a required part of the financial statements, but is supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this information. However, we did not audit this information and, accordingly, we express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the financial statements taken as a whole. The Other Accompanying Information included in (1) pages i through vii, (2) *Part II: Program Performance Results*, (3) pages 59 through 68 and pages 104 through 107 of *Part III: Financial Results, Position, Condition and Auditors' Reports*, and (4) *Part IV: Appendices* is presented for purposes of additional analysis and is not required as part of the basic financial statements. This information has not been subjected to auditing procedures and, accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our reports dated December 20, 2011, on our consideration of the Alcohol and Tobacco Tax and Trade Bureau's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in assessing the results of our audits.

KPMG LLP

December 20, 2011

KPMG LLP
Suite 12000
1801 K Street, NW
Washington, DC 20006

Independent Auditors' Report on Internal Control Over Financial Reporting

Inspector General
United States Department of the Treasury:

Administrator
Alcohol and Tobacco Tax and Trade Bureau:

We have audited the balance sheets of the Alcohol and Tobacco Tax and Trade Bureau as of September 30, 2011 and 2010 and the related statements of net cost, changes in net position, budgetary resources, and custodial activity (hereinafter referred to as "financial statements") for the years then ended, and have issued our report thereon dated December 20, 2011.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America; 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. 07-04, *Audit Requirements for Federal Financial Statements*, as amended. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement.

The management of the Alcohol and Tobacco Tax and Trade Bureau is responsible for establishing and maintaining effective internal control. In planning and performing our fiscal year 2011 audit, we considered the Alcohol and Tobacco Tax and Trade Bureau's internal control over financial reporting by obtaining an understanding of the design effectiveness of the Alcohol and Tobacco Tax and Trade Bureau's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Alcohol and Tobacco Tax and Trade Bureau's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Alcohol and Tobacco Tax and Trade Bureau's internal control over financial reporting. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph of this report and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies, or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, in our fiscal year 2011 audit, we identified a deficiency in internal control over financial reporting that we consider to be a material weakness.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiency described in Exhibit I to be a material weakness.

The Alcohol and Tobacco Tax and Trade Bureau's response to the finding identified in our audit is presented in Exhibit I. We did not audit the Alcohol and Tobacco Tax and Trade Bureau's response and, accordingly, we express no opinion on it.

Exhibit II presents the status of the prior year material weakness.

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

KPMG LLP

December 20, 2011

MATERIAL WEAKNESS

IMPROVEMENTS ARE NEEDED IN THE REVIEW OF THE ALLOWANCE FOR DOUBTFUL ACCOUNTS ON TAX AND TRADE RECEIVABLES

During the 2011 audit we tested journal entry support for the allowance for doubtful accounts on tax and trade receivables. We identified errors in the calculations used to arrive at the allowance for doubtful accounts for tax and trade receivables at year-end. At year-end TTB recorded entries to the allowance account based upon the application of historical data to the year-end receivable balances, however, the calculations used resulted in an understatement to the allowance account by $6.189 million.

Inputs to the computation for partially collectible receivables identified by National Revenue Center (NRC) tax specialists were not properly entered into the Allowance Calculation Worksheet prepared by the Administrative Resource Center (ARC). The amount collectible, determined by NRC specialists, was recorded in the "Partially Collectible & OIC (Offers in Compromise) Allowance" cells, where the amount that should have been recorded was the accounts receivable balance less the amount collectible.

Additionally, an error in the formulas used to calculate the historical average collection rates was committed in the preparation of the spreadsheets for the 2011 allowance computations.

Statement of Federal Financial Accounting Standard (SFFAS) No. 1 states that "An allowance for estimated uncollectible amounts should be recognized to reduce the gross amount of receivables to its net realizable value."

Per OMB Circular No. A-123, *Management's Responsibility for Internal Control*, (revised December 31, 2004): Section II, Subsection E, Paragraph 1: Monitoring the effectiveness of internal control should occur in the normal course of business. Periodic reviews, reconciliations or comparisons of data should be included as part of the regular assigned duties of personnel.

As a result of this weakness, the allowance for doubtful accounts on tax and trade receivables was understated by $6.189 million, due to the general fund was overstated by $5.360 million, and due to the fish and wildlife fund was overstated by $829 thousand.

Recommendation:

We recommend that management of the Alcohol and Tobacco Tax and Trade Bureau conduct a detailed supervisory review of the Allowance Calculation Worksheet prepared by ARC that will ensure the mathematical accuracy of the formulas used to calculate the historical average collection rates and ensure the inputs to the computation for partially collectible receivables are properly entered.

Management's Response:

TTB management recognizes the issue and agrees that corrective actions need to be taken. However, we believe that a more detailed supervisory review may not fully resolve this issue, knowing the very short timeframe we have to compute and record the allowance, and given the complexity of the current procedure. Therefore, we plan to look at the entire methodology and determine what potential changes could be made to simplify the procedure and make it more amenable to a higher quality review. We believe this approach will improve our current business practice and reduce the risk of potential errors.

ALCOHOL AND TOBACCO TAX AND TRADE BUREAU

Status of Prior Year Finding

September 30, 2011

Fiscal Year 2010 Finding	Deficiency Type	Fiscal Year 2011 Status
1) Improvements Are Needed In The Review Of Purchase Requisitions	Material Weakness	Closed

KPMG LLP
Suite 12000
1801 K Street, NW
Washington, DC 20006

Independent Auditors' Report on Compliance and Other Matters

Inspector General
United States Department of the Treasury

Administrator
Alcohol and Tobacco Tax and Trade Bureau:

We have audited the balance sheets of the Alcohol and Tobacco Tax and Trade Bureau as of September 30, 2011 and 2010, and the related statements of net cost, changes in net position, budgetary resources, and custodial activity (hereinafter referred to as "financial statements") for the years then ended, and have issued our report thereon dated December 20, 2011.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America; 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. 07-04, *Audit Requirements for Federal Financial Statements*, as amended. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

The management of the Alcohol and Tobacco Tax and Trade Bureau is responsible for complying with laws, regulations, and contracts applicable to the Alcohol and Tobacco Tax and Trade Bureau. As part of obtaining reasonable assurance about whether the Alcohol and Tobacco Tax and Trade Bureau's financial statements are free of material misstatement, we performed tests of the Alcohol and Tobacco Tax and Trade Bureau's compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of the financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 07-04, including the provisions referred to in Section 803(a) of the *Federal Financial Management Improvement Act of 1996* (FFMIA). We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws, regulations, and contracts applicable to the Alcohol and Tobacco Tax and Trade Bureau. 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 of compliance described in the preceding paragraph of this report, exclusive of those referred to in FFMIA, disclosed no instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 07-04.

The results of our tests of FFMIA disclosed no instances in which the Alcohol and Tobacco Tax and Trade Bureau's financial management systems did not substantially comply with the (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level.

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

KPMG LLP

December 20, 2011

DEPARTMENT OF THE TREASURY
ALCOHOL AND TOBACCO TAX AND TRADE BUREAU
BALANCE SHEETS
As of September 30, 2011 and 2010
(In Thousands)

	2011	2010
ASSETS		
Intragovernmental Assets:		
Fund Balance with Treasury (Note 2)	$37,866	$36,748
Accounts Receivable (Note 3)	352	567
Due from the General Fund (Notes 5 and 8)	2,022	12,802
Advances (Note 7)	829	852
Total Intragovernmental Assets	41,069	50,969
Accounts Receivable (Note 3)	484	343
Tax and Trade Receivables, Net (Notes 4 and 8)	4,310	7,970
Property, Plant and Equipment, Net (Note 6)	20,451	19,257
TOTAL ASSETS (Note 8)	$66,314	$78,539
LIABILITIES		
Intragovernmental Liabilities:		
Accounts Payable	$500	$700
Payroll Benefits	641	581
FECA Liabilities	36	48
Due to the General Fund (Notes 4 and 5)	4,246	7,550
Other Liabilities (Note 9)	61	420
Total Intragovernmental Liabilities	5,484	9,299
Accounts Payable	5,843	6,041
Payroll Benefits	2,792	2,599
FECA Actuarial Liability	308	132
Refunds	2,025	12,802
Unfunded Leave	4,346	4,377
Cash Bond Liabilities (Note 2)	12,447	10,811
Other Liabilities (Note 9)	693	358
TOTAL LIABILITIES	$33,938	$46,419
NET POSITION		
Unexpended Appropriations	$16,559	$17,416
Cumulative Results of Operations	15,817	14,704
TOTAL NET POSITION	$32,376	$32,120
TOTAL LIABILITIES AND NET POSITION	$66,314	$78,539

The accompanying notes are an integral part of these statements.

DEPARTMENT OF THE TREASURY
ALCOHOL AND TOBACCO TAX AND TRADE BUREAU
STATEMENTS OF NET COST
For the Years Ended September 30, 2011 and 2010
(In Thousands)

	2011	2010
PROTECT THE PUBLIC		
Program Costs		
Intragovernmental Gross Costs	$14,495	$15,366
Less: Intragovernmental Earned Revenue	(27)	-
Intragovernmental Net Costs	14,468	15,366
Gross Costs with the Public	38,339	39,537
Less: Earned Revenues from the Public	(156)	(8)
Net Costs with the Public	38,183	39,529
Total Net Program Cost	$52,651	$54,895
COLLECT THE REVENUE		
Program Costs		
Intragovernmental Gross Costs	$15,214	$14,950
Less: Intragovernmental Earned Revenue	(512)	(97)
Intragovernmental Net Costs	14,702	14,853
Gross Costs with the Public	40,240	38,470
Less: Earned Revenues from the Public	(2,941)	(2,606)
Net Costs with the Public	37,299	35,864
Total Net Program Cost	$52,001	$50,717
NET COST OF OPERATIONS (Note 13)	$104,652	$105,612

The accompanying notes are an integral part of these statements.

DEPARTMENT OF THE TREASURY
ALCOHOL AND TOBACCO TAX AND TRADE BUREAU
STATEMENTS OF CHANGES IN NET POSITION
For the Years Ended September 30, 2011 and 2010
(In Thousands)

	2011	2010
Cumulative Results of Operations		
Beginning Balances	$14,704	$11,031
Budgetary Financing Sources		
Appropriations Used	100,938	102,659
Other Financing Sources		
Transfers-in without reimbursement	231	1,528
Imputed Financing from Costs Absorbed by Others (Note 12)	4,596	5,098
Total Financing Sources	105,765	109,285
Net Cost of Operations (Note 13)	(104,652)	(105,612)
Net Change	1,113	3,673
Cumulative Results of Operations	$15,817	$14,704
UNEXPENDED APPROPRIATIONS		
Beginning Balances	$17,416	$17,734
Budgetary Financing Sources		
Appropriations Received	101,000	103,000
Other Adjustments	(919)	(659)
Appropriations Used	(100,938)	(102,659)
Total Budgetary Financing Sources	(857)	(318)
Net Position of Unexpended Appropriations	$16,559	$17,416
TOTAL NET POSITION	$32,376	$32,120

The accompanying notes are an integral part of these statements.

DEPARTMENT OF THE TREASURY
ALCOHOL AND TOBACCO TAX AND TRADE BUREAU
STATEMENTS OF BUDGETARY RESOURCES
For the Years Ended September 30, 2011 and 2010
(In Thousands)

	2011	2010
BUDGETARY RESOURCES (Note 14)		
Unobligated Balance - Beginning of Period	$4,845	$3,157
Recoveries of Prior Year Obligations	1,501	1,408
Budget Authority:		
Appropriations Received	101,000	103,000
Spending Authority from Offsetting Collections, Earned:		
Collected	3,939	4,196
Change in Receivable from Federal Sources	(72)	44
Change in Unfilled Customer Orders:		
Without Advance from Federal Sources	218	(200)
Subtotal	105,085	107,040
Permanently Not Available	(920)	(659)
TOTAL BUDGETARY RESOURCES	110,511	110,946
STATUS OF BUDGETARY RESOURCES		
Obligations Incurred: (Note 15)		
Direct	$103,038	$102,117
Reimbursable	3,955	3,984
Subtotal	106,993	106,101
Unobligated Balance Apportioned	1,758	3,247
Unobligated Balance not Available	1,760	1,598
TOTAL STATUS OF BUDGETARY RESOURCES	$110,511	$110,946
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS:		
Unpaid Obligations Brought Forward, Oct 1	$22,141	$20,509
Uncollected Customer Payments from Federal Sources Brought Forward Oct 1	(1,407)	(1,563)
Total Unpaid Obligated Balance Brought Forward, Net	20,734	18,946
Obligations Incurred, Net	106,993	106,101
Gross Outlays	104,872	103,060
Recoveries of Prior Year Unpaid Obligations, Actual	(1,501)	(1,408)
Change in Uncollected Customer Payments from Federal Sources	(146)	156
Obligated Balances, Net End of Period:		
Unpaid Obligations	22,762	22,141
Uncollected Customer Payments from Federal Sources	(1,554)	(1,407)
Total Unpaid Obligated Balance, Net, End of Period	21,208	20,734
Net Outlays		
Gross Outlays	104,872	103,060
Offsetting Collections	(3,939)	(4,196)
Distributed Offsetting Receipts	(10)	(9)
NET OUTLAYS	$100,923	$98,855

The accompanying notes are an integral part of these statements.

DEPARTMENT OF THE TREASURY
ALCOHOL AND TOBACCO TAX AND TRADE BUREAU
STATEMENTS OF CUSTODIAL ACTIVITY
For the Years Ended September 30, 2011 and 2010
(In Thousands)

	2011	2010
SOURCES OF CUSTODIAL REVENUE		
Revenue Received		
Excise Taxes (Note 16)	$23,457,049	$23,756,513
Interest, Fines and Penalties	4,351	3,597
Other Custodial Revenue	10	9
Total Revenue Received (Note 17)	23,461,410	23,760,119
Refunds and Drawbacks (Note 16)	(340,416)	(326,143)
Net Revenue Received	23,120,994	23,433,976
Accrual Adjustment	7,117	(5,370)
Total Sources of Custodial Revenue	$23,128,111	$23,428,606
DISPOSITION OF CUSTODIAL REVENUE		
Amounts Provided to Non-Federal Entities (Note 16)	461,632	387,057
Amounts Provided to Fund the Federal Government (Note 17)	22,659,362	23,046,919
Accrual Adjustment	7,117	(5,370)
Total Disposition of Custodial Revenue	$23,128,111	$23,428,606
NET CUSTODIAL REVENUE ACTIVITY	$ -	$ -

The accompanying notes are an integral part of these statements.

Notes to the Financial Statements

Note 1. Summary of Significant Accounting Policies

A. Reporting Entity

The Alcohol and Tobacco Tax and Trade Bureau (TTB) was established on January 24, 2003, as a result of the Homeland Security Act of 2002. The Act transferred firearms, explosives, and arson functions of the Bureau of Alcohol, Tobacco and Firearms (ATF) to the Department of Justice and retained the tax collection and consumer protection provisions of the Internal Revenue Code (IRC) and Federal Alcohol Administration Act in TTB within the Department of the Treasury. While the agency has a new name, the history of TTB's regulatory responsibility dates back to the creation of the Department of the Treasury and the first Federal taxes levied on distilled spirits in 1791. TTB has two primary programs: Collect the Revenue and Protect the Public. Under the Collect the Revenue program, TTB collects alcohol, tobacco, firearms, and ammunition excise taxes, and under its Protect the Public program, TTB protects the consumer by ensuring that alcohol beverages are labeled, advertised, and marketed in accordance with the law, and facilitates trade in beverage and industrial alcohols.

B. Basis of Presentation

The financial statements were prepared to report the significant assets, liabilities, and net cost of operations, changes in net position, budgetary resources, and custodial activities of TTB. The financial statements have been prepared from the books and records of TTB in conformity with generally accepted accounting principles (GAAP) in the United States, and form and content guidance for entity financial statements issued by the Office of Management and Budget (OMB) in OMB Circular A-136. TTB's accounting policies are summarized in this note. GAAP for Federal entities is prescribed by the Federal Accounting Standards Advisory Board (FASAB), which has been designated the official accounting standards-setting body for the Federal Government by the American Institute of Certified Public Accountants.

C. Basis of Accounting

Transactions are recorded on a proprietary accrual and a budgetary basis of accounting. Under the accrual basis, revenues are recorded when earned and expenses are recorded when incurred, regardless of when cash is exchanged. However, under the budgetary basis, funds availability is recorded based upon legal considerations and constraints. As a result, certain line items on the proprietary statements may not equal similar lines on the budgetary financial statements.

D. Revenue and Financing Sources

(1) Exchange Revenue

Exchange Revenues are inflows of resources to a Government entity that the entity has earned by providing something of value to the public or another Government entity at a price. The majority of the Exchange Revenues earned by the Bureau result from providing services to the Government of Puerto Rico, as well as other Treasury entities.

(2) Financing Sources

Financing sources provide inflows of resources during the reporting period and include appropriations used and imputed financing. Unexpended appropriations are recognized separately in determining net position, but are not financing sources until used. Imputed financing sources are the result of other Federal entities financing costs on behalf of TTB.

TTB receives the majority of the funding needed to support the Bureau through congressional appropriations. The appropriations received are annual and multi-year funding that may be used, within statutory limits, for operating and capital expenditures.

(3) Imputed Financing Sources

Imputed financing sources are the result of Federal entities financing costs on behalf of TTB. Those entities pay future benefits for health insurance, life insurance, and pension benefits for TTB employees.

E. Custodial Revenue

For TTB, most custodial revenues result from collecting taxes on alcohol and tobacco products, which are transferred to the General Fund, and recognized as a non-exchange revenue on the Federal government's consolidated financial statements. The excise taxes collected by TTB come from businesses, and the taxes are imposed and collected at the producer and importer levels of operations. Members of the regulated industries paying excise taxes are distilleries, breweries, bonded wineries, bonded wine cellars, manufacturers of cigarette tubes, manufacturers of tobacco products, and manufacturers and importers of firearms and ammunition. These taxes are recorded on the records on a cash basis of accounting. The Statement of Custodial Activity is presented on a modified accrual basis.

F. Fund Balance with Treasury

The Fund Balance with Treasury is the undisbursed account balance with the Treasury, primarily resulting from undisbursed appropriations. The balance is available within statutory limits to pay current liabilities and finance authorized purchase obligations. The Fund Balance also includes a non-entity balance, primarily the result of custodial activities related to collecting escrow payments designed to finance Offers-in-Compromise and cash bonds held in lieu of corporate surety bonds guaranteeing payment of taxes.

G. Accounts Receivable

Intragovernmental accounts receivable consist of amounts due under reimbursable agreements with Federal entities for services provided by TTB. Public accounts receivable consist of taxes, penalties, and interest that have been assessed but unpaid at year end.

Receivables due from Federal agencies are considered to be fully collectible. An allowance for doubtful accounts is established for public receivables based on specific identification and individual analysis.

H. Property, Plant, and Equipment

Property, plant, and equipment purchased with a cost greater than or equal to $25,000 per unit and a useful life of two years or more, is capitalized and depreciated. Normal repairs and maintenance are charged to expense as incurred.

TTB also capitalizes internal use of software when the unit cost or development costs are greater than or equal to $25,000. The same threshold also applies to enhancements that add significant functionality to the software. TTB will amortize this software based on its classification. The classifications are as follows: 1) Enterprise and other business software (five years), and 2) Personal productivity and desktop operating software (three years).

Additionally, TTB also capitalizes like assets purchased in bulk when the unit price is greater than or equal to $5,000 and less than $25,000, with the aggregated purchase amount greater than or equal to $250,000.

Assets are depreciated on a straight-line basis beginning the month the asset was put in to use.

I. Advances

Advances are payments made to cover certain periodic expenses before those expenses are incurred. In accordance with Public Law 91-614, TTB participated in the Treasury's Working Capital Fund for which it receives services on a reimbursable basis. Payments from TTB to Treasury are made in advance and are authorized for services that have been deemed as more advantageous and more economical when provided centrally. The services provided include those for telecommunications, payroll/personnel systems, printing, and other central services. The amount reported represents the balance available at the end of the fiscal year after charges/expenses incurred by the fund are deducted.

J. Non-entity Assets

Non-entity assets consist primarily of cash and receivables for excise taxes and fees that are to be distributed to the Treasury, other Federal agencies, and other governments. Non-entity assets are not considered a financing source (revenue) available to offset the operating expenses of TTB.

K. Liabilities

Liabilities represent the amount of monies, or other resources, that are likely to be paid by TTB as the result of a transaction or event that has already occurred. However, no liability can be paid by TTB absent an appropriation. Liabilities for which an appropriation has not been enacted and for which there is uncertainty an appropriation will be enacted, are classified as a liability not covered by budgetary resources. Also, the Government, acting in its sovereign capacity, can abrogate liabilities of TTB that arise from other than contracts.

Intragovernmental liabilities consist of amounts payable to the Treasury for collections of excise tax, fees receivable, payments to other Federal agencies, and accrued Federal Employees' Compensation Act (FECA) charges. Liabilities also include amounts due to be refunded to taxpayers, as well as amounts held in escrow for Offers-in-Compromise and cash bonds held in guaranteeing payment of taxes.

L. Litigation Contingencies and Settlements

Probable and estimable litigation and claims against TTB are recognized as a liability and expense for the full amount of the expected loss. Expected litigation and claim losses include settlements to be paid from the Treasury Judgment Fund (Judgment Fund) on behalf of TTB and settlements to be paid from Bureau appropriations. The Judgment Fund pays Bivens-type tort claims. Settlements paid from the Judgment Fund for TTB are recognized as an expense and imputed financing source.

M. Annual, Sick, and Other Leave

Annual and compensatory leave earned by TTB employees, but not yet used, is reported as an accrued liability. The accrued balance is adjusted annually to current pay rates. Any portions of the accrued leave, for which funding is not available, are recorded as an unfunded liability. Sick and other leave are expensed as taken.

N. Interest on Late Payments

Pursuant to the prompt payment Act, 31 # U.S.C. & 3901-3907, Federal agencies must pay interest on payments for goods or services made to business concerns after their due date. The due date is generally 30 days after receipt of a proper invoice or acceptance of the goods or services.

O. Retirement Plan

Employees hired after December 31, 1983, are automatically covered by FERS and Social Security. For most employees hired after December 31, 1983, TTB also contributes the employers' matching share of Social Security. For the FERS basic benefit, employees contribute 0.8 percent of basic pay while TTB contributes 11.2 percent, for a total contribution rate of 12.0 percent in FY 2011, as well as FY 2010. The cost of providing a FERS basic benefit, as provided by the Office of Personnel Management (OPM), is equal to the amounts contributed by TTB and the employees.

All employees are eligible to contribute to the Thrift Savings Plan (TSP). For those employees participating in the FERS, a TSP account is automatically established and TTB makes a mandatory 1 percent contribution to this account. In addition, TTB makes matching contributions, ranging from 1 to 4 percent, for FERS-eligible employees who contribute to their TSP accounts. Matching contributions are not made to the TSP accounts established by CSRS employees.

TTB recognized the full cost of providing future pension and other retirement benefits (ORB) for current employees as required by Statement of Federal Financial Accounting Standards (SFFAS) No. 5. Full cost includes pension and ORB contributions paid out of Bureau appropriations and costs financed by OPM. Costs financed by OPM are reported in the accompanying financial statements as an imputed financing revenue source. Reporting amounts such as plan assets, accumulated plan benefits, or unfunded liabilities, if any, is the responsibility of OPM.

P. Federal Employees' Compensation Act

The Federal Employees' Compensation Act (FECA) provides income and medical cost protection to covered Federal civilian employees injured on the job and employees who have incurred a work-related injury or occupational disease. The future workers' compensation estimates were generated from an application of actuarial procedures developed to estimate the liability for FECA benefits. The actuarial liability estimates for FECA benefits include the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases. The liability is determined using the paid losses extrapolation method, which is calculated over the next 37-year period. This method utilizes historical benefit patterns related to a specific incurred period to predict ultimate payments related to that period.

Claims are paid for TTB employees by the Department of Labor (DOL) from the FECA fund, for which TTB reimburses DOL. The accrued liability represents claims paid by DOL for TTB employees, for which the fund has not been reimbursed. The actuarial liability is an estimate of future costs to be paid on claims made by TTB employees. The estimated future cost is not obligated against budgetary resources until the year in which the cost is billed to TTB.

Q. Use of Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amount of assets and liabilities, as well as the disclosure of contingent liabilities at the date of the financial statements, and the amount of revenues and cost reported during the period. Actual results could differ from those estimates.

R. Tax Exempt Status

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

Note 2. Fund Balance with Treasury

Fund Balance with Treasury as of September 30, 2011 and 2010 consisted of the following (in thousands):

	2011	2010
Fund Balances:		
General Funds	$24,726	$25,579
Other Funds	13,140	11,169
Total	$37,866	$36,748
Status of Fund Balances:		
Unobligated Balance - Available	$1,758	$3,247
Unobligated Balance - Unavailable	1,760	1,598
Obligated Balance Not Yet Disbursed	21,208	20,734
Subtotal	24,726	25,579
Adjustment for Non-Budgetary Funds	13,140	11,169
Total Status of Fund Balances	$37,866	$36,748

The other funds and non-budgetary fund balance primarily represents cash bonds, which are cash payments made to the Bureau by taxpayers, in lieu of obtaining corporate surety bonds, guaranteeing payment of taxes. It also includes Offers-in-Compromise (OIC). OICs are payments made to the Bureau, being held in escrow, to finance offers from taxpayers to settle their tax debt at less than the assessed amount.

The unobligated balance that is unavailable is the balance of prior years' expired appropriations.

Note 3. Accounts Receivable

Accounts Receivable as of September 30, 2011 and 2010 consisted of the following (in thousands):

	2011	2010
Intragovernmental Accounts Receivable:		
Due from Treasury Departmental Offices	$ -	$81
Due from Treasury Executive Office of Asset Forfieture	82	470
Due from Community Development Financial Institutions Fund	246	16
Due from General Services Administration	24	-
Total Intragovernmental Accounts Receivable	$352	$567
Due from the Government of Puerto Rico	$479	$331
Due from Commercial Vendors	-	5
Due from Employees	5	7
Total Accounts Receivable Due from the Public	$484	$343

No allowance for doubtful accounts has been recognized, nor have any accounts been written off. All intragovernmental accounts receivable are considered fully collectible. Additionally, other non-Federal receivables consist of a receivable from the government of Puerto Rico, which is collected via an offset to cover-over payments the Bureau remits to Puerto Rico, and employee accounts receivable, which can be collected via salary offsets.

Note 4. Tax and Trade Receivables, Net

Tax and Trade Receivables as of September 30, 2011 and 2010 consisted of the following (in thousands):

	2011	2010
Tax and Trade Receivables	$24,201	$97,158
Interest Receivable	4,292	13,240
Penalties, Fines and Administrative Fees Receivable	6,069	10,125
Total Tax and Trade Receivables	34,562	120,523
Allowance for Doubtful Accounts	(30,252)	(112,553)
Total Tax and Trade Receivables, Net	$4,310	$7,970

All tax and trade receivables are non-entity assets. An allowance for uncollectible amounts has been established based on: 1) an analysis of individual receivable balances and 2) the application of historical non-collection rates for similar types of receivables. Because current laws governing the collection period for these tax assessments, 26 U.S.C. 6502, stipulate taxes are collectible for 10 years from the date the taxes were assessed, a large amount of aged receivables that are not likely to be collected have been offset with an allowance, but not written off. This is an offsetting liability reported as Due to the General Fund.

The large decrease in gross receivables and related allowance is primarily the result of a settlement being reached with one taxpayer and more than $83 million in receivables, which had been previously estimated as uncollectible, were written off.

Note 5. Due from the General Fund and Due to the General Fund

In addition to collecting taxes from the alcohol and tobacco industries, the Bureau also is responsible for paying refunds, when applicable, to those same industry members. Amounts due from the General Fund represent a receivable from appropriations to cover the Bureau's accrued refund liability to alcohol and tobacco excise taxpayers.

	2011	2010
Due from the General Fund (in thousands)	$2,022	$12,802

Amounts due to the General Fund primarily represent the balance of receivables related to Alcohol and Tobacco excise taxes. Receivables related to Firearms and Ammunition excise taxes are payable to the Department of Interior's Fish and Wildlife Restoration Fund, not the General Fund.

	2011	2010
Due to the General Fund (in thousands)	$4,246	$7,550

Note 6. Property, Plant, and Equipment, Net (PP&E)

Property, Plant and Equipment as of September 30, 2011 and 2010 consisted of the following (in thousands):

2011	Estimated Useful Life (Years)	Acquisition Value	Accumulated Depreciation	Net Book Value
Internal Use Software	3 - 5	$13,625	$4,770	$8,855
Equipment	4 - 6	9,034	5,596	3,438
Leasehold Improvements	2 - 5	796	562	234
Building	40	9,772	1,848	7,924
Construction in Process		-	-	-
Total PP&E		$33,227	$12,776	$20,451

2010	Estimated Useful Life (Years)	Acquisition Value	Accumulated Depreciation	Net Book Value
Internal Use Software	3 - 5	$11,060	$4,346	$6,714
Equipment	4 - 6	8,357	4,697	3,660
Leasehold Improvements	2 - 5	691	462	229
Building	40	9,772	1,592	8,180
Construction in Process		474	-	474
Total PP&E		$30,354	$11,097	$19,257

Depreciation and amortization are calculated using the straight-line method.

The balance in the buildings account represents TTB's 13.2 percent equity interest in the National Laboratory Center facility in Beltsville, Maryland, which TTB co-owns with ATF.

Note 7. Advances

Intragovernmental advances consist of the balances paid to Treasury's Working Capital Fund that have not yet been earned and billed by the fund.

Note 8. Non-entity Assets

Non-entity Assets as of September 30, 2011 and 2010 consisted of the following (in thousands):

	2011	2010
Intragovernmental Non-entity Assets:		
Fund Balance with Treasury	$13,140	$11,169
Due from the General Fund	2,022	12,802
Total Intragovernmental Non-entity Assets	15,162	23,971
Tax and Trade Receivables, Net	4,310	7,970
Total Non-Entity Assets	19,472	31,941
Total Entity Assets	46,842	46,598
Total Assets	$66,314	$78,539

Note 9. Other Liabilities

Other Liabilities as of September 30, 2011 and 2010 constisted of the following (in thousands):

	2011	2010
Due to the Fish and Wildlife Fund	$61	$420
Other Intragovernmental Liabilities	61	420
Offers-in-Compromise not yet Accepted	693	358
Total Other Liabilities with the Public	693	358
Total Other Liabilities	$754	$778

All Other Liabilities are considered current liabilities.

Note 10. Liabilities Not Covered by Budgetary Resources

Liabilities not Covered by Budgetary Resources as of September 30, 2011 and 2010 consisted of the following (in thousands):

	2011	2010
Accrued FECA Liability	$36	$48
Total Intragovernmental Liabilities not Covered by Budgetary Resources	36	48
FECA Actuarial Liability	308	132
Accrued Leave	4,346	4,377
Total Liabilities with the Public not Covered by Budgetary Resources	4,654	4,509
Total Liabilities not Covered By Budgetary Resouces	4,690	4,557
Total Liabilities Covered by Budgetary Resources	29,248	41,862
Total Liabilities	$33,938	$46,419

Note 11. Future Funding Requirements

Total liabilities not covered by budgetary resources generally do not equal the total financing sources yet to be provided on the Reconciliation of Net Cost of Operations to Budget. The amounts reported on the Balance Sheet are period ending balances, while the amounts reported on the Reconciliation of Net Cost of Operations to Budget are activity for the period.

Generally, liabilities not covered by budgetary resources require future funding and can be liquidated only with the enactment of future appropriations.

Note 12. Imputed Financing

Imputed Financing as of September 30, 2011 and 2010 consisted of the following (in thousands):

	2011	2010
Health Insurance	$2,613	$2,665
Life Insurance	8	8
Pension	1,975	2,425
Total Imputed Financing	$4,596	$5,098

Imputed financing recognizes actual cost of future benefits to be paid by other Federal entities. These benefits include Federal Employees Health and Benefits Program (FEHB), Federal Employees Group Life Insurance Program (FEGLI), and pensions. Imputed financing also recognizes costs paid by the Judgment Fund. The Fund was established and funded by Congress under 31 U.S.C. 1304 to pay in whole or in part court judgments and settlement agreements negotiated by Treasury on behalf of agencies, as well as certain types of administrative awards. The Judgment Fund did not pay out any awards on TTB's behalf during fiscal years 2011 or 2010.

TTB does not report CSRS assets, FERS assets, accumulated plan benefits, or unfunded liabilities, if any, applicable to retirement plans because the accounting for and reporting of such amounts is the responsibility of OPM. Based on cost factors provided by OPM, which vary by retirement plan, estimated future pension benefits for TTB employees, to be paid by OPM, totaled $2.0 million and $2.4 million for fiscal years 2011 and 2010 respectively. Similarly, OPM rather than TTB, reports liabilities for future payments to retired employees who participate in the FEHB and FEGLI programs. The FEHB cost factor applied to a weighted average number of employees enrolled in the FEHB program increased in FY 2011 to $6,027 from $5,906 in FY 2010, producing $2.6 million and $2.7 million of imputed cost for employees' health benefits in each respective year. The cost factor, as provided by OPM, for employees enrolled in the FEGLI program, remained unchanged from FY 2010 to FY 2011, at .02 percent of employees' basic pay. The FEGLI amounts totaling $8,000 each are also included as an expense and imputed financing source in TTB financial statements for fiscal years 2011 and 2010, respectively.

Note 13. Consolidated Gross Cost and Earned Revenue by Budget Functional Classification

Consolidated Gross Cost and Earned Revenue by Budget Function Classification as of September 30, 2011 and 2010 consisted of the following (in thousands):

Fiscal Year Ended September 30, 2011

Activity	Budget Function Classification (BFC)	BFC Code	Gross Costs	Earned Revenue	Net Costs
Intragovernmental	Central Fiscal Operations	803	$29,709	$(539)	$29,170
With the Public	Central Fiscal Operations	803	78,579	(3,097)	75,482
Consolidated	Central Fiscal Operations	803	$108,288	$(3,636)	$104,652

Fiscal Year Ended September 30, 2010

Activity	Budget Function Classification (BFC)	BFC Code	Gross Costs	Earned Revenue	Net Costs
Intragovernmental	Central Fiscal Operations	803	$30,316	$(97)	$30,219
With the Public	Central Fiscal Operations	803	78,007	(2,614)	75,393
Consolidated	Central Fiscal Operations	803	$108,323	$(2,711)	$105,612

Note 14. Statement of Budgetary Resources vs. Budget of the United States Government

The following charts displays balances from the FY 2010 Statement of Budgetary Resources and actual fiscal year balances included in the FY 2012 Presidents Budgets. There were no differences. The FY 2013 budget, which would include FY 2011 actuals, had not been published at the time of this report.

Fiscal Year Ended September 30, 2010 (In Millions / Unaudited)	**Statement of Budgetary Resourses**	**President's Budget**
Budgetary Resources Available for Obligation	$107	$107
Status of Budgetary Resources Available for Obligation:		
Obligations Incurred	$106	$106
Unobligated Balance Carried Forward, End of Year	3	3
Total Status of Budgetary Resources Available for Obligation	$109	$109
Net Outlays	$99	$99

Additionally, the FY 2012 President's Budget disclosed budget authority of $378 million for FY 2010, funding cover-over payments to Puerto Rico, which is not reported in the Statement of Budgetary Resources.

The cover-over payments and associated tax revenues are reported as custodial activity of the Bureau. The tax revenues are not available for use in the operation of the Bureau and are not reported on the Statement of Net Cost. Likewise, the resultant cover-over payments are not recognized as an operating expense of the Bureau. Consequently, to present the refunds as an expense of the Bureau on the Statement of Net Cost would be inconsistent with the reporting of the related Federal tax revenue and would materially distort the costs incurred by the Bureau in meeting its strategic objectives. Further, since this activity is not reported on the Statement of Net Cost, it would be contradictory to report the budget authority on the Statement of Budgetary Resources.

Note 15. Apportionment Categories of Obligations Incurred

Obligations Incurred as of September 30, 2011 and 2010 consisted of the following (in thousands):

Fiscal Year	Apportionment Category	Direct Obligations	Reimbursable Obligations	Total Obligations Incurred
2011	Category B	$103,038	$3,955	$106,993
2010	Category B	$102,117	$3,984	$106,101

The amount of direct and reimbursable obligations against amounts apportioned under Category B is reported in the table above. Apportionment categories are determined by the apportionment categories reported on the Standard Form 132 *Apportionment and Reapportionment Schedule*. Category B represents annual apportionments.

	2011	2010
Undelivered Orders End of Period	$13,813	$13,073

Note 16. Net Custodial Revenue Activity

- **Excise Taxes**

  As an agent of the Federal Government and as authorized by 26 U.S.C., TTB collects excise taxes from alcohol, tobacco, firearms, and ammunition industries. In addition, special occupational taxes are collected from certain alcohol and tobacco businesses. During FY 2011 and FY 2010, TTB collected $23.5 billion and $23.8 billion respectively in taxes, interest, and other custodial revenues.

  Substantially all of the taxes collected by TTB net of related refund disbursements are remitted to the Department of Treasury General Fund. The Department of Treasury further distributes this revenue to Federal agencies in accordance with various laws and regulations. The firearms and ammunition excise taxes are an exception. Those revenues are remitted to the Fish and Wildlife Restoration Fund under provisions of the Pittman-Robertson Act of 1937.

- **Refunds and Other Payments**

During FY 2011 and FY 2010, TTB issued nearly $802 million and $713 million in refunds, cover-over payments, and drawback payments in the respective years.

<u>Tax Refunds</u>

Tax Refunds result when taxpayers file returns for payments made for a given tax period and the result of the return is an overpayment.

<u>Cover-over Payments</u>

Federal excise taxes are collected under the Internal Revenue Code of 1986, 26 U.S.C., on certain articles produced in Puerto Rico and the Virgin Islands, and imported into the United States. In accordance with 26 U.S.C. 7652, such taxes collected on rum imported into the United States are custodial revenues and "covered over," or paid into, the treasuries of Puerto Rico and the Virgin Islands.

TTB maintains operations in Puerto Rico to enforce the provisions of chapter 51 in respect to items of Puerto Rican manufacture brought in to the United States. These operations include conducting annual revenue, application, and product integrity investigations of large alcohol and tobacco industry members. Except for application investigations, TTB investigates medium and small alcohol and tobacco producers in response to specific problems and risk indicators. Revenue inspections are used to verify that TTB is collecting all of the revenue that is rightfully due from the taxpayer. TTB staff in Puerto Rico also conducts qualification inspections of all distilled spirits producers/processors, wineries, wholesalers, importers, Manufacturer of Nonbeverage Products (MNBP) claimants, and Specially Denatured Alcohol permit applicants. All costs associated with the functioning and supporting of the Puerto Rico office, $3.0 million and $2.6 million in FY 2011 and FY 2010 respectively, are offset against the cover-over payments made by the United States to Puerto Rico.

<u>Drawbacks</u>

Under current law, 26 U.S.C. 5134, MNBP permittees may be eligible to claim a refund of tax paid on distilled spirits used in their products. In the case of distilled spirits, on which the tax has been paid or determined, a drawback shall be allowed on each proof gallon at the rate of $1 less than the rate at which the distilled spirits tax had been paid or determined. The refund is due upon the claimant providing evidence that the distilled spirits on which the tax has been paid or determined were unfit for beverage purposes and were used in the manufacture or production of medicines, medicinal preparations, food products, flavors, flavoring extracts, or perfume.

Refunds, Drawbacks and Cover-over Payments as of September 30, 2011 and 2010 consisted of the following (in thousands):

	2011	2010
Alcohol and Tobacco Excise Tax Refunds	$33,414	$28,232
Drawbacks on MNBP Claims	306,584	297,596
Interest and Other Payments	418	315
Refunds and Drawbacks	340,416	326,143
Cover-over Payments - Puerto Rico	452,040	378,186
Cover-over Payments - Virgin Islands	9,592	8,871
Amounts Provided to Non-federal Entities	461,632	387,057
Total Refunds, Drawbacks and Coverover Payments	$802,048	$713,200

Note 17. Custodial Revenue

Collection and Disposition of Custodial Revenue as of September 30, 2011 and 2010 consisted of the following (in thousands):

FY 2011 Collections and Refunds by Tax Year

Revenue Type	2011	2010	2009	Pre-2009	FY 2011 Total
Excise Taxes	$17,199,511	$6,240,989	$9,052	$7,497	$23,457,049
Fines, Penalties, Interest and Other	3,736	466	64	95	4,361
Total Revenue Received	17,203,247	6,241,455	9,116	7,592	23,461,410
Less: Amounts Collected for Non-federal Entities	(461,632)	-	-	-	(461,632)
Total	$16,741,615	$6,241,455	$9,116	$7,592	$22,999,778
Refund Type					
Excise Taxes	$165,693	$162,377	$11,744	$429	$340,243
Fines, Penalties, Interest and Other	173	-	-	-	173
Total Refunds & Drawbacks	$165,866	$162,377	$11,744	$429	$340,416
Amounts Provided to Fund the Federal Government	$16,575,749	$6,079,078	$(2,628)	$7,163	$22,659,362

FY 2010 Collections and Refunds by Tax Year

Revenue Type	2010	2009	2008	Pre-2008	FY 2010 Total
Excise Taxes	$17,379,680	$6,365,498	$2,249	$9,086	$23,756,513
Fines, Penalties, Interest and Other	2,491	629	91	395	3,606
Total Revenue Received	17,382,171	6,366,127	2,340	9,481	23,760,119
Less: Amounts Collected for Non-federal Entities	(387,057)	-	-	-	(387,057)
Total	$16,995,114	$6,366,127	$2,340	$9,481	$23,373,062
Refund Type					
Excise Taxes	$171,499	$150,309	$2,659	$1,543	$326,010
Fines, Penalties, Interest and Other	133	-	-	-	133
Total Refunds & Drawbacks	$171,632	$150,309	$2,659	$1,543	$326,143
Amounts Provided to Fund the Federal Government	$16,823,482	$6,215,818	$(319)	$7,938	$23,046,919

Note 18. Reconciliation of Net Cost of Operations to Budget

The Reconciliation of Net Cost of Operations to Budget explains the difference between the budgetary net obligations and the proprietary net cost of operations.

Reconciliation of Net Cost of Operations to Budget, as of September 30, 2011 and 2010 consisted of the following (in thousands):

	2011	2010
Resources Used to Finance Activities		
Budgetary Resources Obligated		
Obligations Incurred	$106,993	$106,101
Less: Spending Authority from Offsetting Collections and Recoveries	(5,586)	(5,448)
Obligations Net of Offsetting Collections and Recoveries	101,407	100,653
Less: Offsetting Receipts	(10)	(9)
Net Obligations	101,397	100,644
Other Resources		
Transfers-in without Reimbursement	231	1,528
Imputed Financing from Costs Absorbed by Others	4,596	5,098
Net Other Resources Used to Finance Activities	4,827	6,626
Total Resources Used to Finance Activities	$106,224	$107,270

Resources Used to Finance Items not Part of the Net Cost Of Operations		
Change in Budgetary Resources Obligated for Goods, Services and Benefits Ordered but not Yet Provided (+/-)	$523	$(2,006)
Resources that Fund Expenses Recognized in Prior Periods	42	124
Other Budgetary Offsetting Collections and Receipts that do not Affect Net Cost of Operations	221	1,519
Resources that Finance the Acquisition of Assets	3,311	5,402
Other Resources or Adjustments to Net Obligated Resources that do not Affect Net Cost of Operations (+/-)	(241)	(1,528)
Total Resources Used to Finance Items not Part of the Net Cost of Operations	$3,856	$3,511
Total Resources Used to Finance the Net Cost of Operations	$102,368	$103,759
Components of the Net Cost of Operations Requiring or Generating Resources in Future Periods		
Components Requiring or Generating Resources in Future Periods:		
Increase in Annual Leave Liability	$ -	$58
Other (+/-)	176	-
Total Components of Net Cost of Operations that will Require or Generate Resources in Future Periods	$176	$58
Components of the Net Cost of Operations not Requiring or Generating Resources		
Depreciation and Amortization	$2,108	$1,795
Total Components of Net Cost of Operations that will not Require or Generate Resources	$2,108	$1,795
Total Components of Net Cost of Operations that will not Require or Generate Resources in the Current Period	$2,284	$1,853
NET COST OF OPERATIONS	$104,652	$105,612

Note 19: Contingent Liabilities

As of September 30, 2011, TTB is party to four legal actions, regarding personnel matters, where legal counsel believes an unfavorable outcome is probable or reasonably possible. TTB estimates the maximum amount plaintiffs can recover for these four cases is $382,000. It is estimated that TTB's potential liability on two of the four cases will approximate $5,200. The potential liability on the other two cases cannot be estimated.

TTB is also party to two additional actions, regarding personnel matters, where the likelihood of an unfavorable outcome cannot be determined. The maximum potential liability on the two cases would be $600,000. Further, a case arose after September 30, 2011 pertaining to actions that took place prior September 30, 2011. TTB has already reached a tentative settlement on the matter and estimates the liability to be $51,000.

Required Supplementary Information (Unaudited)

Budgetary Information

Budgetary information aggregated for the purposes of the Statement of Budgetary Resources should be disaggregated for each of an entity's major budget accounts (i.e., Approriated Funds, Trust Funds, Revolving Funds, or other funds) and presented as Supplementary Information. However, for proprietary reporting, TTB only has appropriated funds. Consequently, a Combining Statement of Budgetary Resources disaggregated by fund type has not been presented.

Excise Tax and Other Collections

Required Supplementary Information
Excise Tax and Other Collections by Fiscal Year
Unaudited (In Thousands)

Fiscal Year	Alcohol	Tobacco	FAET	SOT	FST	Other	Total
2002	$6,889,401	$7,763,652	$205,027	$101,893	$115,609	$159	$15,075,741
2003	6,910,631	7,380,807	193,414	103,781	1,628	-	14,590,261
2004	6,995,366	7,433,852	216,006	100,562	-	359	14,746,145
2005	7,074,076	7,409,608	225,818	10,190	9	141	14,719,842
2006	7,182,940	7,350,058	249,578	2,895	638	146	14,786,255
2007	7,232,138	7,194,081	287,835	2,808	-	32	14,716,894
2008	7,420,576	6,851,705	312,622	448	-	634	14,585,985
2009	7,424,292	11,548,504	452,693	272	1,192,375	970	20,619,106
2010	7,476,789	15,913,479	360,813	300	8,558	180	23,760,119
2011	7,594,330	15,515,073	344,262	268	5,220	2,257	23,461,410
Average	$7,220,054	$9,436,082	$284,807	$32,342	$132,404	$488	$17,106,176

FAET – Firearms and Ammunition Excise Tax
SOT – Special Occupational Tax
FST – Floor Stock Tax

The sharp decrease in SOT tax collections was the result of a new law that became effective during fiscal year 2005 that suspended the collection of most of the taxes. The law became permanent in 2008.

TTB collects FAET taxes on behalf of the Department of Interior, U.S. Fish and Wildlife Service, and deposits the collections directly into the Fish and Wildlife Restoration Fund. During fiscal years 2011 and 2010, TTB incurred $1.5 million and $2.3 million respectively of direct and indirect costs associated with collecting the FAET taxes. The law currently does not provide for TTB to recover these costs. The cost of the program was communicated to the U.S. Fish and Wildlife Service so the agency could properly record an imputed cost in its financial records.

Refunds, Cover-over Payments, and Drawback Payments

Required Supplementary Information
Refunds, Cover-over Payments and Drawback Payments by Fiscal Year
Unaudited (In Thousands)

Fiscal Year	Cover Over Puerto Rico	Cover Over Virgin Islands	A&T Excise Tax	Drawbacks MNBP Claims	Interest and Other	Total
2002	$340,362	$5,145	$10,523	$361,854	$1,855	$719,739
2003	356,144	6,405	15,168	296,168	2,011	675,896
2004	335,293	6,244	15,409	355,605	1,216	713,767
2005	419,602	6,010	18,504	317,132	2,100	763,348
2006	358,664	6,491	17,524	337,632	699	721,010
2007	459,278	8,054	13,208	335,706	972	817,218
2008	373,418	7,615	14,125	283,462	2,938	681,558
2009	472,695	8,624	17,791	268,612	252	767,974
2010	378,186	8,871	28,232	297,596	315	713,200
2011	452,040	9,592	33,414	306,584	418	802,048
Average	$394,568	$7,305	$18,390	$316,035	$1,278	$737,576

A&T – Alcohol and Tobacco
MNBP – Manufacturer of Nonbeverage Products
Note: During December 2010, the Puerto Rico cover-over rate was increased from $10.50 per proof gallon to $13.25 per proof gallon, with retroactive provisions, resulting in a substantial increase in the Puerto Rico cover-over payments in FY 2011. The increased rate expires December 31, 2011.

Other Accompanying Information (Unaudited)

Intragovernmental Assets

Other Accompanying Information
Intragovernmental Assets
As of September 30, 2011
Unaudited (In Thousands)

Trading Partner	Agency Code	Fund Balance W/ Treasury	Accounts Receivable	Advances
Department of the Treasury	20	$37,866	$352	$829
General Fund	99	-	2,022	-
Total		$37,866	$2,374	$829

Other Accompanying Information
Intragovernmental Assets
As of September 30, 2010
Unaudited (In Thousands)

Trading Partner	Agency Code	Fund Balance W/ Treasury	Accounts Receivable	Advances
Department of the Treasury	20	$36,748	$567	$852
General Fund	99	-	12,802	-
Total		$36,748	$13,369	$852

Intragovernmental Liabilities

Other Accompanying Information
Intragovernmental Liabilities
As of September 30, 2011
Unaudited (In Thousands)

Trading Partner	Agency Code	Accounts Payable	Accrued FECA	Custodial and Other Liabilities
Government Printing Office	04	$154	$ -	$ -
Department of the Interior	14	-	-	61
Department of Justice	15	150	-	-
Department of Labor	16	-	36	-
Department of the Treasury	20	36	-	-
Office of Personnel Management	24	-	-	476
General Services Administration	47	158	-	-
Treasury General Fund	99	2	-	4,246
Total		$500	$36	$4,783

Other Accompanying Information
Intragovernmental Liabilities
As of September 30, 2010
Unaudited (In Thousands)

Trading Partner	Agency Code	Accounts Payable	Accrued FECA	Custodial and Other Liabilities
Government Printing Office	04	$19	$ -	$ -
Department of the Interior	14	-	-	420
Department of Justice	15	273	-	-
Department of Labor	16	-	48	-
Department of the Treasury	20	2	-	-
Office of Personnel Management	24	-	-	422
General Services Administration	47	404	-	-
Treasury General Fund	99	2	-	7,709
Total		$700	$48	$8,551

Intragovernmental Earned Revenue

Other Accompanying Information
Intragovernmental Earned Revenue
For the Fiscal Years Ended September 30, 2011 and 2010
Unaudited (In Thousands)

Trading Partner	Agency Code	2011	2010
Department of Treasury	20	$514	$97
GSA	47	25	-
Total		$539	$97

Budget Function Classification (BFC)	BFC Code	2011	2010
Central Fiscal Operations	803	$539	$97
Total		$539	$97

Intragovernmental Gross Cost

Other Accompanying Information
Intragovernmental Gross Cost
For the Fiscal Years Ended September 30, 2011 and 2010
Unaudited (In Thousands)

Trading Partner	Agency Code	2011	2010
Library of Congress	03	$69	$53
Government Printing Office	04	257	176
Department of Interior	14	-	60
Department of Justice	15	651	694
Department of Labor	16	16	11
United States Postal Services	18	44	-
Department of State	19	1	18
Department of the Treasury	20	6,172	6,453
Office of Personnel Management	24	12,914	13,171
General Services Administration	47	6,213	6,375
Environmental Protection Agency	68	8	20
Department of Homeland Security	70	362	290
Department of Health and Human Services	75	2	29
National Archives Records Administration	88	30	36
Department of Defense	97	95	38
General Fund	99	2,875	2,892
Total		$29,709	$30,316

During fiscal years 2011 and 2010, TTB incurred costs with other Federal agencies totaling approximately $30 million in each of the respective years. The majority of those costs were associated with the five entities detailed below.

- **Department of Justice:** TTB paid ATF $651,000 and $694,000 in fiscal years 2011 and 2010 respectively for shared lab space and shared building services.
- **Department of the Treasury:** The Bureau received services from Treasury's Working Capital Fund, as well as administrative services from the Bureau of Public Debt's Administrative Resource Center, in fiscal years 2011 and 2010 in the amounts of $6.2 million and $6.5 million respectively.
- **Office of Personnel Management:** TTB incurred $12.9 million and $13.2 million in costs for employee benefits for fiscal years 2011 and 2010 respectively.
- **General Services Administration:** TTB paid $6.2 million and $6.4 million to GSA for rent and information technology services in fiscal years 2011 and 2010 respectively.
- **General Fund:** The Bureau paid $2.9 million in each of the respective years for employee benefits and lockbox fees.

Part IV: Appendices

Principal Officers of TTB

Administrator . . . . .John Manfreda

Deputy Administrator . . . . Mary Ryan

Equal Employment Opportunity and Diversity Advancement. . . . . .Altivia Jackson

Assistant Administrator, Field Operations . . . . Tom Crone

Assistant Administrator, Headquarters Operations . . . . William Foster

Assistant Administrator, Management/CFO. . . . . Cheri Mitchell

Assistant Administrator, Information Resources/CIO . . . . .Robert Hughes

Director, Office of Inspection . . . . Theresa Glasscock

Executive Liaison for Industry and State Matters . . . . Susan Evans

Chief Counsel . . . . .Robert Tobiassen

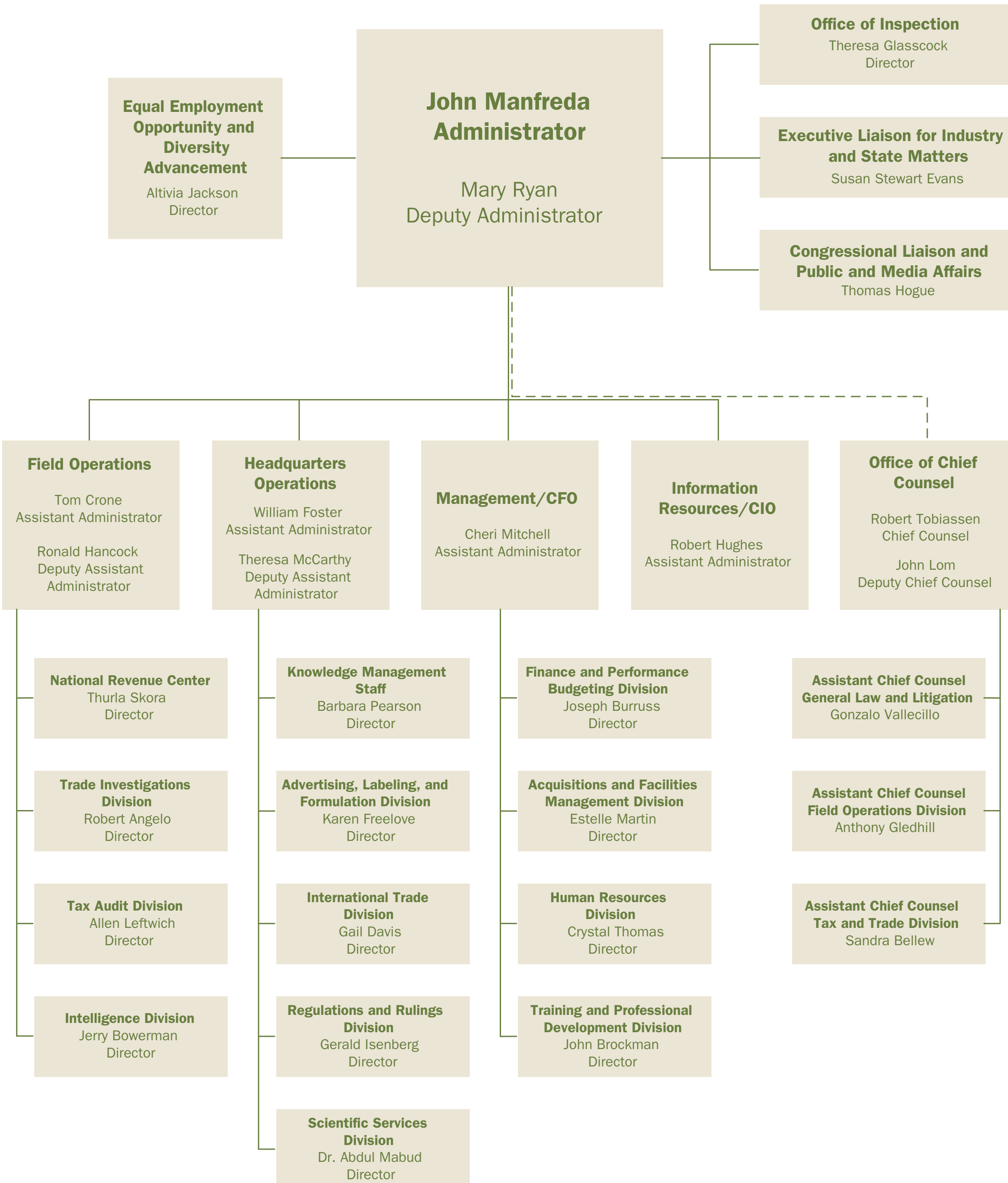
For additional information, contact:

Alcohol and Tobacco Tax and Trade Bureau
1310 G Street, NW, Box 12
Washington, DC 20005

(202) 453-2000

http://www.ttb.gov

TTB Organization Chart



Connecting the Treasury and TTB Strategic Plans

Economy: U.S. and World Economies Perform at Full Economic Potential		
TREASURY STRATEGIC GOALS AND OBJECTIVES	**TTB STRATEGIC GOALS**	**TTB OBJECTIVES**
TREASURY ECONOMIC STRATEGIC OBJECTIVE: Improved economic opportunity, mobility and security with robust, real, sustainable economic growth at home and abroad **Outcome:** Strong U.S. economic competitiveness	**PROTECT THE PUBLIC (PTP):** Alcohol and tobacco industry operators meet permit qualifications, and alcohol beverage products comply with Federal production, labeling, and marketing requirements	**TTB PTP OBJECTIVES** **PTP 1. BUSINESS INTEGRITY:** Assure that only qualified persons and business entities operate within the industries TTB regulates **PTP 2. PRODUCT INTEGRITY:** Assure that alcohol beverage products comply with Federal production, labeling, and advertising requirements **PTP 3. MARKET INTEGRITY:** Assure fair trade practices throughout the alcohol beverage marketplace

Finance: Effectively Managed U.S. Government Finances		
TREASURY STRATEGIC GOALS AND OBJECTIVES	**TTB STRATEGIC GOALS**	**TTB OBJECTIVES**
TREASURY FINANCIAL STRATEGIC OBJECTIVE: Available cash resources to operate the government **Outcome:** Revenue collected when due through a fair and uniform application of the law at the lowest possible cost	**COLLECT THE REVENUE (CTR):** Enforce the tax code to ensure proper Federal tax payment on alcohol, tobacco, firearms, and ammunition products	**TTB CTR OBJECTIVES** **CTR 1. TAX VERIFICATION AND VALIDATION:** Assure voluntary compliance in the timely and accurate remittance of tax payments **CTR 2. CIVIL AND CRIMINAL ENFORCEMENT:** Detect and address noncompliance, excise tax evasion, and other criminal violations of the Internal Revenue Code in the industries TTB regulates

Security: Strengthened International Financial System Security and Enhanced U.S. National Security		
TREASURY STRATEGIC GOALS AND OBJECTIVES	**TTB STRATEGIC GOALS**	**TTB OBJECTIVES**
TREASURY SECURITY STRATEGIC OBJECTIVE: Prevented terrorism and promoted the Nation's security through strengthened international financial systems **Outcome:** 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	**PROTECT THE PUBLIC:** Alcohol and tobacco industry operators meet permit qualifications, and alcohol beverage products comply with Federal production, labeling, and marketing requirements	**TTB PTP OBJECTIVES (Security):** **PTP 1. BUSINESS INTEGRITY:** Assure that only qualified persons and business entities operate within the industries TTB regulates

Management: Management and Organizational Excellence		
TREASURY STRATEGIC GOALS AND OBJECTIVES	**TTB STRATEGIC GOALS**	**TTB OBJECTIVES**
TREASURY MANAGEMENT STRATEGIC OBJECTIVE: Enabled and effective Treasury Department **Outcome:** A citizen-centered, results-oriented and strategically aligned organization **Outcome:** Exceptional accountability and transparency	**MANAGEMENT AND ORGANIZATIONAL EXCELLENCE:** Maximize performance, efficiency, and program results through effective resource and human capital management	**TTB MGT OBJECTIVES:** **MGT 1. HUMAN CAPITAL MANAGEMENT:** Maintain a qualified, engaged, and satisfied workforce **MGT 2. TECHNOLOGY SOLUTIONS:** Deliver effective, streamlined, and flexible IT solutions that add value and support program performance **MGT 3. FINANCE AND PERFORMANCE RESULTS:** Facilitate strategic management and financial accountability through the delivery of timely and reliable financial and performance information

Note: *TTB revised its goals and objectives in FY 2010, and will reflect these changes in its next iteration of its strategic plan.*

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