Annual Plan
Fiscal Year 2007

Office of Inspector General

DEPARTMENT OF THE TREASURY

FOREWORD

We are pleased to provide our Fiscal Year 2007 Annual Plan. This document outlines the major initiatives, priorities, and challenges of our office in assisting the Department of the Treasury with fulfilling its mission.

The projects described in this Annual Plan represent the collective judgment by our office of the areas of known or emerging risks and vulnerabilities of the Department, based on our planning process. Included for the first time in the Annual Plan is our perspective on the most significant integrity risks to the Department's programs and operations, and a discussion of specific proactive initiatives by our auditors and investigators related to these risks. To achieve the maximum benefit of this Annual Plan, we strongly encourage Treasury and bureau management to use it to identify areas for self-assessment and to take corrective measures when vulnerabilities and control weaknesses are identified. This is especially important for those issues we have identified as significant but, because of our resources, we do not expect to address this year.

December 2006

This page intentionally left blank.

Contents

This page intentionally left blank.

Overview

Introduction

This planning document outlines the major initiatives, priorities, and challenges of our office to assist the Department of the Treasury (Treasury) in fulfilling its mission, priorities, and plans. This document further provides senior officials of the Department, the Administration, members of Congress, and other stakeholders with a greater understanding of who we are, what we do, and what our intended work will be for fiscal year 2007.

Each of the four components of the Office of Inspector General (Audit, Investigations, Counsel, and Management) contributed to the development of this plan. In its respective sections, each component describes its function, role, and organizational structure, and the expected challenges its respective workforce may encounter in fiscal year 2007.

Background

In 1989, the Secretary of the Treasury established the Office of Inspector General (OIG) in accordance with the 1988 amendments to the Inspector General (IG) Act. Section 2 of the IG Act sets out OIG's major duties and responsibilities:

- Conduct and supervise audits and investigations.

- Provide leadership and coordination of policies that (1) promote economy, efficiency, and effectiveness in Treasury programs and operations; and (2) prevent and detect fraud and abuse in Treasury programs and operations.

- Provide a means for keeping the Secretary and the Congress fully and currently informed about problems and deficiencies in Treasury programs and operations.

- Submit semiannual reports to the Congress, through the Secretary of the Treasury, summarizing OIG activities during the preceding period that disclose problems, abuses, or deficiencies in the administration of Treasury programs and operations. These semiannual reports are also to discuss the recommendations for corrective action made by the OIG.

The OIG is headed by an Inspector General who is appointed by the President of the United States, with the advice and consent of the Senate. The Inspector General exercises his or her duties and responsibilities on behalf of all Treasury operations, except those of the Internal Revenue Service (IRS).[1]

Specifically, the Treasury OIG has jurisdiction over the following Treasury bureaus:

- **Alcohol and Tobacco Tax and Trade Bureau** (TTB) – enforces and administers laws covering the production, use, and distribution of alcohol and tobacco products. TTB also collects excise taxes for firearms and ammunition. Annual tax collections by TTB are approximately $15 billion.

- **Bureau of Engraving and Printing** (BEP) – produces U.S. currency and other government securities and redeems damaged or mutilated currency for the public. BEP is also authorized by the Bureau of Engraving and Printing Security Printing Amendments Act of 2000 (P.L. 106-849) to produce currency and other documents for foreign governments. During fiscal year 2005, BEP delivered 8.5 billion Federal Reserve Notes and 5 billion stamps. Its cumulative results of operations decreased $18.5 million during the fiscal year.

- **Bureau of the Public Debt** (BPD) – borrows the money needed to operate the federal government, accounts for the resulting debt, and provides reimbursable support services to federal agencies. BPD administers the public debt by issuing and servicing U.S. Treasury marketable, savings, and special-purpose securities. The total debt held by the public is approximately $4.8 trillion. This amount includes all federal debt held by individuals, corporations, state and local governments, foreign governments, and other entities outside of the U.S. government less agency securities. BPD is also responsible for $3.7 trillion of intragovernmental debt holdings. The total interest expense on the debt outstanding for fiscal years 2005 and 2006 is approximately $354 billion and $403 billion, respectively.

- **Financial Crimes Enforcement Network** (FinCEN) – administers the Bank Secrecy Act (BSA); supports law enforcement, intelligence, and regulatory agencies in the sharing and analysis of financial intelligence; and builds global cooperation with financial intelligence units of other countries. To administer the BSA, FinCEN issues regulations, regulatory rulings, and interpretive guidance to regulators examining financial institutions for BSA compliance, and when necessary, takes enforcement action against entities violating the statute.

[1] In 1998, through the Internal Revenue Service Restructuring and Reform Act of 1998, Congress established the Treasury Inspector General for Tax Administration, which exercises authority for the IRS under the IG Act.

FinCEN supports federal, state, and local law enforcement by facilitating information sharing, providing access to BSA data, and producing analytical products. In its global role, FinCEN is the U.S. Financial Intelligence Unit (FIU) representative and coordinates its efforts with FIUs throughout the world.

- **Financial Management Service** (FMS) – provides central payment services for all executive branch agencies; operates the federal government's collections and deposit systems; provides government-wide accounting and accounting services, including preparation of the Financial Report of the United States Government (the consolidated financial statements for the preceding fiscal year that cover the executive branch, as well as parts of the legislative and judicial branches); and manages the collection of delinquent debt owed the government. FMS collected approximately $2.9 trillion in receipts for fiscal year 2006. Total cash outlays for federal government obligations for fiscal year 2006 were approximately $2.7 trillion.

- **U.S. Mint** (Mint) – produces circulating coinage for use by the general population; produces and sells commemorative, numismatic, and investment products; and protects the federal government's precious metals and other monetary assets that are held in the custody of the Mint. During fiscal year 2005, the Mint transferred $775 million to the Treasury General Fund. During calendar year 2005, the Mint manufactured 15.3 billion coins for the Federal Reserve System. The Mint also maintains physical custody and protection of the nation's $100 billion of U.S. gold and silver assets.

- **Office of the Comptroller of the Currency** (OCC) – charters, regulates, and supervises national banks to ensure a safe, sound, and competitive banking system. As of September 2005, there were 1,934 national banks and 52 federal branches with totaling assets of more than $5.6 trillion.

- **Office of Thrift Supervision** (OTS) – charters, regulates, and examines federal thrift institutions to ensure their safety and soundness. As of September 2005, OTS oversaw more than 8,800 thrifts with assets totaling approximately $1.46 trillion.

In addition to the above bureaus, other offices and programs under our jurisdiction include the following:

- **Departmental Offices** (DO) – formulates policy and manages Treasury operations.

- **Office of Terrorism and Financial Intelligence** (TFI) – develops, organizes, and implements U.S. government strategies to combat terrorist financing and financial crime, both internationally and domestically. Reporting to TFI are **FinCEN**, the **Office of Foreign Assets Control** (OFAC), and the **Treasury Executive Office for Asset Forfeiture** (TEOAF). OFAC administers and enforces economic and trade sanctions based on U.S. foreign policy and national security goals against targeted foreign countries, terrorists, international narcotics traffickers, and those engaged in activities related to the proliferation of weapons of mass destruction. TEOAF manages the **Treasury Forfeiture Fund** which supports Treasury's national asset forfeiture program in a manner that results in federal law enforcement's continued effective use of asset forfeiture as a law enforcement sanction to punish and deter criminal activity.

- **Office of International Affairs** (OIA)—advises and assists in the formulation and execution of U.S. international economic and financial policy, including the development of policies with respect to international financial, economic, monetary, trade, investment, bilateral aid, environment, debt, development, and energy programs, including U.S. participation in international financial institutions.

- **Exchange Stabilization Fund** (ESF) – through the Secretary of the Treasury, deals in gold and foreign exchange and other instruments of credit and securities as deemed necessary, consistent with U.S. obligations in the International Monetary Fund, regarding orderly exchange arrangements and a stable system of exchange rates.

- **Community Development Financial Institutions (CDFI) Fund** – provides equity investments, grants, loans, and technical assistance to new and existing community development financial institutions; provides grants to insured depository institutions to facilitate investment in CDFI and increase community lending activities; and administers the New Markets Tax Credit Program by providing allocations of tax credits to Community Development Entities (CDE), which in turn provide the tax credits to entities that invest in the CDE.

- **Treasury Working Capital Fund** (WCF) – established as a revolving fund, provides centralized administrative services to be used by more than one bureau or agency. The WCF is financed by advance payments and reimbursements from user bureaus, agencies, and activities to cover the cost of operations.

- **Federal Financing Bank** (FFB) – provides federal and federally-assisted borrowing, primarily to finance direct agency activities such as the construction of federal buildings by the General Services Administration and meeting the financing requirements of the U.S. Postal Service, and ensures the coordination of such borrowing from the public in a manner least disruptive to private financial markets and institutions.

- **Treasury Franchise Fund** – operated as an entrepreneurial government enterprise, provides common administrative support services on a competitive and fully cost-reimbursable basis. The four service components are human resources, procurement, accounting, and travel. The desired result is to have internal administrative services delivered in the most effective and least costly manner. The Fund's services and products are offered on a voluntary and competitive basis to promote greater economy (reduced costs), increase productivity and efficiency in the use of resources, and ensure compliance with applicable laws and regulations. For fiscal year 2007, service activities are expected to have spending authority of more than $900 million.

- **Office of D.C. Pensions** – makes federal benefit payments associated with the District of Columbia retirement programs for police officers, firefighters, teachers, and judges.

- **Air Transportation Stabilization Board** – issues federal credit instruments (loan guarantees) to assist air carriers that suffered losses as a result of the terrorist attacks on September 11, 2001.

Established in one department, these entities have broad and complex responsibilities to promote prosperous and stable U.S. and world economies; preserve the integrity of financial systems; manage the government's finances effectively; and manage Treasury resources efficiently to accomplish the mission and provide high quality customer service.

Organizational Structure and Fiscal Resources

As previously stated, the Inspector General heads the OIG. Serving with the Inspector General in the immediate office is the Deputy Inspector General. The Deputy Inspector General shares responsibility for the leadership of the OIG workforce and management of the OIG's resources.

Overview

The OIG has four components which are headquartered in Washington, D.C.:

- Office of Audit
- Office of Investigations
- Office of Counsel
- Office of Management

The Department of the Treasury Appropriations Act, 2006, funded OIG at $17 million for fiscal year 2006.

OIG Performance Measures

OIG established performance measures for the Office of Audit and the Office of Investigations, as discussed below.

Office of Audit
Program Performance Measures

For the Office of Audit, we established the following performance and audit workload measures:

<u>Audit Performance Measure 1</u> – *During fiscal year 2007, it is our goal to complete 56 audits and evaluations.*

The purposes of audits and evaluations are to (1) promote economy, efficiency, and effectiveness of Treasury programs and operations; (2) prevent and detect fraud, waste, and abuse in those programs and operations; and (3) keep the Secretary of the Treasury and the Congress fully informed. Audits and evaluations are also a key element in fulfilling the government's duty to be accountable to the public. Our audits and evaluations result in written products that are sequentially numbered and provide the basis for reporting under this performance measure.

<u>Audit Performance Measure 2</u> - *During fiscal year 2007, it is our goal to complete 100 percent of audits required by statute by the required date.*

Underlying legislation mandating certain audit work generally prescribes, or authorizes the Office of Management and Budget (OMB) to prescribe, the required completion date for recurring audits, such as those for annual audited financial statements. For other types of mandated audit work, such as a material loss review (MLR) of a failed financial institution, the legislation generally prescribes a timeframe to issue a report

(6 months for an MLR, as an example) from the date of an event that triggers the audit. The date an audit report is issued establishes whether the audit was completed by the required date. For nonrecurring audits, such as MLRs, the report will state the date of the event that triggered the audit, and the date the report was issued establishes whether the audit was completed by the required date.

Audit Workload Measure - *Monetary Benefits Identified*.

Our audits and evaluations may identify *questioned costs* or *make recommendations that funds be put to better use or that action be taken to generate revenue enhancements*. The term *questioned cost* means a cost that is questioned by our office because of (1) an alleged violation of a provision of a law, regulation, contract, grant, cooperative agreement, or other agreement or document governing the expenditure of funds; (2) a finding that, at the time of the audit, such cost is not supported by adequate documentation; or (3) a finding that the expenditure of funds for the intended purpose is unnecessary or unreasonable. The term *recommendation that funds be put to better use* means a recommendation by our office that funds could be used more efficiently if management of an entity took actions to implement and complete the recommendation, including: (1) reductions in outlays; (2) deobligation of funds from programs or operations; (3) withdrawal of interest subsidy costs on loans or loan guarantees, insurance, or bonds; (4) costs not incurred by implementing recommended improvements related to the operations of the entity, a contractor, or a grantee; (5) avoidance of unnecessary expenditures noted in pre-award reviews of contract or grant agreements; or (6) any other savings that are specifically identified. The term *revenue enhancements* means an action recommended by our office that would, if implemented, increase the General Fund receipts of the federal government. Our audit and evaluation reports include, where appropriate, a schedule of monetary benefits identified, which provides the basis for reporting the workload measure.

Office of Investigations
Program Performance Measure

For the Office of Investigations, we established the following program performance measure:

Investigative Performance Measure - *Investigations referred for criminal prosecution, civil litigation, or corrective administrative action.*

Our goal for referrals of investigations for ***criminal prosecution*** is within 1 year of case initiation. Our goal for referrals of investigations for ***civil litigation*** is within 1 year of case initiation (or within 120 calendar days of judicial clearance to proceed when criminal prosecution precludes a parallel civil proceeding). Our goal for referrals of

conduct matters for administrative ***disciplinary*** action is within 120 calendar days of prosecutorial or judicial clearance. Examples of such disciplinary actions include: (1) suspension of access to national security information, (2) suspension of security clearance, and (3) revocation of security clearance upon termination of the employee or contractor upon conviction or entering a guilty plea. Our goal for referrals of ***conduct*** matters for administrative ***suspension*** and/or ***debarment*** action is within 20 work days (30 calendar days) of prosecutorial or judicial clearance. Examples of such actions include: (1) suspension of a contractor or individual upon return of an indictment or information filing; and/or (2) permanent debarment of a contractor or individual at the time of conviction or upon entering a guilty plea.

Our office also issues Management Implication Reports on a suspected or identified ***weakness*** or ***vulnerability*** identified during an investigation requiring administrative action to correct and/or improve the economy, efficiency, and effectiveness of Treasury programs and operations.

OIG Component Organizations and Fiscal Year 2007 Initiatives

This section describes the functions, organizational structures, priorities, and fiscal year 2007 initiatives for the four components of OIG.

Office of Audit

The Assistant Inspector General for Audit (AIGA) is responsible for supervising auditing activities relating to Treasury programs and operations.

The Office of Audit conducts or oversees the conduct of performance, financial, information technology (IT), and contract audits as well as evaluations. The purpose of these audits and evaluations is to improve the quality, reduce the cost, and increase the integrity of Treasury's programs and operations. The work of the Office is performed in compliance with the standards and guidelines established by the Comptroller General of the United States and the President's Council on Integrity and Efficiency (PCIE).

Organizational Structure The AIGA has two deputies—one for Performance Audits and the other for Financial Management and Information Technology Audits. In addition, the AIGA's immediate office includes staff responsible for policy, planning, and quality assurance. These offices are located in Washington, D.C. The Office of Audit also has a field office located in Boston, MA.

In addition to its authorized staffing, the Office of Audit uses independent public accounting (IPA) firms under contract to perform the Treasury consolidated financial statement audit and a substantial portion of the financial statement audits of Treasury bureaus and other activities required pursuant to the Chief Financial Officer (CFO) Act, the Government Management Reform Act (GMRA), and other statutes. The Office also uses a contracted IPA to perform the required annual independent evaluation of the Department's information security program and practices for its unclassified systems.

Performance Audit

Under the management and direction of the Deputy Assistant Inspector General for Performance Audit are four Directors of Audit. The Directors of Audit are responsible for performance audits conducted by their staff in Washington, D.C., and Boston, as well as for coordinating audit planning for their assigned functional areas to ensure that audits of highest priority are included in the annual plan. The functional areas of the Directors are described below:

Director, Banking Audit, provides leadership for performance audits of OCC, OTS, and other banking-related Treasury components.

Director, Fiscal Service Audit, provides leadership for performance audits of FMS, BPD, CDFI Fund, and OIA. The Director is also responsible for managing OIG's responsibilities under the Single Audit Act.

Director, Departmental Offices/Manufacturing/Procurement Audit, provides leadership for performance audits of Treasury's Departmental Offices, BEP, and the Mint, as well as for performance audits of procurement activities in all Treasury bureaus and offices. The Director is also responsible for managing OIG's contract audit function.

Director, Revenue/Terrorist Financing and Money Laundering Audit, provides leadership for performance audits of the operations in all Treasury bureaus, with a concentration of work in TTB, TFI, FinCEN, OFAC, and TEOAF.

Financial Management and Information Technology Audit

Under the management and direction of the Deputy Assistant Inspector General for Financial Management and Information Technology Audit are two Directors of Audit. The Directors are responsible for audits performed by Washington, D.C., staff and for oversight of work performed by contracted IPA firms. Also, they are responsible for planning the audits in their assigned functional areas to ensure that audits of highest priority are included in the annual plan. The functional areas addressed by each Director are described below:

Director, Consolidated Financial Audit, is responsible for performing or providing oversight of contractors performing the annual audit of the Department's consolidated financial statements pursuant to the CFO Act and GMRA, and for performing or overseeing contractors performing audits of other components or activities that are material to Treasury or are required to be audited by other statutes. The Director coordinates with the U.S. Government Accountability Office (GAO) with respect to its audits of IRS and BPD's Schedule of Federal Debt, as the amounts from IRS and BPD's Schedule of Federal Debt are included in the Department's consolidated financial statements.

Director, Information Technology Audit, conducts or oversees contractors conducting reviews of the acquisition, use, and disposal of complex computer and other information technology systems. The Director is also responsible for the overall management of information technology as a capital and managerial asset of the Department. The reviews are performed to ensure that the systems are effective, efficient, productive, and economical; contain adequate safeguards to protect data integrity and data processing; consistently support Treasury needs; and are developed and operated in accordance with all applicable policies, standards, and procedures.

OIG COMPONENT ORGANIZATIONS AND FISCAL YEAR 2007 INITIATIVES

Fiscal Year 2007 Planning Approach This plan reflects our effort to provide appropriate audit and evaluation coverage to Treasury and its bureaus given our available resources. In formulating the plan, we also considered (a) observations and suggestions by our managers, auditors, evaluators, and investigators; (b) the Administration's fiscal year 2007 budget priorities for Treasury; and (c) recent Congressional activity, testimony by Treasury officials, and remarks by Treasury, OMB, and Congressional officials and staff indicating significant areas of interest.

Key features of this plan include the following:

- *Department-wide Perspective* The plan emphasizes the issues of greatest significance to the Department rather than to individual bureaus.

- *Customer and Stakeholder Participation* We provided a draft plan to Treasury officials for comment. The Directors and their staffs met with Department and bureau officials and staff throughout the year to solicit audit suggestions. We also solicited input from other interested staff with OMB, various Congressional committees, and GAO.

- *Responsiveness to Changing Priorities and Needs* The plan will be subject to revision throughout the year to accommodate new legislative requirements, changing bureau missions, and unforeseeable events or high-priority requests for our audit services.

- *Continuity* The plan is a dynamic document that will be updated and continued beyond fiscal year 2007.

Audit Priorities for Fiscal Year 2007

Priority 1 - Audit products mandated by law

Our office must allocate significant resources to meet legislative requirements related to (1) audited financial statements and financial-related review work; (2) information security; (3) in certain instances, failed financial institutions; and (4) Treasury Franchise Fund procurement activities on behalf of the Department of Defense.

Priority 2 - Audit products that support the President's Management Agenda

The President's Management Agenda (PMA) parallels our mission of improving the economy, effectiveness, and efficiency of the Department's programs and operations. Accordingly, for fiscal year 2007, we have included audits to assess the Department's progress in addressing the PMA's five government-wide initiatives (*Strategic Management of Human Capital, Competitive Sourcing, Improved Financial Performance, Expanded Electronic Government, and Budget and Performance Integration*) and one program initiative affecting Treasury (*Eliminating Improper Payments*).

Priority 3 – Audit products that address known serious deficiencies and emerging risks in the Department's programs and operations

We will undertake audits during fiscal year 2007 to assess the Department's progress in addressing serious deficiencies and emerging risks. Principal areas of our continued focus will be IT security and Terrorist Financing/Money Laundering. A significant body of work is planned in these areas.

<u>Relationship of Audit Plan to Treasury Strategic Plan</u> The mission of the Department of the Treasury, as stated in its strategic plan for fiscal years 2003-2008, is to promote the conditions for prosperity and stability in the United States and encourage prosperity and stability in the rest of the world. To accomplish this mission, the Department identified five strategic goals. As part of our audit planning process, we identified seven core "issue areas" that address one or several of Treasury's strategic goals. The table below shows the link between specific Treasury strategic goals and OIG issue areas:

Treasury Strategic Goal	OIG Issue Area
Promote prosperous U.S. and world economies	• Domestic and International Assistance Programs
Promote stable U.S. and world economies	• Bill and Coin Manufacturing, Marketing, and Distribution Operations
Preserve the integrity of financial systems	• Terrorist Financing, Money Laundering, and Foreign Assets Control • Safety, Soundness, and Accessibility of Financial Services
Manage the U.S. government's finances effectively	• Government-wide Financial Services and Debt Management • Revenue Collection and Industry Regulation
Ensure professionalism, excellence, integrity, and accountability in the management and conduct of Treasury	• Treasury General Management and Infrastructure Support (Financial Management, Information Systems Security, and General Management)

The Treasury General Management and Infrastructure Support issue area cuts across all five of the Department's strategic goals. It encompasses such activities as financial management, IT security, major systems and other capital investments, human capital, initiatives to identify and reduce improper payments, and procurement.

Audit Initiatives for Fiscal Year 2007 Through our planning process, we identified 41 projects that we will initiate during fiscal year 2007. We will also complete work on 13 projects started during fiscal year 2006. Additionally, we identified 82 high-priority projects that must be deferred to a future year because our resources do not permit them to be undertaken in fiscal year 2007. Our in-process and planned work and projects for future consideration are described in more detail in the *OIG Issue Areas and Planned Projects* section of this document.

Office of Investigations

The Assistant Inspector General for Investigations (AIGI) is the Treasury Inspector General's senior law enforcement official responsible for the overall investigative and oversight activities of the OIG relating to the programs and operations of the Department of the Treasury, except for those of IRS.

Organizational Structure The AIGI is supported by a Deputy Assistant Inspector General for Investigations who manages two divisions—the Investigations Division and the Operations Division. At present, the office responds to all allegations of fraud and other crimes from our office in Washington, D.C.

The Role of Investigations The Office of Investigation's (OI) role within the OIG is to conduct and provide oversight of investigations relating to programs and operations of the Department and its bureaus. OI is responsible for the prevention, detection, and investigation of fraud, waste, and abuse in Treasury programs and operations.

Types of investigations conducted by OI include allegations of serious employee misconduct, procurement fraud, and other criminal acts perpetrated by Treasury employees and/or external parties. OI receives and investigates complaints or information from employees, contractors, members of the public, GAO, and Congress alleging criminal or other misconduct constituting a violation of laws, rules, or regulations.

OI performs both ***reactive*** and ***proactive*** work. The majority of the work involves responding to and mitigating ongoing criminal activity by conducting, supervising, or otherwise overseeing investigations involving fraud and other crimes. Proactively, OI exercises a law enforcement or criminal investigative-oriented leadership role designed to engage and support Treasury's bureaus and offices. As a team, our collective objective is to ***prevent or deter*** and ***detect or identify*** activities that range from improper to illegal conduct. Together, our collective efforts ensure that the Secretary and Congress are kept fully and currently informed.

OIG COMPONENT ORGANIZATIONS AND FISCAL YEAR 2007 INITIATIVES

In accordance with the IG Act, the Treasury OIG's ***primary*** responsibility is to counter wasteful and abusive practices. However, the IG Act also empowered the IG community with the responsibility to combat fraud. As such, the Treasury OIG has ***concurrent*** responsibility with the Federal Bureau of Investigation (FBI) to combat ***fraud and other crimes*** that occur within or are directed against the Department's programs and operations. Therefore, a significant amount of our work has the potential to be investigated jointly with the FBI and other federal law enforcement partners—often as part of a task force working in close cooperation with the U.S. Department of Justice (DOJ).

Because the IG community is responsible for investigative oversight of the ***programs and operations*** of their departments or agencies, we investigate ***fraud and other crimes*** that occur within and are directed against government programs and operations. Such crime often involves perpetrators who are either on the inside (government employees or contractors) or on the outside (the regulated community, external parties, and the public at large) acting alone or in collusion with another to obtain access to inside information or resources.

Cyber Investigative Branch In today's society, there is no crime that cannot be facilitated or committed through the use of technology. As such, even with the best state of the art equipment and personnel, criminals exploit the very same technology to commit crime. To this end, the Treasury OIG's Cyber Investigative Branch has been involved in over 40 cases in fiscal year 2006. Effectively, every case that the OI has been involved in over the past year, and unavoidably in the years to come, will have a cyber nexus. Therefore, recruiting, acquiring, training and retaining the 'best and brightest' cyber personnel will be necessary as we continue to fulfill both the PMA and the Department's strategic and annual planning goals.

Investigative Priorities for Fiscal Year 2007

We are committed to developing a vigorous, comprehensive, and capable investigative program. With this in mind, we established the following four overarching investigative priorities for 2007 which are intended to detect and prevent fraud and other crimes against the Department's programs and operations.

Priority 1 – Criminal and serious employee misconduct

Investigating complaints involving alleged criminal and other serious misconduct by employees of the Department is our highest investigative priority. OI investigates allegations of the general crimes enumerated in Title 18 of the United States Code, other federal crimes, alleged violations of the Ethics in Government Act, and allegations of serious misconduct prohibited by the Standards of Ethical Conduct for Employees of the Executive Branch. In addition, several bureaus and offices of the Department have additional rules and regulations relating to ethical standards for their own employees. OI also investigates complaints of alleged violations of these rules and regulations.

OI produces investigative reports that refer criminal and other serious employee misconduct matters to DOJ for criminal prosecution, civil litigation, or upon declination, to the Department's legal and personnel professionals for administrative adjudication. Their actions range from verbal counseling to letters of reprimand, suspension, demotion, and removal.

As an on-going fiscal year 2007 joint audit/investigative initiative, the OIG is reviewing the Department's management of claims under the Federal Employee's Compensation Act. This initiative is described on page 42. The Office of Investigations is also planning to: (1) conduct Outreach presentations to Treasury employees and other lawful users of BSA data (as described on page 55); and (2) jointly review, with the Office of Audit, the Mint's controls over its inventory of raw materials and finished products (as described on page 82).

Priority 2 – Fraud Involving Contracts, Grants, Guarantees, and Funds

We conduct investigations into allegations of fraud and other crimes involving Treasury contracts, grants, loan guarantees, and federal funds. Such allegations often involve contractors who are providing or seeking to provide goods or services to the Department. Complaints are received from employees, contractors, members of the public, and Congress alleging criminal or other misconduct constituting a violation of laws, rules, or regulations.

OIG has planned, as a joint audit/investigative initiative, a review of CDFI Fund post-award grant activities. This initiative is described on page 87.

Priority 3 – Financial Programs and Operations Crime

We also conduct and supervise a wide variety of investigations relating to the financial programs and operations of the Department. These programs and operations involve issuing licenses, providing benefits, and exercising oversight of U.S. financial institutions. Such investigations are usually conducted jointly with the U.S. Secret Service, Federal Deposit Insurance Corporation (FDIC) OIG, FBI, and DOJ.

As part of this priority, the Office of Investigations has undertaken an initiative with a number of other OIGs to identify improper benefit payments made by Treasury. This initiative is described on page 64.

Priority 4 – Critical Infrastructure and Fiscal Protection

Treasury has an important role in securing the homeland's financial sector. Our efforts in this area focus on detecting, investigating, and deterring electronic crimes and addressing threats to the Department's critical infrastructure.

As part of our priority work in this area, the Office of Investigations has created an initiative designed to leverage the Department's distributed computing capability to counter encryption software in furtherance of OIG's investigative mission. This project is described on page 34.

Relationship of Investigative Priorities to the Department's Top Priorities

OIG's four overarching investigative priorities are intended to detect and prevent fraud and other crimes against the Department's programs and operations. The following chart identifies the Secretary of the Treasury's top policy priorities for fiscal year 2006 and provides a crosswalk to our investigative priorities to demonstrate the relationship between the investigative and policy priorities.

Secretary's Fiscal Year 2006 Strategic Goals	OIG Investigative Priorities			
	Criminal and Serious Employee Misconduct	Fraud Involving Contracts, Grants, Guarantees, and Funds	Financial Programs and Operations Crimes	Critical Infrastructure and Fiscal Protection
Promote prosperous U.S. and world economies		√	√	
Promote stable U.S. and world economies		√	√	
Preserve the integrity of financial systems		√	√	√
Measure the U.S. government's finances effectively				√
Ensure professionalism, excellence, integrity, and accountability in the management and conduct of the Department of the Treasury	√	√		

Investigative Products

The following table depicts the OIG product and service line, or tools, that we use to address the investigative priorities and initiatives.

Product/Service	Definition	Remedy Support		
		Criminal	Civil	Administrative
Investigation	An investigation or inquiry conducted under the cognizant criminal, civil, or administrative standards.	√	√	√
Management Implication Report	A report identifying policy or systemic deficiencies, vulnerabilities, and conditions that leave a program or office susceptible to fraud and is issued as a byproduct to an investigation when warranted.		√	√
Quality assurance review	A review or spot check intended to assess compliance with laws, rules and regulations, and policy.		√	√
Awareness briefing	A presentation to employees and contractors that provides an understanding of ethical conduct and red flags of misconduct			√

Communication

The Office of Investigations continues to enhance and promote the OIG Hotline program as a mechanism that employees, contractors, and the general public can use to report instances of waste, fraud, and abuse relating to Treasury's programs and operations. The OIG Web site offers individuals the opportunity to forward complaints and allegations directly to OIG's Hotline (http://www.ustreas.gov/inspector-general/hotline.shtml).

Office of Counsel

The Counsel to the Inspector General serves as the senior legal and policy adviser to the Inspector General, Deputy Inspector General, and the Assistant Inspectors General. The Counsel has responsibility for all legal work in OIG.

The Role of the Office of Counsel The Office of Counsel provides legal advice on issues arising during the statutorily mandated investigative, oversight, and audit activities conducted by the Offices of Audit and Investigations. In addition, the Office of Counsel provides legal advice on issues concerning government contracts, appropriations, budget formulation and execution, disclosure, records retention, tax information safeguards, equal employment opportunity, and personnel law. The Office represents OIG in administrative proceedings before the Merit Systems Protection Board (MSPB) and the Equal Employment Opportunity Commission (EEOC).

The Office manages the OIG ethics program, which includes financial disclosure, training, and advice on the governing law and regulations. In the area of disclosure law, the Office of Counsel manages OIG's Freedom of Information Act (FOIA) and Privacy Act programs. The Office of Counsel also coordinates document requests from Congress and from litigation, as well as responding to Giglio[2] requests from the Department of Justice for information on Treasury personnel.

Counsel Initiatives for Fiscal Year 2007 The Office of Counsel will support OIG investigative, oversight, and audit activities by responding to requests for legal advice, and through reviewing and processing requests for the issuance of Inspector General subpoenas. In the area of disclosure, the Office of Counsel will focus resources to provide timely responses to FOIA and Privacy Act requests, and to carry out its litigation responsibilities in MSPB and EEOC cases. Based upon past experience, the Office of Counsel expects to process 40 initial FOIA/Privacy Act requests and four appeals from those initial responses. In the area of electronic FOIA, the Office of Counsel expects to review approximately 50 audit, evaluation, and oversight reports for posting on the OIG web site. The Office of Counsel will review the Privacy Act systems of records notices for both OIG's investigative and administrative records systems, with a view to possible revision, and will provide procedural review and training services as the OIG Senior Agency Official for Privacy. The Office will coordinate with the Department in updating the Treasury Order and Directives that establish and define OIG's authority, responsibility, and organization. Finally, the Office of Counsel will respond to Giglio requests, coordinate responses to document requests from Congress, and respond to discovery requests arising from litigation involving the Department and its bureaus. The Office of Counsel will provide training on the IG Act and other subjects in connection with new employee orientation and in-service training. The Office will obtain necessary training in order to provide advice in emerging areas of OIG responsibility. As statutorily mandated, the Office will review legislative and regulatory proposals and, where appropriate, will coordinate comments.

Office of Management

The Office of Management coordinates resources and policy activities that support the OIG mission. Resources and policy activities include the following functions: administrative

[2] Giglio v. United States, 405 U.S. 150 (1972), requires the government to provide potential impeachment evidence to criminal defendants about government employees who may testify at their trials. Such evidence generally includes specific instances of proven misconduct, evidence of reputation for credibility, prior inconsistent statements, and evidence suggesting bias.

services, budget and finance, human resources, information technology, general policies and procedures, and liaison to PCIE and other organizations.

Organizational Structure The Administrative Services function coordinates internal and external services relating to the acquisition, maintenance, and disposition of all OIG material assets. This includes the procurement of goods and services and all logistics support, auditor and investigator travel, credentials and official identification issuance, records management and disposal, facilities management, issuance of OIG-wide policy, health and safety, and physical and information security at all OIG offices.

The Budget and Finance function synchronizes the formulation, coordination and presentation, and execution of OIG integrated financial and performance plans and financial management services to OIG. This comprises the development, justification, and presentation of future-year budget requests to the Department, OMB, and Congress. Through budget execution, OIG determines annual funding allocations, tracks and analyzes spending patterns, processes financial documents, and reports on the use of resources.

The Human Resources function manages a complete range of internal and external personnel and payroll services to OIG employees. These services include recruitment and staffing; position classification and management; employee relations and performance management; training, awards, and recognition; employee development; benefits; personnel actions processing; and payroll processing.

The Information Technology function develops and maintains OIG automated data and integrated voice systems. This includes ensuring electronic infrastructure sufficiency and the proper installation, support, maintenance, and management of hardware, software, and voice and data telecommunications.

Management Initiatives for Fiscal Year 2007 The Office of Management will continue to identify operational efficiencies to improve management support, while identifying opportunities to reduce costs. It will continue to enable OIG to maintain its independence from Treasury programs and policies, while continuing to provide OIG offices with required administrative support.

Specifically, for the Administrative Services function, OIG has a working agreement with the BPD Administrative Resources Center (ARC) for procurement, travel, and permanent change-of-station services on an annual and individual service basis. Additionally, the Administrative Services function continues to coordinate efforts for the published policy directives issuance using plain language, to-the-point style, photos, and graphics and to conduct an annual physical inventory of certain property.

For the Budget and Finance function, OIG has a working agreement with ARC for budget execution and accounting services. The function oversees the use of the Oracle financial system for OIG, which increases the timeliness of financial information and provides for reconciling transactions more efficiently and effectively.

For the Human Resources function, OIG has a working agreement with ARC for a portion of its staffing and classification servicing. OIG and ARC use CareerConnector, the Department's automated recruitment system, which facilitates the hiring of employees within 30 days after closing of vacancy announcements. Additionally, ARC processes OIG payroll and routine personnel actions; and provides benefits and performance management services.

For the Information Technology function, OIG has streamlined operations. Efforts continue to support the implementation of new management information systems; improve the implementation and quality of mobile communications; and ensure that automated systems are fully maintained, up-to-date, operational, and secure at all times.

Introduction

This section provides general background information on our overall assessment of significant management challenges facing the Department and a summary of progress in meeting certain Administration initiatives. Following this background are brief descriptions of each OIG issue area, including (1) a description of significant risks to Treasury programs and operations, (2) in-progress audit and investigative projects and new projects to be started during fiscal year 2007, and (3) projects that have been identified through our planning process but will not be undertaken this fiscal year. Our discussion of risks is based principally on (1) prior audit and investigative work, (2) the initiation of new programs or operations, and/or (3) increased funding initiatives in mature programs or operations.

Management Challenges

In accordance with the Reports Consolidation Act of 2000, the IG annually provides the Secretary of the Treasury with OIG's perspective on the most serious management and performance challenges facing the Department. Among other things, the Secretary must include these challenges in the Department's annual Performance and Accountability Report. In October 2005, the IG reported five challenges to former Secretary Snow that we believe seriously impeded the Department's ability to conduct its program responsibilities and ensure the integrity of its operations. These challenges are (1) Corporate Management, (2) Management of Capital Investments, (3) Information Security, (4) Linking Resources to Results, and (5) Anti-Money Laundering and Terrorist Financing/Bank Secrecy Act Enforcement. In a memorandum dated October 16, 2006, the IG reported to Secretary Paulson that while some progress on each of these five challenges has been made, they continue to represent significant risks to the Department.

The five management and performance challenges are summarized below:

- <u>Corporate Management</u> This is an overarching management challenge. Treasury needs to provide effective corporate leadership in order to resolve serious bureau and program office deficiencies that adversely affect the performance of Treasury as a whole. In particular, Treasury needs to assert strong leadership and supervision over IRS to resolve the longstanding material weaknesses and system deficiencies that hamper the timely and reliable information necessary to effectively manage IRS operations. In addition, while progress has been made, the Department has not fully implemented a corporate-level control structure to ensure that capital investments are properly managed, information about government operations and citizens is adequately secured, and financial resources used by Treasury can be linked to its operational results. The increasing emphasis on agencywide accountability envisioned in the management reform legislation of the past decade and the

President's Management Agenda, has underscored the need for effective corporate management at Treasury. With nine bureaus and many program offices, Treasury is a highly decentralized organization. As such, Treasury management should ensure consistency, cohesiveness, and economy among all bureaus and program offices in achieving Treasury's goals and objectives.

This past year, we noted that the Department's senior leadership has asserted more direct and substantive involvement in developing and implementing Treasury-wide polices and initiatives across a number of fronts. Also, the Deputy Secretary recently issued a memorandum requiring that internal control programs (programs to ensure accountability and promote effective management and stewardship) be included in all fiscal year 2007 senior leadership performance plans. In the future, this type of direct involvement by senior leadership needs to be maintained so that progress continues.

- Management of Capital Investments Treasury needs to better manage large acquisitions of mission-critical systems and other capital investments. In the past, serious problems have been identified with the Treasury Communications Enterprise (TCE) procurement, Treasury's HR Connect system, and the Treasury and Annex Repair and Restoration project. This year, we note continuing issues with TCE and new problems have been brought to light with BSA Direct, and the Web based Electronic Fraud Detection System (Web EFDS). Specifically, we found that the TCE procurement, estimated to cost $1 billion over its useful life, was poorly planned, executed, and documented. Treasury amended and reopened the TCE solicitation in October 2005, but has yet to award the TCE contract.[3] In July 2006, after nearly 2 years in development and $15 million spent, FinCEN terminated its contract for the storage and retrieval component of BSA Direct after significant concerns were raised about schedule delays and project management. IRS had similar problems with Web EFDS, a system costing more than $20 million that was intended to prevent fraudulent refunds. In April 2006, after a significant delay, IRS stopped all development activities for Web EFDS. IRS also was unable to use EFDS to prevent fraudulent refunds during processing year 2006. The Treasury Inspector General for Tax Administration (TIGTA) reported that without Web EFDS, more than $300 million in fraudulent refunds may have been allowed.

The Deputy Secretary recently emphasized the need to better manage information technology capital investments to the heads of Treasury bureaus, noting that this is a responsibility of all senior management and not just that of the Chief Information Officer. Involvement and accountability at the top is a critical factor to ensure the successful implementation of systems.

[3] As a subsequent event, on December 21, 2006, Treasury announced that the TCE solicitation was cancelled.

- Information Security Despite some notable accomplishments, the Department needs to improve its information security program and practices to achieve compliance with the Federal Information Security Management Act of 2002 (FISMA) and OMB requirements. In the past, we reported that Treasury's systems inventory was not accurate, complete, or consistently reported. During the past year, the Department overcame this weakness in its security program by providing direction to the bureaus in developing a Department-wide inventory of information systems. Although the Department still needs to implement additional actions to further improve the system inventory, we believe the inventory is substantially complete and generally conforms to applicable requirements. Nevertheless, we reported that information security deficiencies at Treasury, in the aggregate, constitute substantial noncompliance with FISMA. Improvements are needed in a number of areas such as certification and accreditation, tracking corrective actions, and incident response. Also, during 2006 OMB required agencies to perform specific actions to protect certain personally identifiable information. Treasury faces significant challenges to meet these requirements. In this regard, the Department needs to ensure that security controls pertaining to personally identifiable information are addressed Treasury-wide. In a July 2006 memorandum to Treasury bureaus, the Department provided implementation guidance and required bureaus to identify their specific actions taken and planned, including dates, to address weaknesses in security controls pertaining to personally identifiable information.

- Linking Resources to Results Because the Department has not fully developed and incorporated managerial cost accounting (MCA) into its business activities, the Department cannot adequately link financial resources to operating results. This inhibits comprehensive program performance reporting and meaningful cost-benefit analyses of the Department's programs and operations. MCA involves the accumulation and analysis of financial and nonfinancial data, resulting in the allocation of costs to organizational pursuits such as performance goals, programs, activities, and outputs, and should be a fundamental part of a financial/performance management system. In response to a critical Government Accountability Office report on MCA at Treasury, the Department developed a high-level MCA implementation plan. This plan focuses on (1) clarifying and reaffirming the Department's MCA policy for all bureaus; (2) identifying MCA needs across the Department; (3) ensuring that MCA needs are linked to the Department's strategic plan, budget, and performance measures; (4) identifying gaps between Department and bureau needs and existing MCA capabilities; and (5) developing plans to eliminate these gaps. However, none of the specific action items in the plan have been completed and target dates for certain actions have been missed.

- Anti-Money Laundering and Terrorist Financing/Bank Secrecy Act Enforcement
Treasury faces unique challenges in carrying out its responsibilities under the BSA and USA Patriot Act to prevent and detect money laundering and terrorist financing. To effectively prevent and detect financial crimes and terrorist financing it is necessary to have: (1) strong control environments at financial institutions that ensure that business is conducted with reputable parties, and large currency transactions and suspicious activities are properly and timely reported to Treasury; (2) strong federal and state regulatory agencies that examine and enforce the BSA and USA Patriot Act requirements at financial institutions; and (3) strong analytical capacity to identify and refer to law enforcement leads provided through reports filed by financial institutions. While FinCEN is the Treasury bureau responsible for administering BSA, it relies on other Treasury and non-Treasury agencies to enforce compliance with the act's requirements. OFAC, the Treasury office responsible for administering U.S. foreign sanction programs, also relies on other Treasury and non-Treasury agencies to ensure compliance with OFAC requirements. Past audits and Congressional hearings, however, have identified serious regulatory gaps in the detection of and/or timely enforcement action against financial institutions for BSA and related violations.

To improve compliance and address some of these gaps, Treasury created TFI through which FinCEN and OFAC now report. In addition, FinCEN, beginning in 2004, (1) created a compliance office to improve BSA oversight and coordination with financial institution regulators; and (2) entered into memoranda of understanding (MOU) with the federal banking regulators, IRS, and most states to enhance communication and coordination. Furthermore, OCC and OTS took immediate steps to improve their respective documentation of OFAC examinations. OFAC also executed MOUs with the federal banking regulators that provides for increased information sharing. While similar to the MOUs between FinCEN and the regulators, legislative impairments may ultimately limit the information shared with OFAC. For this reason and others, the effectiveness of these actions to address regulatory gaps and ultimately improve compliance is yet to be determined.

During this semiannual period, we completed audits at FinCEN, OCC, and OTS related to this management challenge, which are discussed in the next section of this report. Given the criticality of this management challenge to the Department's mission, we will continue to devote a significant portion of our audit resources on this management challenge.

Administration Initiatives

The PMA consists of five government-wide management initiatives on which each department and major agency is to be measured annually. These initiatives are:

(1) Strategic Management of Human Capital, (2) Competitive Sourcing, (3) Improved Financial Performance, (4) Expanded Electronic Government, and (5) Budget and Performance Integration. The Executive Branch Management Scorecard tracks how well these five initiatives are being executed, using a color-coded scoring system. An agency's status is given a green for success, yellow for mixed results, and red for unsatisfactory. Similarly, progress ratings are given, with green indicating implementation is proceeding as planned, yellow indicating that there is slippage in the implementation schedule, and red indicating that the initiative is in serious jeopardy. As of the fourth quarter of fiscal year 2006, Treasury's status was green for Strategic Management of Human Capital and Competitive Sourcing, yellow for Expanded Electronic Government and Budget and Performance Integration, and red for Financial Performance.

In conjunction with the Budget and Performance Integration initiative, OMB developed the **Program Assessment Rating Tool (PART)** in 2002 to assess agency programs. Fiscal year 2007 will mark the fifth year in which PART will be used to assess program performance, help link performance to budget decisions, and make recommendations to improve program results. By the end of 2006, OMB expects to complete assessments for all federal programs. To date, it has assessed about 80 percent of all Federal programs.

The following table summarizes the results of PART assessments during the fiscal years 2002 through 2005 budget cycles for Treasury programs that are subject to our oversight:

Program	Budget Year of Assessment	Rating
ATF Consumer Product Safety Activities (TTB)	2002	Adequate
Bank Enterprise Award (CDFI Fund)	2002	Results Not Demonstrated
Office of Foreign Assets Control	2002	Results Not Demonstrated
National Bank Supervision (OCC)	2002	Effective
Thrift Institution and Savings Association Supervision (OTS)	2002	Effective
U.S. Mint: Coin Production	2002	Effective
International Development Association (OIA)	2002	Adequate
Administering the Public Debt (BPD)	2003	Effective
African Development Fund (OIA)	2003	Results Not Demonstrated
FMS Debt Collection	2003	Effective
FMS Payments	2003	Effective
New Currency Manufacturing (BEP)	2003	Effective
Treasury Technical Assistance (OIA)	2003	Adequate
FMS Collections	2004	Effective
New Markets Tax Credit	2004	Adequate
Global Environment Facility (OIA)	2004	Results Not Demonstrated
Tropical Forest Conservation Act	2004	Results Not Demonstrated
CDFI Fund: Financial and Technical Assistance	2004	Adequate
ATF Collect the Revenue Program (TTB)	2005	Effective
BSA Data Collection, Retrieval and Sharing	2005	Moderately Effective
U.S. Mint: Numismatic Program	2005	Effective
U.S. Mint: Protection Program	2005	Effective

OMB announced that for 2006, the following non-IRS Treasury programs will be assessed under PART: Bank Secrecy Act Administration, Bank Secrecy Act Analysis; BEP – Protection; and FMS Government-wide Accounting.

Treasury General Management and Infrastructure Support - Financial Management

Office of Audit Contact: Michael P. Fitzgerald, Director of Audit (202) 927-5789
Office of Investigations Contact: Gerry Garren, Special Agent in Charge, Financial Crimes

Issue Area Discussion

Legislative Mandates Financial audits are required for the Department and certain component entities pursuant to various statutes and other reporting requirements. The annual audit of Treasury's financial statements is performed pursuant to the requirements of GMRA. OMB also designated IRS as a Treasury component entity required to issue stand-alone audited financial statements under GMRA. Other Treasury component entities required to have stand-alone audited financial statements are BEP, ESF, FFB, OCC, Mint, Treasury Forfeiture Fund, Office of the District of Columbia Pensions, CDFI Fund, and OTS. In addition, certain accounts and activities of BPD and FMS that are material to the Department's financial statements are audited separately. Furthermore, FinCEN's financial statements are audited as a management initiative.

The Federal Financial Management Improvement Act of 1996 (FFMIA) requires that our annual audits of Treasury's financial statements report on whether its financial management systems comply with federal financial management systems requirements, applicable federal accounting standards, and the standard general ledger at the transaction level. FFMIA also requires us to include in our semiannual reports to Congress instances when the Department has not met targets in making its accounting systems compliant with FFMIA requirements.

IPAs, GAO, and OIG perform the financial statement audits. IPAs, under OIG supervision, audit the Department's consolidated financial statements and the financial statements of component entities except for: (1) IRS's financial statements and BPD's Schedule of Federal Debt, which are audited by GAO; and (2) the Mint's Schedule of Custodial Gold and Silver Reserves, which is audited by OIG staff.

Program Responsibilities The Department has responsibility for certain recently implemented government programs. These programs may generate complex accounting and auditing issues that must be closely monitored and ultimately resolved as part of the audit of the Department-wide financial statements. Programs that will need to be reviewed as part of the audit of the fiscal year 2007 Department-wide financial statements include the following:

- Terrorism Risk Insurance Act of 2002 (P.L. 107-297) and Terrorism Risk Insurance Extension Act of 2005 (P.L. 109-144) The purpose of this program is to stabilize market disruptions due to acts of terrorism. The program provides funding for a temporary federal program that will pay 90 percent of the insured losses arising from acts of terrorism above insurers' deductibles. The program has a $100 billion cap.

In addition, the Department maintains the WCF, which was established in 1970 to provide centrally common administrative services across the Department, achieve economies or scale, and eliminate duplication of effort and redundancies. Central services in the WCF include: telecommunications, printing, duplicating, graphics, computer support/usage, personnel/payroll, automated financial management systems, training, short-term management assistance, procurement, information technology services, equal employment opportunity services, and environmental health and safety services. These services are provided on a reimbursable basis to Treasury components at rates that recover the fund's operating expenses, including accrual of annual leave and depreciation of equipment. For fiscal year 2007, new obligations of the fund are estimated at $253 million.

Known Weaknesses The Department received an unqualified audit opinion on its fiscal year 2006 consolidated financial statements. IRS continued to make progress in addressing its financial management challenges and resolved or substantially mitigated several material weaknesses and reportable conditions in its internal control. However, serious internal control, and financial management systems deficiencies still exist, and the IRS again had to rely extensively on resource-intensive compensating processes to prepare its financial statements. The IPA's audit report on the Department's fiscal year 2006 consolidated financial statements disclosed one material weakness, two other reportable conditions, and two instances of noncompliance with laws and regulations exclusive of FFMIA. The IPA also reported that the Department's financial management systems did not substantially comply with the requirements of FFMIA. The following material weakness in internal control and other reportable conditions at the Department-wide level were identified in the audit report:

Material Weakness

- Financial management practices at the IRS (repeat condition)

Reportable Conditions

- Electronic data processing controls and information security programs over financial systems (repeat condition)
- Controls over transactions and balances related to the international assistance programs

Reportable Instances of Noncompliance With Laws and Regulations Exclusive of FFMIA

- Noncompliance with Internal Revenue Code Section 6325 related to untimely release of federal tax liens
- Noncompliance with the Federal Information Security Management Act of 2002

In addition, the IPA reported that two possible instances of Anti-Deficiency Act violations related to transactions and activities of the Treasury Franchise Fund and Departmental Offices were under review by the Department's General Counsel and management.

In Progress and Planned Fiscal Year 2007 Projects

Audits of Financial Statements for the Department and Financial Statements or Schedules for Component Entities and Activities (In Progress)

Audit Objective To determine whether the financial statements and schedules are fairly presented in all material respects. The audits will also report on internal control, compliance with laws and regulations, and compliance with FFMIA. During fiscal year 2007, we will complete audit work for the fiscal year 2006 financial statements and schedules. We will also begin audit work for the fiscal year 2007 financial statements and schedules. We anticipate that these projects will require 8,300 hours by OIG staff during the fiscal year. (PMA Initiative Supported: Improved Financial Performance)

Treasury's Working Capital Fund (In Progress)

Audit Objective To determine if the costs that the Department's WCF charges to the bureaus are consistent with the costs the WCF incurs for projects it performs on their behalf. Specifically, we plan to review: (1) the existence, timeliness, and consistency of reconciliations between the actual costs incurred by the WCF and costs billed to bureaus; (2) whether costs charged by the WCF are appropriate; (3) whether costs charged by the WCF to specific bureaus are supported by appropriate documentation; and (4) the reasonableness of assumptions, data, processes, or models used by the WCF to estimate its annual costs. This project is a joint effort with TIGTA and we anticipate that it will require 3,600 hours to complete in fiscal year 2007. (PMA Initiative Supported: Improved Financial Performance)

Treasury General Management and Infrastructure Support - Information Systems Security

Office of Audit Contact: Louis C. King, Director of Audit (202) 927-5774
Office of Investigations Contact: Alfred H. Lewis, Team Leader, Cyber Division, (202) 927-5356

Issue Area Discussion

Threats to Treasury's information systems include terrorists, criminals, and computer hackers. Such external threats are likely to be increasing given that hacking tools are becoming more readily available and relatively easy to use. In addition, information security systems face potential threats from insiders (i.e., authorized users) who have a significant knowledge of Treasury's systems and their operation. Because of the nature of Treasury's missions, top-notch information security is paramount to prevent malicious outsiders or insiders from:

- Disrupting key Treasury functions (e.g., collection of revenues, issuing payments, managing the government's cash, making money, preventing financial crimes, etc.),
- Compromising classified or confidential Treasury information,
- Obtaining or disclosing sensitive or private citizen information,
- Destroying or altering information needed to accomplish Treasury's missions,
- Stealing valuable equipment or technology, and
- Inappropriately using Treasury resources.

In addition, recent and new technologies (e.g., wireless networks) have provided greater convenience and accessibility to the honest Treasury user, but at the same time have increased the vulnerability of Treasury information and resources. Because IT plays a crucial role in accomplishing all of Treasury's strategic objectives and activities, it is indispensable that Treasury have an information security program that ensures the integrity of Treasury's information systems and the reliability and confidentiality of its data.

Legislative Mandate FISMA requires Treasury to have an annual independent evaluation of its information security program and practices to determine the effectiveness of such program and practices. As required by law, TIGTA conducts the annual independent evaluation as it pertains to IRS. A contractor under our supervision conducts the annual independent evaluation as it pertains to the remainder of Treasury's unclassified systems. The results of the evaluations are provided to OMB by the date set by OMB. In addition, FISMA requires that agencies with national security systems include such systems in the annual evaluation process. Treasury OIG staff conduct the annual evaluations of Treasury's national security systems.

Known Weaknesses Based on the results of the OIG's FISMA independent evaluation of the Department's unclassified systems and TIGTA's evaluation of IRS's systems, we reported in October 2006 that despite notable progress, Treasury had deficiencies that, in aggregate, constitute substantial noncompliance with FISMA. The most important of these deficiencies follow:

- Non-IRS and offices within Treasury have significant deficiencies in their information security program and practices. Concerns were identified in the following areas at various bureaus: certification and accreditation, training, plans of actions and milestones, system interfaces, security self-assessments, system categorization, configuration management process, and incident response process.

- IRS also continues to have shortcomings in its information security program and practices. TIGTA reported significant deficiencies in the following areas: continuous monitoring of systems, incident reporting procedures, and training employees with key security responsibilities.

- We reported several matters pertaining to national security systems.

We also identified areas where Treasury improved its information security program and practices. Most notably, Treasury now has complete and properly categorized inventories of its national security systems. We also generally agree with the Office of the Chief Information Officer on the total number of Treasury systems. In addition, we noted in our FISMA evaluation report that TIGTA reported that IRS has made steady progress in complying with FISMA requirements.

Potential Integrity Risks We believe integrity risks associated with the Department's information systems include the potential (1) disruption of key Treasury functions; (2) compromise of classified or confidential Treasury information; (3) loss of sensitive or personally identifiable information; (4) destruction or alteration of information needed to accomplish Treasury's missions; (5) loss of equipment or technology; and (6) inappropriate use of Treasury resources.

In Progress and Planned Fiscal Year 2007 Projects

Fiscal Year 2007 FISMA Independent Evaluation – Unclassified Systems

Evaluation Objective A contractor under our supervision will determine if Treasury's information security program and practices, as they related to Treasury's unclassified systems, are adequate. In addition, the contractor will determine the progress made in resolving previously reported FISMA weaknesses. We anticipate that 500 hours by OIG staff will be needed to supervise the contractor. (PMA Initiative Supported: Expanded Electronic Government)

Fiscal Year 2007 FISMA Independent Evaluation – National Security Systems

Evaluation Objective To determine if Treasury's information security program and practices, as they relate to Treasury's national security systems, are adequate. In addition, we will determine the progress made in resolving previously reported FISMA weaknesses. We anticipate that this evaluation will require 400 hours. (PMA Initiative Supported: Expanded Electronic Government)

Disaster Recovery Exercises (On-going)

Audit Objective To determine if Treasury and its components can recover their operations in the event of a disaster (e.g., terrorist attacks, severe weather events). We will observe scheduled disaster recovery exercises on a selective basis. We anticipate each observation and evaluation of the exercise will require 400 hours. (PMA Initiative Supported: Expanded Electronic Government)

Network and System Vulnerabilities Assessment (On-going)

Audit Objective To identify potential security vulnerabilities that may compromise Treasury bureaus' networks and systems, leaving them open to misuse and malicious attacks. For fiscal year 2007, we plan to focus on FinCEN, TTB, and FMS's Hyattsville Regional Operating Center. We anticipate each Treasury bureau review will require between 1,500 and 2,000 hours. (PMA Initiative Supported: Expanded Electronic Government)

Penetration Testing (On-going)

Audit Objective To determine if (1) computer hackers can use common or specialized tools to gain unauthorized and illegal access to Treasury's networks, (2) malicious internal users can use these same tools or other techniques to gain unauthorized access to systems, and

(3) unauthorized outsiders or personnel can gain access to sensitive computer equipment. For fiscal year 2007, we plan to perform this audit at OCC. We anticipate that each Treasury bureau review will require 1,000 hours. (PMA Initiative Supported: Expanded Electronic Government)

Common Identification Standard for Federal Employees and Contractors (HSPD-12)

Background Wide variations in the quality and security of forms of identification used to gain access to secure Federal and other facilities where there is potential for terrorist attacks need to be eliminated. Therefore, in August 2004, the President issued Homeland Security Presidential Directive 12 (HSPD-12), *Policy for a Common Identification Standard for Federal Employees and Contractors*. HSPD-12 set forth the policy of the United States to enhance security, increase government efficiency, reduce identity fraud, and protect personal privacy by establishing a mandatory, government-wide standard for “secure and reliable forms of identification” issued by the Federal Government to its employees and contractors (including contractor employees). “Secure and reliable forms of identification” for purposes of HSPD-12 means identification that (a) is issued based on sound criteria for verifying an individual employee’s identity; (b) is strongly resistant to identify fraud, tampering, counterfeiting, and terrorist exploitation; (c) can be rapidly authenticated electronically; and (d) is issued only by providers whose reliability has been established by an official accreditation process.

Audit Objective To determine what steps Treasury has taken to implement the requirements set forth in HSPD-12. We anticipate that this project will require 1,000 hours. (PMA Initiative Supported: Expanded Electronic Government)

Treasury Implementation of IPv6

Background Internet Protocol version (IPv) 6 is the next generation protocol designed by the Internet Engineering Task Force to replace the current protocol, IPv4. Most of today’s internet uses IPv4, which is now nearly 20 years old. IPv6 fixes a number of problems in IPv4, such as the limited number of available IPv4 addresses. IPv6 is expected to gradually replace IPv4, with the two coexisting for a number of years during a transition period. OMB set a June 2008 deadline for civilian agencies to add the new technology to their networks.

Audit Objective To determine what steps Treasury has taken to prepare for implementation of IPv6 throughout the Department. We anticipate that this project will require 1,500 hours. (PMA Initiative Supported: Expanded Electronic Government)

Distributed Network Attack Initiative

Background Today's criminals commonly use encryption as a means to hide their disreputable acts. Traditionally, law enforcement has been ill equipped to confront the issue of decryption in a timely manner. In an effort to assist in protecting the Department against this criminal element, a joint OIG distributed network attack project can provide the following benefits:

- Leverage technology in order to successfully decrypt files in a timely manner.
- Facilitate cooperation internally by involving every computer in the fight against the cyber-based criminal element.
- Facilitate external coordination, cooperation and liaison through providing assistance in criminal cases of national importance.
- Provide an integrated decryption capability which is seamlessly integrated in the computer forensics process.

Investigative Objective To utilize distributed processing across the Treasury network to decrypt available encryption software in order to further the investigative process.

Projects Under Consideration for Future OIG Annual Plans

System Certification and Accreditation Processes

Audit Objective To determine whether Treasury's processes to certify and accredit systems are adequate to (1) identify risks to Treasury's assets, information, and personnel associated with the implementation of systems; (2) allow accrediting officials to properly evaluate and assume responsibility for such risks; and (3) provide a documented basis for management's determinations to accredit systems. We anticipate that this project will require 1,000 hours. (PMA Initiative Supported: Expanded Electronic Government)

Cyber-Based Systems – Critical Infrastructure Protection Program

Audit Objective To determine (1) what progress Treasury has made in identifying and prioritizing its critical infrastructure, (2) if Treasury is adequately protecting this infrastructure from terrorist attacks, and (3) if Treasury is in compliance with other requirements of Homeland Security Presidential Directive 7. We anticipate that this project require 800 hours. (PMA Initiative Supported: Expanded Electronic Government)

Web Servers – Controls and Security

Audit Objective To determine if Treasury and its bureaus have adequate security controls over its web servers, which provide internet users access to Treasury information and services, to protect against unauthorized access or malicious attacks from outside users. We anticipate that this project will require 2,000 hours. (PMA Initiative Supported: Expanded Electronic Government)

Treasury's Enterprise Environment

Audit Objective To determine if the Treasury Chief Information Officer (CIO) and bureau CIOs have implemented an enterprise environment framework that eliminates redundancy, reduces cost, improves quality and timeliness of information, enhances system integration, and properly secures information. We anticipate that this project will require 1,600 hours. (PMA Initiative Supported: Expanded Electronic Government)

Treasury Integration of IT Life-Cycle Security Costs Into Its Capital Planning and Investment Control Process

Audit Objective To determine whether the Department is appropriately budgeting for IT life-cycle security costs in its capital planning and investment process. Further we will determine whether the Department is effectively focusing on system life-cycle security needs and can support the requested funding to address IT security weaknesses. We anticipate that this project will require 1,600 hours. (PMA Initiative Supported: Expanded Electronic Government)

Data Centers – Security Reviews

Audit Objective To determine if physical and logical controls are implemented to protect bureau data centers from malicious intrusions, destruction or disclosure of sensitive data, and theft or damage to valuable assets. Specifically, we plan to review (1) organization and management, (2) computer operations, (3) physical security, (4) environmental controls, (5) hardware and software inventory management, and (6) continuity of operations. We anticipate that this project will require 1,600 hours. (PMA Initiative Supported: Expanded Electronic Government)

Wireless Network Security

Audit Objective To determine whether (1) the use of wireless networks at Treasury and its bureaus is exposing sensitive information to increased security risks (e.g., unauthorized disclosure), (2) there are any unauthorized wireless networks on Treasury premises, and

(3) Treasury has established adequate policy and oversight regarding wireless networking. We anticipate that this project will require 800 hours. (PMA Initiative Supported: Expanded Electronic Government)

Treasury General Management and Infrastructure Support – General Management

Office of Audit Contact: Thomas E. Byrnes, Director of Audit (202) 927-5904
Office of Investigations Contact: Gerry Garren, Special Agent in Charge, Financial Crimes

Issue Area Discussion

In addition to the Financial Management and IT Security, the Treasury General Management and Infrastructure Support issue area encompasses other management activities to ensure that the Department's resources are used efficiently and effectively to carry out Treasury programs and operations. While not all-inclusive, examples of broad management activities that warrant audit coverage are discussed below.

Information Technology Capital Investments Sound business practices for the acquisition and maintenance of information systems (including hardware and software) are necessary to support Treasury's mission to manage resources effectively. Absent such practices, Treasury may:

- Develop or inadvertently acquire duplicative systems;
- Pay higher prices for commercial off-the-shelf products by not obtaining volume discounts;
- Develop systems that do not adequately or fully address Treasury's needs or provide management with information needed to accomplish Treasury's key missions;
- Exceed projected or reasonable costs to develop, acquire, or maintain systems;
- Acquire or develop systems that do not adequately secure and protect Treasury's classified, confidential, or sensitive information; and
- Implement systems that do not readily integrate with existing systems.

In an August 2005 memorandum, OMB outlined a number of steps federal agencies must take for all new major IT projects, ongoing major IT developmental projects, and high-risk projects to better ensure improved execution and performance as well as promote more effective oversight (OMB Memorandum M-05-23, *Improving Information Technology Project Planning and Execution*). Specific procedures were prescribed to implement the principles of: (1) establishing and validating performance measurement baselines with clear cost, schedule, and performance goals; (2) managing and measuring projects to within 10 percent of baseline goals through use of an Earned Value Management System

(EVMS)[4] or, for steady-state projects, perform operational analyses[5]; (3) assigning to each project a qualified project manager; and (4) avoiding duplication by leveraging inter-agency and government-wide investments to support common missions or other common requirements. The memorandum also prescribed milestones for certain actions. For example, for all ongoing major IT projects with development efforts, it required that current cost, schedule, and performance baselines be independently validated for reasonableness by March 31, 2006, and before obligating fiscal year 2006 funds. Additionally, the memorandum required that agencies work with OMB to identify any high-risk projects by August 15, 2005. Beginning September 15, 2005, and quarterly thereafter, the CIO must assess, confirm, and document the performance of these high-risk projects. For high-risk projects that are not meeting performance criteria, the CIO must provide documentation (quarterly) to OMB and the IG on the specific performance shortfalls, their cause, the plan of action and milestones to correct the shortfalls, and additional funding and the source of funding to improve performance.

In this regard, the Treasury CIO, in conjunction with OMB, initially identified 3 non-IRS systems as high-risk: FinCEN's BSA Direct, Treasury Foreign Intelligence Network (TFIN), and HR Connect. BPD's Oracle Federal financials Systems was subsequently added to the list and BSA Direct was dropped beginning with the September 30, 2006, reporting period. Although Treasury's quarterly report to OMB for the quarterly ending December 31, 2005, indicated no performance issues with BSA Direct, the FinCEN Director issued a stop work order in March 2006 and then terminated the contract in July 2006 for developing the storage and retrieval component of BSA Direct after significant concerns were raised about schedule delays and project management. The system had been in development for 2 years and $15 million was expended on it. On the other hand, Treasury has been reporting performance issues with TFIN.

Although not identified as high-risk by Treasury, the development of IRS's redesigned Electronic Fraud Detection System web-based application was halted during 2006. Thus, IRS was unable to use the system to prevent fraudulent refunds during the 2006 processing year.

---

[4] "Earned value" is a management technique that relates resource planning to schedules and to technical cost and schedule requirements. All work is planned, budgeted, and scheduled in time-phased "planned value" increments constituting a cost and schedule measurement baseline. There are two major objectives of an earned value system to (1) encourage contractors to use effective internal cost and schedule management control systems and (2) permit the customer to be able to rely on timely data produced by those systems for determining product-oriented contract status.

[5] Operational analysis is a system to measure the performance and cost of an operational asset against the baseline established in the planning phase.

Human Capital In the area of human capital management, the Federal Activities Inventory Reform Act of 1998 (FAIR Act) has major implications for Treasury. According to recent data, Treasury ranks fifth among federal government agencies in the number of positions classified as commercial in nature.

The Department is also engaged in implementing a multi-year automated, integrated Human Resources (HR) system called HR Connect, which has been identified as a high-risk project. This Department-wide system is intended to bring about significant changes in HR practices through the year 2007. Appropriated funding to support this initiative is maintained at the Department and managed by the HR System Program Office. In its fiscal year 2005 Capital Asset Plan and Business Case, the HR Connect Program Office (HRCPO) reported that over the 15-year life of the program, it expected to incur total project investment and operational costs of about $415 million and receive total benefits of about $899 million. HRCPO attributed $174 million of productivity savings, and over $110 million to other savings for staff redirection. In February 2005, TIGTA reported that, among other things, the underlying analysis provided by the HRCPO does not support the savings claimed, especially those related to staff reassignments or reductions. As such, the expected savings of $899 million was unsubstantiated.

Improper Payments Erroneous payments in Federal programs can result from payments to ineligible program beneficiaries, over- or underpayments to beneficiaries, or duplicative payments. The Improper Payments Information Act of 2002 requires agencies to review annually all programs vulnerable to significant erroneous payments. Agencies must also estimate the extent of erroneous payments. Agencies estimating more than $10 million in erroneous payments are required to send a report to Congress and to develop a plan for reducing those payments. GAO and OMB have estimated that improper payments cost the federal government at least $30 billion a year, and there is strong evidence that the costs actually exceed this level. The Administration has made the reduction of improper and erroneous payments a focus of the President's Management Agenda. Treasury reported that for fiscal year 2005, no non-IRS programs or activities were a high-risk for significant erroneous payments.

Procurement Contract activity involving major procurements by the Department and its bureaus totals approximately $1.2 billion annually. Use of government credit cards for micro-purchases (generally for goods and services under $2,500) is also extensive, and a strong control environment over this activity is essential to prevent abuse. Approximately 85 percent of Treasury's purchases above the micro-purchases level are through Firm-Fixed Price contracts. OIG is the Department's focal point for obtaining pre-award, costs incurred, and other contract audits requested by Departmental Offices and the bureaus. These audits are typically performed by the Defense Contract Audit Agency under OIG oversight. During fiscal year 2006, approximately $19.9 million of pre-award and $1.7 million of contract close-out costs were audited for the Treasury bureaus.

Non-Appropriated Activities Four Treasury bureaus (BEP, the Mint, OCC, and OTS) do not receive appropriated funds; instead, they operate with revolving funds. BEP and the Mint assess charges for manufactured goods, while OCC and OTS assess fees for regulatory activities. These four bureaus generally have greater latitude than Treasury's appropriated bureaus in how they conduct their operations.

Treasury Franchise Fund First piloted pursuant to GMRA, the Treasury Franchise Fund was permanently established by the Transportation, Treasury, Independent Agencies, and General Government Appropriations Act, 2005 (P.L. 108-447). The Fund is a revolving fund that is used to supply financial and administrative services on a fee-for-service basis. Activities include consolidated/integrated administrative management; financial management administrative support; and financial systems, consulting, and training Services. The Fund consists of four entities: FedSource; Administrative Resource Center, a component of BPD; Federal Consulting Group; and Treasury Agency Services. The Administrative Resource Center was recognized as a Center of Excellence in the Financial Management Line of Business in 2005, making it eligible to enter into competitions to provide cross-agency financial management services on a government-wide basis. For fiscal years 2003 through 2005, the Fund facilitated procurement services totaling over $1 billion. For fiscal year 2007, service activities are expected to have new budget authority of $1 billion and employ 820 people.

Potential Integrity Risks Departmental Offices has overall policy, oversight and management responsibilities for the Treasury Department. Potential integrity risks are posed by both external personnel -- contractors/consultants, terrorists and hackers; as well as internal personnel – employees, who can be disgruntled, unethical, or untrained. Such personnel can pose potential integrity risks by: (1) disrupting Treasury functions, (2) violating laws, (3) awarding contracts for less than best value, (4) receiving bribes or kick-backs, (5) stealing or revealing sensitive data, and (6) receiving Federal Workers' Compensation Program benefits under false pretenses in violation of the Federal Employee Compensation Act (FECA), and (7) otherwise conduct activities in a manner that wastes taxpayer's money.

Over the last few years, Treasury experienced many operational changes that can impact its susceptibility to potential integrity risks. For instance, Treasury's Departmental Offices are still recovering from divestiture of the majority of Treasury's law enforcement bureaus and functions in fiscal year 2003 as a result of the Homeland Security Act of 2002 (P.L. 107-296). In March 2003, Treasury divested U.S. Customs Service, Federal Law Enforcement Training Center, and United States Secret Service to the resources to the Department of Homeland Security. In addition, the Act directed the Treasury to establish the Alcohol and Tobacco Tax and Trade bureau, transferring the law enforcement function of Bureau of Alcohol Tobacco and Firearms to the DOJ.

In addition, past audits have indicated that the Department has not effectively managed its capital investments (e.g., Treasury Building and Annex Repair and Restoration, TCE, HR Connect). Certain capital investments, such as TCE, are funded through the Department's Working Capital Fund. Accordingly, such projects do not receive the same scrutiny by OMB and Congress as directly appropriated projects.

In particular, one such integrity risk OIG identified relates to Treasury's management of FECA. Some individuals fraudulently receive FECA benefits that are otherwise intended for deserving employees and their families who, as a result of performing their duties, were injured, made ill, or lost their lives. In fiscal year 2005, the Department incurred over $9.5 million in non-IRS FECA claims. These dollars come directly from the funds appropriated or otherwise earmarked to run the specific agencies and as such, any fraudulent claims made against the program have a direct effect on the agencies ability to accomplish its mission and provide services to the American public. As a member of the IG community's Federal Workers' Compensation Forum, OIG jointly participates in an ongoing effort to adopt best business practices to effectively manage and reduce workers' compensation costs, to identify the measures that have potential to substantially reduce these costs. These efforts ultimately strengthen the alliance between the OIG community and program offices to better detect and prevent potential fraud, waste, and mismanagement within the FECA program.

In Progress and Planned Fiscal Year 2007 Projects

Treasury Procurements on Behalf of the Department of Defense (In Progress)

Background During fiscal year 2005, the Department of Defense (DoD) procured property and services through the Treasury Franchise Fund totaling over $400 million. In coordination with DoD OIG, we are auditing Treasury's procurements on behalf of DoD. This coordinated audit is required by Section 811 of the National Defense Authorization Act for Fiscal Year 2006 (NDAA).[6] During fiscal year 2006, pursuant to NDAA, DoD OIG and our office determined that the Treasury Franchise Fund was not compliant with DoD procurement requirements, but had a program in place to improve compliance. Our respective determination was based on tests of fiscal year 2005 procurement activity. With this determination, NDAA requires DoD OIG and our office to perform a second review of the Treasury Franchise Fund to assess compliance with DoD procurement requirements during fiscal year 2006. We are to determine, by June 15, 2007, whether Treasury is in compliance or not in compliance with DoD procurement requirements. If

[6] P.L. 109-163.

Treasury is found to be noncompliant, DoD may be significantly limited in procuring property and services through the Treasury Franchise Fund.

Audit Objective To determine whether Treasury's procurement policies, procedures, and internal controls applicable to the procurement of products and services on behalf of DoD, and the manner in which they are administered, are adequate to ensure Treasury's compliance with laws and regulations that apply to procurements of property and services made directly by DoD. Our audit is focused on FedSource, a component of the Treasury Franchise Fund, but will also include work at BPD's Administrative Resource Center, another Fund component. We anticipate that this project will require 3,600 hours. (PMA Initiative Supported: Improved Financial Performance)

Contract Audit Oversight Activities (On-Going)

Audit Objective To oversee and coordinate Defense Contract Audit Agency contract audit services requested by procurement officers. We anticipate that 400 hours will be required for this activity during fiscal year 2007. (PMA Initiative Supported: Improved Financial Performance)

Treasury's Workers' Compensation Program Initiative (In Progress)

Background When a federal employee is injured while performing his/her duties, prompt action should be taken to ensure the employee receives appropriate FECA benefits and returns to duty as quickly as possible. Once an employee reports an injury, he/she is to be informed of his/her rights and obligations under FECA. Generally, employees should receive appropriate medical attention from either a Treasury health unit, a hospital emergency room, or a private physician. If the employee is unable to return to his/her duties as a result of the injury, then he/she is entitled to up to 45 days of continuation of pay. If the employee is still unable to return to work at the end of the 45 days, he/she is entitled to compensation for lost wages following a short period without pay. Compensation is based on an assessment of medical conditions and pay rate at the time of the injury. The employee's case should then be monitored until a physician certifies the employee as fit to return to work. Among other things, agencies need to stay in touch with injured employees while they are receiving compensation, identify jobs suitable for them, and take steps to reemploy recovered or recovering employees as soon as the medical evidence shows that this is possible.

Audit/Investigative Objective To determine whether Treasury offices and bureaus have effective programs in place to monitor employees receiving workers' compensation payments. OIG auditors will also analyze FECA data and files for indicators of program abuse and refer such instances to the Office of Investigations for further inquiry. We anticipate that this project will require 500 staff hours to complete DO oversight and 2,900 hours at each Treasury bureau selected. (PMA Initiative Supported: Improved Financial Performance)

Treasury Efforts to Prevent Inappropriate Export of Sensitive Military Technology (Follow-Up)

Background NDAA for fiscal year 2000 requires the President to annually report to Congress on the transfer of military sensitive technology to countries and entities of concern. NDAA also contains a requirement that from 2000 to 2007, the Inspectors General of the Departments of Commerce, Defense, Energy, and State, in consultation with the Directors of the Central Intelligence Agency and Federal Bureau of Investigation, conduct audits to address the policies and procedures of the U.S. government with respect to these exports. As a result, the OIGs from Commerce, Defense, Energy, State and Treasury formed a working group to conduct annual reviews of the export licensing process. Following the Homeland Security Act of 2003, which transferred the U.S. Customs Service to Homeland Security and the Bureau of Alcohol, Tobacco, and Firearms to the Department of Justice, Treasury's involvement is more limited. Currently, OFAC supplements the "watch lists" of Commerce and State with the names of specifically designated nationals and persons who are barred from U.S. trade due to embargoes or economic sanctions. In a related role, Treasury also chairs the Committee on Foreign Investments in the United States (CFIUS), which reviews foreign mergers and acquisitions of U.S. businesses with potential national security implications.

Audit Objective To determine whether the recommendations in Treasury OIG export controls audit reports relating to CFIUS and OFAC were effectively implemented. The prior audit reports that are the subject of this follow-up audit are *Department of the Treasury Efforts to Prevent Illicit Transfers of U.S. Military Technologies* (OIG-00-072; issued March 23, 2000) and *EXPORT LICENSING PROCESS: Progress Has Been Made But Better Cooperation And Coordination Are Needed* (OIG-02-065; issued March 14, 2002). We anticipate that this project will require 800 hours.

Section 522 – Treasury Privacy and Data Protection Procedures

Background The Transportation, Treasury, Independent Agency, and General Government Appropriation Act, 2005 (P.L. 108-447, Division H) requires that within 12 months of the law's enactment (by December 2005), each agency shall establish and implement comprehensive privacy and data protection procedures governing the collection, use, sharing, disclosure, transfer, storage, and security of information in an identifiable form relating to the agency employees and the public. The Act also requires that at least every

2 years, an independent evaluation be made of (1) the agency's use of information in identifiable form and (2) the privacy and data protection procedures of the agency.

Audit Objective To evaluate Treasury's (1) use of information in identifiable form and (2) privacy and data protection procedures. We anticipate that this project will require 2,000 hours. (PMA Initiative Supported: Expanded Electronic Government)

Treasury Foreign Intelligence Network Redesign and Modernization Project

Background The modernization of the TFIN, a system critical to the support of Treasury's national security mission, is Treasury's highest systems development priority. Treasury received appropriated funds of approximately $6 million in fiscal year 2006 and has requested approximately $21 million for fiscal year 2007 for this project.

Audit Objective The objectives of this audit are to determine whether (1) the project business case for the TFIN redesign and modernization is based on appropriate and supportable assumptions and cost/benefit estimates, (2) procurement requirements were followed in the acquisition of contract support, and (3) sound project management principles are being followed in carrying out the project. We anticipate that this project will require 2,400 hours. (PMA Initiative Supported: Expanded Electronic Government)

Corrective Action Verification (On-going)

Background Treasury and bureau management is responsible to implement agreed to audit recommendations made by OIG. Management records its planned corrective actions to audit recommendations and their completion in a Department tracking system called the Joint Audit Management Enterprise System.

Audit Objective To determine whether management has taken corrective action that is responsive to the intent of selected recommendations from prior OIG audit reports. In selecting recommendations for verification, we will also consider open recommendations that are over 1-year to assess the progress made towards implementing planned actions. We plan to complete 4 corrective action verifications during fiscal year 2007. We anticipate that each verification will require 100 hours.

BPD Administrative Resource Center User Fees Collection and Reimbursable Agreements

Audit Objective To determine if (1) ARC is operating independently from BPD funding, (2) ARC is collecting user fees and reimbursements for all of its services in a timely manner, (3) ARC has appropriate systems established to monitor its collection efforts, (4) reimbursable agreements provide for reimbursement for all the services provided by

ARC, and (5) ARC is accounting for the full cost incurred for providing its services. We anticipate that this project will require 2,400 hours. (PMA Initiative Supported: Improved Financial Performance)

Projects Under Consideration for Future OIG Annual Plans

Treasury Information Technology Project Planning and Execution

Audit Objective To assess the Department's implementation of the IT project planning and execution requirements prescribed in OMB Memorandum M-05-23, *Improving Information Technology Project Planning and Execution*. As part of this audit, we plan to assess the use of EVMS and operational analyses where appropriate and the process used by the Department to identify and, as appropriate, monitor high-risk projects. We anticipate that this project will require 2,400 hours. (PMA Initiatives Supported: Improved Financial Management and Expanded Electronic Government)

Employee Bonus Policies at Non-Appropriated Bureaus

Audit Objective To determine whether (1) policies for employee bonuses at non-appropriated bureaus are in accordance with the law and (2) bonuses paid conform to established policies. Separate audits are planned at each bureau, beginning with a pilot audit at the Mint. We anticipate that each project will require 2,400 hours. (PMA Initiative Supported: Strategic Management of Human Capital)

HR Connect Processing Controls

Audit Objective To determine if appropriate controls were implemented over the processing of personnel actions and access to employee information. We anticipate that this project will require 2,000 hours. (PMA Initiative Supported: Strategic Management of Human Capital)

Treasury Policies for Replacing Personal Computers

Audit Objective To determine whether the Department's policies for replacing personal computers conform with norms and best practices in the government/private sector. We anticipate that this project will require 1,200 hours. (PMA Initiative Supported: Improved Financial Management)

Bureau Controls Over Government-Issued Travel Cards

Audit Objective To determine whether bureau controls over the use of travel cards are adequate. Separate audits are planned for selected bureaus. We anticipate that each project will require 1,200 hours. (PMA Initiative Supported: Improved Financial Performance)

FAIR Act Implementation

Audit Objective To determine if Treasury has identified government activities that are "commercial in nature" in accordance with the FAIR Act and taken action to meet OMB requirements to compete or outsource the commercial activities. We anticipate that this project will require 2,000 hours. (PMA Initiative Supported: Competitive Sourcing)

Resolution of Accountable Officer Irregularities

Background Accountable officers include certifying officers, disbursing officers, collecting officials, cashiers, and other officers or employees who are responsible for or have custody of public funds. Treasury Directive (TD) 32-04, *Settlement of Accounts and Relief of Accountable Officers*, establishes the policy and procedures to settle irregularities (e.g., erroneous or improper payments) in the accounts of accountable officers. Requests for relief of accountable officers for liability for irregularities exceeding established thresholds must be referred to GAO for resolution. The resolution of irregularities under these thresholds has been delegated to certain Treasury officials.

Objective To determine whether irregularities in the accounts of Treasury accountable officers are resolved in accordance with TD 32-04. We anticipate that this project will require 800 hours. (PMA Initiative Supported: Improved Financial Management)

Treasury Audit Follow-up System

Audit Objective To determine whether Treasury's audit follow-up system is effective to ensure that audit recommendations are promptly and properly acted upon and that progress on corrective actions is adequately monitored. As part of this audit, we will follow up on the recommendations in OIG-02-059, *GENERAL MANAGEMENT: The Department Needs to Strengthen Its Audit Follow-up System*. We anticipate that this project will require 1,600 hours.

Treasury Safety and Health Program

Background In January 2004, the President announced the Safety, Health, and Return-To-Employment (SHARE) initiative. Under SHARE, each department and independent agency established goals for reducing workplace illness and injury rates, speeding the submission of injury claims forms, and reducing the percentage of Federal employees' production days lost to workplace injuries and illnesses each year. These goals cover fiscal year 2004 through 2006.

Audit Objective To determine Treasury's progress toward established goals for reducing workplace injuries and illnesses. This includes ensuring that the initial submission of injury and illness claim forms are processed in a timely manner, as well as reducing the percentage of employee production days lost to workplace injury or illness. We anticipate that this project will require 1,000 hours. (PMA Initiative Supported: Strategic Management of Human Capital)

Treasury's Implementation of the Improper Payments Information Act

Audit Objective To determine if the Department has implemented an effective process to assess the risks of improper payments by its offices and bureaus that could be subject to reporting under the Improper Payments Information Act of 2002. We anticipate that this project will require 800 hours. (PMA Initiative Supported: Improved Financial Performance)

Intelligence Oversight Board Reporting

Background The Intelligence Oversight Board (IOB) of the President's Foreign Intelligence Advisory Board has an important role in keeping the President informed of issues arising from intelligence activities, as provided in Executive Order (EO) 12863. EO 12863 requires each Intelligence Community General Counsel and Inspector General to report to the IOB regarding intelligence activities they have reason to believe may be unlawful or contrary to EO or any other Presidential Directive. The IOB, in turn, reports any such activities to the President.

To assist the IOB in fulfilling its responsibilities and the Director of National Intelligence's (DNI) related oversight obligations, the Office of the DNI (O/DNI) will assume an enhanced role in the reporting process, including by analyzing reports for the IOB, identifying trends or patterns warranting further action, and ensuring remedial actions are carried out. The O/DNI will provide analyses on a quarterly basis to the IOB, as well as interim reports on significant issues, as appropriate.

Audit Objective To determine if Treasury has established internal guidelines, practices, and procedures for complying with the requirements of E.O. 12863. We anticipate that this project will require 800 hours.

Terrorist Financing, Money Laundering, and Foreign Assets Control

Office of Audit Contact: Donald P. Benson, Director of Audit (617) 223-8640
Office of Investigations Contact: William H. Sterling, III, Acting Special Agent in Charge, Procurement Misconduct Branch, (202) 927-1084

Issue Area Discussion

TFI directs Treasury's efforts to safeguard the U.S. financial system against illicit use, rogue nations, money launderers, terrorist facilitators, weapons of mass destruction proliferators, drug kingpins, counterfeiters, and other threats. TFI provides policy, strategic, and operational direction to the Department on issues which threaten the integrity of the financial system and the nation. TFI, headed by the Under Secretary for Terrorism and Financial Crimes, is comprised of the following organizations:

- Office of Intelligence and Analysis Treasury's intelligence office, staffed by analysts focused on the financial networks of terrorists and others who threaten national security.
- Office of Terrorist Financing and Financial Crimes The policy development and outreach office for TFI, which collaborates with other elements of TFI.
- Office of Foreign Assets Control This office is charged with administering and enforcing U.S. economic and trade sanctions based on foreign policy and national security goals.
- Treasury Executive Office of Asset Forfeiture Through the Treasury Forfeiture Fund, this office manages and directs the proceeds from non-tax related asset forfeitures made by Treasury and the Department of Homeland Security to fund programs and activities aimed at disrupting and dismantling criminal infrastructures.
- Financial Crimes Enforcement Network Safeguards the financial system from the abuses of financial crime, including terrorist financing, money laundering, and other illicit activity.

TFI also collaborates with IRS's Criminal Investigation Division in its anti-money laundering, terrorist financing, and financial crimes cases. In addition, FinCEN and OFAC depend on oversight by financial institution regulators, including OCC, OTS, and IRS within Treasury, and the Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Securities and Exchange Commission, and others outside of Treasury. Moreover, TFI coordinates with law enforcement within the U.S. and, internationally, with the Financial Intelligence Units (similar to FinCEN) located in other countries. Treasury spends more than $500 million to fund Treasury's efforts to detect and deter financial crimes, money laundering, and terrorist financing.

The Department, through FinCEN, and financial institution regulators are responsible for enforcing several key pieces of legislation:

- Bank Secrecy Act The BSA, enacted to help deter, detect, and investigate money laundering, requires financial institutions to file Currency Transaction Reports (CTR) for transactions exceeding $10,000 and Suspicious Activity Reports (SAR) for transactions that are of a suspicious nature. These reports are provided to FinCEN but the report data are managed by the IRS's Detroit Computing Center.

- Annunzio-Wylie Anti-Money Laundering Act (1992) This Act increased penalties for depository institutions that violate federal anti-money laundering laws.
- Money Laundering Suppression Act (1994) This Act mandated certain exemptions to filing CTRs in an effort to reduce the number being reported by 30 percent, directed the Treasury Secretary to designate a single agency to receive SAR filings, required the registration of money service businesses (MSB), and clarified the applicability of the BSA to state-chartered and tribal gaming establishments.
- Money Laundering and Financial Crimes Strategy Act (1998) This Act directed the Treasury Secretary to develop a national strategy for combating money laundering.
- Title III of the USA PATRIOT Act (2001) The USA PATRIOT Act clarified that combating terrorist financing would be prosecutable under existing money laundering laws. The Act (1) requires that each financial institution establish an anti-money laundering program, (2) extends the SARs filing requirement to broker-dealers, (3) requires financial institutions to establish procedures to verify the identities and addresses of customers seeking to open accounts, and (4) requires FinCEN to maintain a highly secure network that allows financial institutions to file BSA reports electronically. (This network was established and is now known as BSA Direct E-Filing.)

FinCEN is primarily responsible for Treasury's effort to enforce the BSA and USA PATRIOT Act. FinCEN works with federal financial regulators to ensure the regulated industries comply with these laws. In this regard, FinCEN finalized an MOU in 2004 with the five federal banking agencies—OCC, OTS, Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, and the National Credit Union Administration—to better share information and improve coordination in ensuring that the BSA is effectively implemented. FinCEN also executed similar MOUs with the IRS and most states and territories. FinCEN is working to obtain agreements with the Securities and Exchange Commission and the Commodities Futures Trading Commission to enhance BSA compliance oversight in the non-bank financial sectors.

In June 2005, FinCEN and the Federal Financial Institutions Examination Council, composed of the five federal banking agencies, issued the *Bank Secrecy Act/Anti-Money Laundering Manual* for uniformly conducting BSA examinations. The publication of this guidance was designed to further ensure consistency and identify additional clarity for conducting these examinations. In addition, the Manual includes examination procedures for OFAC programs.

OFAC's authority to impose controls on transactions and to freeze foreign assets is derived from the President's constitutional and statutory wartime, and national emergency powers. In performing its mission, OFAC relies principally on delegations of authority made pursuant to the President's broad powers under the Trading with the Enemy Act, International Emergency Economic Powers Act, and the United Nations Participation Act to prohibit or regulate commercial or financial transactions involving specific foreign countries, entities, or individuals. In administering and enforcing economic sanctions programs, OFAC maintains a close working relationship with other federal agencies to ensure that these programs are implemented properly and enforced effectively. OFAC works directly with the Department of State; the Department of Commerce; the Department of Justice, the FBI, the Department of Homeland Security's U.S. Customs and Border Protection and U.S. Immigration and Customs Enforcement; bank regulatory agencies; and other law enforcement agencies. OFAC currently administers 30 economic sanctions programs against foreign governments, entities, and individuals. Though 8 of these programs have been terminated, they still require residual administrative and enforcement activities.

Similar to FinCEN, OFAC relies on other regulators to examine and enforce compliance by coverer financial institutions with OFAC requirements. In April 2006, OFAC executed and MOU with the five federal banking agencies to share information and improve coordination.

Treasury also works globally to combat money laundering and terrorist financing. The United States is a member of the international Financial Action Task Force (FATF). FATF is an inter-governmental body created in 1989 whose purpose is the development and promotion of policies, both at national and international levels, to combat money laundering and terrorist financing. The FATF holds an annual exercise to examine the methods and trends – the *typologies* – of money laundering and, since 2001, of terrorist financing. The primary objective is to help FATF policy makers develop and refine anti-money laundering and counter-terrorist financing standards. In addition, the findings obtained from the annual exercise serve as the basis for informing regulatory authorities, law enforcement agencies and financial intelligence units, as well as the general public – on the characteristics and trends of money laundering and terrorist financing. FATF has published "40 + 9 Recommendations" to help bring about international legislative and regulatory reforms.

One aspect of FATF's work is assessing a country's compliance with the international anti-money laundering and combating terrorist financing standards as contained in the "40 + 9 Recommendations." In June 2006, FATF issued a report that evaluates the anti-money laundering and combating terrorist financing regime of the U.S. The report discusses U.S. money laundering and terrorist financing vulnerabilities, strategies, and preventive measures. The report also describes the U.S. financial, law enforcement, legal, and regulatory sectors, and includes recommendations to strengthen U.S. anti-money laundering and combating terrorist financing efforts. With respect to the "40 + 9

Recommendations," the assessment found that the U.S. was Compliant for 15 Recommendations, Largely Compliant for 28 Recommendations; Partially Compliant for 2 Recommendations, and Non-Compliant for 4 Recommendations.

When dealing with international issues, FinCEN and OFAC programs may jointly be used to bring rogue states into line with U.S. interests. For example, North Korea is considered a state sponsor of terrorism and a facilitator of criminal activity to support its repressive regime, is involved in the proliferation of weapons of mass destruction, narcotics trafficking, and smuggling, and has also sponsored the counterfeiting of U.S. currency through the creation and distribution of "supernotes," which are high-quality $100 bills virtually indistinguishable from legitimate U.S. currency. FinCEN has issued a proposed ruling to prohibit U.S. financial institutions from holding correspondent accounts for Banco Delta Asia, designated by Treasury as a "willing pawn" of North Korea. Treasury found the bank to be facilitating North Korean front companies and government agencies engaged in narcotics trafficking, currency counterfeiting, production and distribution of counterfeit cigarettes and pharmaceuticals, and laundering of proceeds. OFAC has also applied its own sanctions programs to North Korea.

A Treasury program that was the subject of Congressional interest and media attention during fiscal year 2006 is the Terrorist Finance Tracking Program (TFTP). TFTP was developed to identify, track, and pursue suspected foreign terrorists, like al Qaida, Hamas, and Hezbollah, and their financial supporters. As part of its mission, Treasury issues subpoenas to the Society for Worldwide Interbank Financial Telecommunication, or SWIFT – a Belgium-based company with U.S. offices that operates a worldwide messaging system used to transmit bank transactions information – seeking information on suspected international terrorists. According to Treasury, TFTP is firmly rooted in sound legal authority, based on statutory mandates and Executive Orders, and does not involve data mining or trolling through the financial records of Americans. Also, Treasury has stated that the program has rigorous safeguards and protocols to protect privacy, including regular, independent audits of the program that have confirmed that the U.S. Government has consistently observed the established safeguards and protocols.

<u>Potential Weaknesses</u> OIG audits in prior years have found problems in either the detection of BSA violations or timely enforcement of BSA. This has continued through the most recent year. As we discussed in prior OIG Annual Plans, FinCEN is dependent on many federal and other regulators to examine institutions for compliance with program requirements. Although the Department has taken steps to strengthen BSA administration, audits in the past year concerned with Treasury's administration of the BSA found that a continuing need for the Department and bureaus to strengthen the anti-money laundering and terrorist financing effort.

- An audit completed in August 2006 on OCC's enforcement of BSA at Wells Fargo Bank found that OCC allowed BSA deficiencies to occur for 5 years before finally taking enforcement action, but the action taken was a questionable non-public action based on safety and soundness weaknesses (*BANK SECRECY ACT: OCC Did Not Take Formal Enforcement Action Against Wells Fargo Bank for Significant BSA Deficiencies*, OIG-06-034)
- An audit of FinCEN's data mining and analysis of BSA data, in accordance with PATRIOT Act requirements, found that FinCEN had made limited progress in conducting this analysis and had weak internal controls that put BSA data at risk. (*TERRORIST FINANCING/MONEY LAUNDERING: FinCEN Has Taken Steps to Better Analyze Bank Secrecy Act Data But Challenges Remain*, OIG-06-030)
- An audit of OFAC's administration of its foreign sanctions programs found that OCC's and OTS's OFAC examination work papers did not provide assurance that national banks and federal and state-chartered thrift institutions were adequately reviewing or effectively administering the programs. The audit found, for every examination sampled, one or more instances in which documentation was sufficient to verify that examiners adequately assessed OFAC program compliance. *(FOREIGN ASSETS CONTROL: Assessing OCC's Examination of OFAC Compliance Was Hampered by Limited Documentation*, OIG-06-033; *FOREIGN ASSETS CONTROL: Assessing OTS's Examination of OFAC Compliance Was Hampered by Limited Documentation*, OIG-06-044)

In addition, FinCEN has had problems in developing the retrieval and sharing component of its planned system known as BSA Direct, which was supposed to allow easier, faster, and more comprehensive access to the BSA database. FinCEN stopped work on this project in March 2006, shortly after a new director was appointed and noticed slippage in milestones and increasing costs. Over $15 million was spent on this failed project.

Other areas of money laundering and terrorist financing concern include cross-border electronic transmittals of funds (wire transfers) and MSBs.

<u>Cross-Border Wire Transfers</u> Section 6302 of the Intelligence Reform and Terrorism Prevention Act of 2004 (P.L. 108-458) directs the Secretary of the Treasury to determine whether reporting requirements should be imposed on financial institutions of certain cross-border wire transfers. If determined that such reporting is reasonably necessary to conduct efforts against money laundering and terrorist financing, the Secretary is also directed to, among other things: (1) determine the technology necessary for FinCEN to receive, keep, exploit, protect the security of, and disseminate information from cross-border wire transfer reports, and (2) prescribe regulations in final form for reporting cross-border wire transfers by December 2007. Prior to any such regulations taking effect, the Act requires that the Secretary certify that the technical capability to receive, store, analyze, and disseminate the information is in

place. The Act also requires that, in preparation for implementing the regulation and data collection system, the Treasury must study and report to Congress the feasibility of implementing such regulations.

MSBs MSBs have had increased difficulty in establishing and maintaining banking services. Many banks are reluctant to deal with the perceived risk of having MSBs as customers and have been terminating accounts or refusing new accounts. This action has reduced banking services for many, particularly those without access to formal banks. Restricting MSB access to banks can drive these transactions underground and reduce transparency, thereby harming U.S. efforts to prevent money laundering and combat terrorist financing.

Our fiscal year 2007 Annual Plan does not include any specific audit projects related to cross-border wire transfers and MSB access to banking services. We will continue to monitor both these areas in our planning of future work.

Potential Integrity Risks The success of Treasury efforts to support law enforcement in the fight against terrorist financing, money laundering, and other financial crime is dependent on honest and complete reporting of currency transactions and suspicious financial activity. In addition to the potential weaknesses we have listed above, we believe there are several potential integrity risks associated with Treasury's management of BSA. Specifically, the integrity risks associated with this area include (1) the failure to file required BSA reports; (2) filing a false or fraudulent BSA report; (3) internal and external misuse of sensitive BSA information contrary to law (i.e., internal disclosure of BSA information to unauthorized persons by Treasury employees or external parties as well as inadvertent disclosure that indicates a program vulnerability or systemic weakness which, if not addressed, places the program and related operations at risk); (4) inappropriate handling or use of sensitive but unclassified, law enforcement sensitive, or classified information; and (5) criminal violations of foreign sanctions program.

Although we have not identified in our prior audits any fraudulent BSA reports or filings, we have identified the potential for this to occur, particularly in our review of data quality issues associated with suspicious activity reporting. We found numerous reports with missing or incomplete data. Also, our recent report reviewing FinCEN's analysis of BSA data found weak internal controls that could allow contractor employees without up-to-date security clearances from accessing sensitive data. Further, we found FinCEN did not have controls in place to prevent its analysts from conducting inappropriate browsing of this data, which includes sensitive financial information. In years past, our Office of Investigations has reported on analysts involved in this type of activity. In addition, GAO has reported on weaknesses in access controls that allowed employees within IRS to inappropriately access BSA data housed at the Detroit Computing Center.

BSA information may only be used for a purpose related to a criminal, tax, or regulatory investigation or proceeding, or in the conduct of intelligence or counterintelligence activities to protect against international terrorism. The unauthorized release of information collected under the BSA may result in criminal prosecution, civil penalties, or administrative sanctions. As a new initiative, the Office of Investigations plans to deliver outreach presentations to FinCEN analysts and other lawful users of BSA data about the proper use and protection of this sensitive information. In addition, the Office of Investigations plans to coordinate with the Federal Law Enforcement Training Center's Financial Fraud Training program to ensure the inclusion of the topic of the safeguarding of BSA information throughout their courses. The Outreach presentations will highlight the mission of OIG and seek to educate employees and others on the ways potential compromise of BSA information can occur as well as identify fraud indicators associated with BSA filings.

The Treasury Forfeiture Fund equitable sharing program allows for any federal, state, or local law enforcement agency that directly participates in an investigation or prosecution that results in a federal forfeiture to request an equitable share of the net proceeds of the forfeiture. There are restrictions on how recipient agencies may use these funds. Recipient agencies must also provide an annual accounting of equitable sharing receipts and expenditures to TEOAF. Prior OIG audits have found instances of misuse of these funds by certain recipient agencies.

Fiscal Year 2007 Projects

Treasury's Administration of the BSA (In Progress)

Audit Objective To determine if Treasury's authorities, delegation, and resources are consistent with its responsibility under the BSA and enhanced provisions of the USA PATRIOT Act. We anticipate that this project will require 1,200 hours to complete in fiscal year 2007.

FinCEN BSA Direct System (In Progress)

Audit Objective To assess FinCEN's efforts in planning, awarding, monitoring, resolving disparities, and reporting performance, for the retrieval and sharing component of the BSA Direct contract. We anticipate that this project will require 5,000 hours to complete in fiscal year 2007.

OTS BSA Supervisory Activities (In Progress)

Audit Objective To assess OTS's compliance examination program to ensure thrift industry association compliance with BSA and PATRIOT Act requirements. We anticipate that this project will require 3,000 hours to complete in fiscal year 2007.

OFAC Monitoring of Compliance Examinations by Financial Institution Regulators for Sanction Programs (In Progress)

Audit Objective To determine whether OFAC has an effective monitoring program to ensure that financial institution regulators adequately examine and enforce financial institution regulators adequately examine and enforce financial institution compliance with sanction programs. As part of this audit, we are reviewing OFAC's use of civil penalties to enforce compliance. During fiscal year 2006, also as part of this audit, we reported on OFAC program compliance examinations by OCC and OTS for a sample of financial institutions. We anticipate that this project will require 600 hours.

FinCEN Monitoring of Suspicious Activity Report Data Quality (Follow-Up)

Background Our office performed three prior audits in which we raised concerns over longstanding SAR data quality and that these data problems could adversely affect FinCEN's ability to meet its core mission relative to BSA and attendant terrorist financing and money laundering programs. Our last audit of this area, completed in March 2005, found that FinCEN had not established data quality standards from which SARs could be routinely monitored for data quality purposes. We also found that most previously reported control weaknesses and conditions remained outstanding. During this audit, we sampled over 400 SARs, finding that 62 percent of them contained one or more data quality problems (i.e., missing, incomplete, inappropriate, and/or inconsistent information) in a data field critical to law enforcement agencies (*FinCEN: Heightened Management Attention Needed Over Longstanding SAR Data Quality Problems;* OIG-05-033). FinCEN has reported that our recommendations in this report are implemented.

Audit Objective To assess the effectiveness of FinCEN's corrective actions to the recommendations in our March 2005 report and evaluate the current processes for accumulating and distributing SAR data to ensure data integrity. We anticipate that this project will require 3,000 hours.

FinCEN Memoranda of Understanding with Financial Institution Regulators

Audit Objective To determine whether (1) FinCEN is receiving timely, complete, and reliable information under the MOUs and (2) the purpose of the MOUs (enhanced communication and coordination to help financial institutions identify, deter, and interdict terrorist financing and money laundering) is being achieved. To address these objectives, we plan to conduct a series of audits at FinCEN, OCC, and OTS. We anticipate that the projects will require a total of 4,000 hours.

Projects Under Consideration for Future OIG Annual Plans

Terrorist Finance Tracking Program Safeguards

Audit Objective To review the safeguards Treasury has established over TFTP. We anticipate that this project will require 2,000 hours.

Securities Industry Reporting of Suspicious Transactions

Audit Objective To determine whether FinCEN has taken adequate steps to ensure securities industry companies comply with BSA. We anticipate that this project will require 2,000 hours.

Insurance Companies Reporting of Suspicious Transactions

Audit Objective To determine what steps FinCEN has taken to assess initial insurance industry compliance with BSA. We anticipate that this project will require 2,000 hours.

OCC BSA Examination of Private Banking (Follow-Up)

Audit Objective Determine whether OCC has implemented the management corrective actions to OIG report *Bank Secrecy Act: OCC Examination Coverage of Trust and Private Banking Services* (OIG-02-016). We anticipate that this project will require 1,200 hours.

Controls Over Intelligence Sharing

Background During fiscal year 2004, we completed an evaluation, requested by the Treasury General Counsel, which found certain issues in the process by which certain Treasury bureaus and offices obtained sensitive and classified intelligence information (OIG-CA-04-003 Classified).

Audit Objective To assess, since the creation of OIA, intelligence sharing within Treasury. We anticipate that this project will require 2,000 hours.

FinCEN Civil Penalties for BSA Program Violations

Audit Objective To determine whether FinCEN is properly assessing civil penalties for all applicable BSA violations, how the penalties are coordinated with the regulatory agencies, and how the amounts of the penalties are established. In addition, we will determine if FinCEN is ensuring that monies for these penalties are collected. We anticipate that this project will require 2,000 hours.

FinCEN's Information Sharing Procedures (Section 314 of the USA PATRIOT Act)

Audit Objective To determine if FinCEN has implemented an effective system to provide for the sharing of information between law enforcement authorities and financial institutions, and among financial institutions themselves, in accordance with Section 314 of the USA PATRIOT Act. We anticipate that this project will require 2,000 hours.

Security Clearances of Individuals Handling Sensitive Bank Secrecy Act Reports

Audit Objective To determine whether adequate controls are in place to ensure Treasury employees and contractor personnel with access to sensitive BSA reports have current and appropriate security clearances. We anticipate that this project will require 2,000 hours.

OCC BSA and USA PATRIOT Act Compliance Examinations and Enforcement Actions

Audit Objective To determine the effectiveness of OCC's programs to conduct supervisory activities and, when necessary, take enforcement actions to ensure that national banks have controls in place and provide the requisite notices to law enforcement to deter and detect money laundering, terrorist financing, and other related criminal acts. Our review will focus on, but not be limited to, changes made by OCC in response to the Riggs Bank and Wells Fargo Bank matters. We anticipate that this project will require 3,000 hours.

OFAC Memoranda of Understanding with Financial Institution Regulators

Audit Objective To determine whether (1) OFAC is receiving timely, complete, and reliable information under the April 2006 MOU with the federal banking regulators and (2) the purpose of the MOU—to help OFAC in fulfilling its role as administrator and enforcer of economic sanctions and to assist the regulators in fulfilling their roles as banking organization supervisors—is being achieved. To address these objectives, we plan to conduct a series of audits at OFAC, OCC, and OTS. We anticipate that the projects will require a total of 3,200 hours.

TEOAF Use of Treasury Forfeiture Fund Receipts to Support Law Enforcement

Audit Objective To determine whether TEOAF has appropriate controls to: (1) distribute funds to eligible law enforcement agencies in accordance with applicable laws, regulations, and policies; and (2) ensure the distributed receipts are used for intended purposes. As part of this work, we plan to determine whether sampled state and local government agencies use equitable sharing funds in accordance with Treasury guidelines. We estimate that this project will involve two local agencies, each of which will require 1,200 hours, for a total of 2,400 hours.

Timely Filing of Bank Secrecy Act Reports

Audit Objective To determine if effective controls are in place to (1) monitor the timeliness of the filing of BSA reports by covered institutions, and (2) ensure enforcement action is taken when warranted. We anticipate that this project will require 2,000 hours.

FinCEN Efforts to Assess the Money Laundering and Terrorist Financing Risks Associated With the Use of Stored Value and Prepaid Cards

Background The use of stored value and prepaid cards is growing at a rapid rate. Recent estimates show consumer spending using these cards to grow from $63 billion in 2004 to $257 billion in 2009. The fact that these cards may be carried in wallets with credit cards, are often indistinguishable from credit cards, and may often be used anonymously, makes them a likely vehicle for potential money launderers or terrorists. Government regulations have not yet caught up with this emerging industry.

Audit Objective To evaluate FinCEN's progress in identifying and addressing the money laundering and terrorist financing risks associated with the use of stored value and prepaid cards. We anticipate that this project will require 2,000 hours.

Financial Institution Filing of Reports to OFAC and FinCEN on Blocked Transactions

Background In interpretive guidance issued in December 2004, FinCEN advised institutions subject to suspicious activity reporting under the BSA that under certain circumstances, reports filed with OFAC of blocked transactions with designated terrorists, foreign terrorist organizations, and narcotics traffickers and trafficker kingpins would fulfill the requirement to file suspicious activity reports with FinCEN on such transactions (i.e., a separate suspicious activity report to FinCEN on the same blocked transaction would no longer be required). However, if the filer has information not included on the blocking report filed with OFAC, a separate suspicious activity report must still be filed with FinCEN including that information.

Audit Objective To determine if OFAC and FinCEN have implemented adequate controls to ensure that the information in reports filed with OFAC on blocked transactions is made available to law enforcement through FinCEN databases as appropriate. We anticipate that this project will require 800 hours.

Financial Industry Use of Interdiction Software to Comply With OFAC Compliance

Background To assist financial institutions in complying with its economic and trade sanctions, OFAC maintains a list of targeted foreign countries, terrorists, international narcotics traffickers, and those engaged in activities related to the proliferation of weapons of mass destruction. While not specifically required by law, many financial institutions use commercial interdiction software to compare customers to the OFAC list. A number of companies produce and sell related software products and services. While OFAC's position is that software is the main method that financial institutions use to identify and report OFAC-related violations, OFAC does not approve or sanction any particular packages for use.

Audit Objective To determine what best practices exist in the federal government to manage risks associated with software packages sold by the private sector that are used to comply with laws and regulations. We anticipate that this project will require 1,200 hours.

OFAC Oversight of the Money Services Business Industry

Audit Objective To determine whether OFAC is effectively coordinating with IRS (the regulator of the MSB industry) to ensure compliance by the industry with OFAC requirements. We anticipate that this project will require 1,600 hours.

Government-wide Financial Services and Debt Management

Office of Audit Contact: Donald R. Kassel, Director of Audit (202) 927-6512
Office of Investigations Contact: Gerry Garren, Special Agent in Charge, Financial Crimes

Issue Area Discussion

As the federal government's financial manager, FMS provides centralized payment, collection, and reporting services for the government. BPD borrows the money needed to operate the federal government and accounts for the resulting debt.

Disbursement and Collections FMS's goal is to provide reliable and accurate processing of federal payments which is an essential part of supporting the U.S. economy. These payments total approximately $1.9 trillion in fiscal year 2006. Accurate, on-time payments are of considerable financial importance to American citizens, whether recipients of Social Security or Veterans' benefits, income tax refunds, or other federal payments. During fiscal year 2006, FMS issued more than 964 million payments via paper check and electronically transferred funds to more than 100 million individuals and businesses.

FMS also collected approximately $2.9 trillion annually in payments to the government through 10,000 financial institutions. Nearly $2.3 trillion of this amount is collected electronically.

Since enactment of the Debt Collection Improvement Act of 1996 (DCIA), FMS reported that it has collected about $27.7 billion in delinquent debt. DCIA authorizes the Secretary of the Treasury to collect delinquent non-tax debt owed to the federal government. DCIA requires that agencies turn over to FMS for collection any debt that has been delinquent for a period of 180 days. FMS collects the debt while working closely with federal agencies, such as the Departments of Education, Housing and Urban Development, and Health and Human Services, to identify eligible debts and encourage referral to FMS for collection. Critical to the success of collection efforts is the cooperation of the participating federal program agencies. At the close of fiscal year 2006, FMS reported that 100 percent ($37.8 billion) of the eligible federal debts had been referred for collection by payment offset. For the same time period, 95 percent ($8.1 billion) of the eligible debts had been referred to the Cross-Servicing Program for collection. Through the Treasury Offset Program (TOP), total collections were $3.2 billion for fiscal year 2006. Additionally, $130.1 million was collected through the Cross-Servicing Program, for a total of over $3.3 billion for fiscal year 2006.

Public Debt The goal of Treasury debt management is to achieve the lowest borrowing costs over time, and Treasury debt managers commit to regular and predictable debt issuance in pursuing this goal. Treasury debt management decisions are made in an ongoing process, which incorporates deliberate and distinct processes, but also is flexible in that it takes into account new information as it may become available.

Government-wide Financial Services and Debt Management

The federal debt has two major components: Debt Held by the Public and Intragovernmental Holdings. Debt Held by the Public is the federal debt held by individuals, corporations, state or local governments, foreign governments, and other entities outside of the U.S. government. Types of securities held by the public include Treasury Bills, Treasury Notes, Treasury Bonds, Treasury Inflation-Protected Securities, U.S. Savings Bonds, State and Local Government Series, Foreign Series, and Domestic Series. Intragovernmental Holdings are primarily Government Account Series securities held by federal government trust funds, revolving funds, and special funds. As of September 30, 2006, the total federal debt outstanding was $8.5 trillion, of which $4.8 trillion was Debt Held by the Public, and $3.7 trillion was Intragovernmental Holdings. As of September 30, 2005, the total federal debt outstanding was $7.9 trillion. The fiscal year 2006 interest expense on the federal debt managed by BPD was $404 billion, a marked increase from the fiscal year 2005 interest expense of $355 billion.

Like FMS, BPD's operations demand modernized electronic and information system technology. BPD implemented the TreasuryDirect system in 2002. Currently, TreasuryDirect holds more than $8.4 billion in over 289,000 accounts.

Due to competing priorities of our office, FMS programs have received little performance audit coverage during recent years. In this regard, our most recent work included a 2003 audit of FMS Plastic Card Network, a system established on behalf of federal agencies to collect fees and other revenues through credit cards. This audit identified several opportunities to better use funds totaling $3.6 billion. The last time we reviewed FMS's DCIA activities was in 1999. Since we last substantively reviewed FMS payment and collection systems, federal payments and collections have grown substantially, and become increasingly electronic.

Likewise, we have not performed any recent performance audits of BPD's programs for managing the public debt.

<u>Potential Integrity Risks</u> We believe integrity risks associated with government-wide financial services and debt management include fraud and abuse by means of (1) unauthorized access to sensitive information, (2) filing false applications and claims, (3) providing false statements to obtain federal assistance or funds, (4) diversion of benefit proceeds, (5) check forgery, (6) promised services not delivered, and (7) misuse and mismanagement of federal funds. Furthermore, program risks related to this issue area include the inability to collect debt, inability to recover in a disaster, misallocation of program costs, disruption of the federal payment function and service to the public. The changing nature of crime and recent technological innovations requires that law enforcement look for and implement new ways and techniques to identify and prevent future criminal activity.

In an effort to proactively minimize potential integrity risks, OIG is exploring the use of data mining methods[7] to analyze FMS payments to reveal hidden patterns relating to criminal activity, trends, relationships and correlations between the data. Based upon the collection of this sensitive data, trends and patterns will be identified to discover ongoing fraud and abuse directed against and, perhaps, occurring within the operations of the FMS.

During 2006, the Office of Investigations initiated, with the OIGs of five other agencies, a project to proactively identify potentially fraudulent benefit payments warranting further investigation. The other agencies we are working with on this initiative are the Department of Veterans Affairs, the Social Security Administration, the Railroad Retirement Board, the Office of Personnel Management, and the Defense Criminal Investigative Service. This Treasury OIG initiative directly supports the President's Management Agenda to reduce improper payments government-wide. Chief among our roles is to help federal agencies detect, investigate, and prevent criminal activity related to improper benefit payments, thus helping to ensure that taxpayer dollars are spent wisely and efficiently. Since its inception through September 30, 2006, we opened, in conjunction with the other participating OIGs, 20 investigative cases involving nearly $1.4 million in payments and made 3 arrests.

In Progress and Planned Fiscal Year 2007 Projects

FMS Controls Over Disbursements

Audit Objective To determine, through a series of audits involving both electronic funds transfers and check payments, whether FMS has adequate internal controls over its disbursement process to ensure the integrity of payments is appropriate. We anticipate that this first audit will require 2,000 hours. (PMA Initiative Supported: Improved Financial Performance)

FMS Acquisition of Banking Services (Follow-Up)

Background The Consolidated Appropriations Act, 2004, authorized a permanent, indefinite appropriation for FMS to use to acquire banking services. In the past, these services were paid for through compensating balances maintained with certain financial institutions. A fiscal year 2003 OIG audit of FMS's Plastic Card Network (OIG-03-088) found that the use of compensating balances was expensive and FMS did not have adequate controls to ensure that the costs of banking services acquired through compensating balances were appropriate.

[7] Data mining is the process of extracting meaningful information from large databases.

Audit Objective To determine whether FMS is acquiring banking services in an appropriate and cost effective manner. We anticipate that this project will require 1,600 hours. (PMA Initiative Supported: Improved Financial Performance)

Improper Benefit Payments Initiative

Background In an effort to proactively address potential systemic vulnerabilities, OIG is using data mining methods[8] to analyze FMS payments to reveal hidden patterns relating to criminal activity, trends, relationships and correlations between the data. Based upon the collection of this sensitive data, trends and patterns will be identified to discover ongoing fraud and abuse directed against and, perhaps, occurring within the operations of the FMS. During 2006, the Office of Investigations brought together OIGs of five other agencies, and commenced an initiative to utilize mined data to proactively identify potentially fraudulent benefit payments warranting further investigation. The agencies participating in this initiative are the Department of Veterans Affairs, the Social Security Administration, the Railroad Retirement Board, the Office of Personnel Management, and the Defense Criminal Investigative Service. Since its inception through September 30, 2006, Treasury OIG has opened, in conjunction with the other participating OIGs, 20 investigative cases involving nearly $1.4 million in payments and made 10 arrests.

Investigative Objective In support of the President's Management Agenda, our objective is to reduce improper payments government-wide. We plan to continue our analysis of Treasury's payment data to detect, investigate, and prevent criminal activity related to improper benefit payments.

Projects Under Consideration for Future OIG Annual Plans

FMS Use of the Internet Payment Platform

Background The Internet Payment Platform (IPP) is an Internet-based payment information portal for use by Federal agencies and their vendors. According to FMS, as currently planned, IPP will not be used as a vehicle to certify or disburse payments. Information created throughout the Procurement-to-Pay cycle will be accumulated and made assessable by the IPP. IPP is also intended to provide a digital alternative to paper-based purchasing and invoicing processes by making purchase orders and invoices accessible via the internet. By automating current paper-based or fax-based transactions, it is anticipated that the IPP will expedite the processing of vendor payments by agencies. It is also

[8] Data mining is the process of extracting meaningful information from large databases.

anticipated that the IPP portal will allow for more efficient exchange of invoice/payment processing information between Federal agencies and their vendors by providing access to information on purchase orders, invoices, and Treasury-disbursed payments. FMS piloted the IPP from January 2003 to June 2004, and is working on the rollout which is scheduled for November 2007. (PMA Initiative Supported: Improved Financial Performance)

Audit Objective To determine if FMS (1) implemented proper security measures and controls for the IPP, (2) identified and addressed issues found in the IPP pilot program, and (3) established an implementation plan to provide IPP to all agencies. We anticipate that this project will require 2,000 hours. (PMA Initiative Supported: Improved Financial Performance)

FMS Treasury Check Information System

Background Implemented by FMS in 2006, the Treasury Check Information System (TCIS) records and reconciles the worldwide issuance and payment of U.S. Treasury checks. This system also allows end users to query FMS's Payments, Claims & Enhanced Reconciliation (PACER) system for claim status on Automated Clearing House (ACH) payments

Audit Objective To determine if TCIS is meeting its intended purpose. We anticipate that this audit will require 2,000 hours.

BPD's TreasuryDirect System (Follow-Up)

Audit Objective To determine whether BPD has adequate controls, including fraud deterrence, for transactions conducted over the internet-based TreasuryDirect system. We anticipate that this audit will require 2,000 hours.

FMS's Approach to Providing Services to Federal Agencies

Background A recent OIG Corrective Action Verification report relating to a recommendation made in a prior report, *FMS's Plastic Card Network* (OIG-03-088), found that FMS was in the process of developing and implementing a long-term collection strategy. This strategy would involve the design of a collection mix for each agency that would achieve cost efficiency by using the most cost-effective collection methods for each agency. The approach is aimed at lowering transaction costs for each agency, thereby lowering overall costs to the federal government. The costs of federal collection are steadily increasing as the volume of collections increase each year. The operating expenses for Plastic Card Network service alone cost FMS more than $290 million from fiscal year 2002 through fiscal year 2005. FMS plans to conduct a pilot test of the approach with Tier 1 agencies – a group of federal agencies selected by FMS to test the approach – in a phased-in manner during calendar year 2007.

Audit Objective To determine whether FMS has taken action to implement the new collection strategy and evaluate its effectiveness. We anticipate that this audit will require 300 hours. (PMA Initiative Supported: Improved Financial Performance)

FMS Administration of DCIA Activities

Audit Objective To determine whether FMS is effective in its administration of DCIA activities. We anticipate that this project will require 2,000 hours. (PMA Initiative Supported: Improved Financial Performance)

FMS DebtCheck Program

Background FMS developed a debt management program – DebtCheck – which allows agencies and outside lenders to determine whether applicants for federal loans, loan insurance, or loan guarantees owe delinquent non-tax debt or delinquent child support to the federal government. Federal agencies are required to deny loans, loan insurance, or loan guarantees to entities that owe delinquent, non-tax debt to the federal government. By Executive Order, this prohibition has been extended to delinquent child-support debtors whose debts have been referred to the TOP for administrative offset.

Initial rollout of the program began with the Small Business Administration in February 2003. The current process is web-based; batch application processing is expected to be available in 2007. Agencies are being phased in gradually.

Audit Objective To determine if FMS has effectively implemented the DebtCheck program and is working with other federal agencies to ensure that delinquent debtors do not receive further Federal funds. We anticipate that this project will require 1,600 hours. (PMA Initiative Supported: Improved Financial Performance)

Safety, Soundness, and Accessibility of Financial Services

Office of Audit Contact: Alain Dubois, Director of Audit (202) 927-0382
Office of Investigations Contact: Gerry Garren, Special Agent in Charge, Financial Crimes

Issue Area Discussion

One of Treasury's strategic objectives is to provide a flexible legal and regulatory framework that ensures a safe and sound national financial system promoting the growth of financial services, access to financial services, and fair treatment of banking and thrift customers. Two important components of this financial system are the nation's banking and thrift industries with over $10 trillion in combined assets. OCC and OTS are Treasury's two main regulatory agencies responsible for overseeing the two industries.

OCC is responsible for licensing, regulating, and supervising approximately 1,800 nationally chartered banks and over 50 federal branches or agencies of foreign banks. OCC supervised national banks hold over $6 trillion in commercial banking assets. OCC has approximately 2,800 employees located throughout the U.S., and funds its operations ($579 million in fiscal year 2006) largely through assessments levied on national banks and from various licensing fees.

OTS charters, regulates and supervise the vast majority of the nation's savings associations, commonly referred to as "thrifts." OTS supervised approximately 850 of the nation's thrifts accounting for over $1.5 trillion of total thrift assets. OTS also supervised approximately 480 U.S.-domiciled holding company enterprises with approximately $7.2 trillion in consolidated assets.[9] OTS has approximately 900 employees located in Washington, D.C., and across four regional offices. OTS's fiscal year 2006 operating budget totaled approximately $216 million, which like OCC, is largely funded through assessments.

OCC and OTS share four similar strategic goals: (1) a safe and sound national banking and thrift system; (2) fair access to financial services and fair treatment of customers; (3) a flexible legal and regulatory framework that enables their respective industries to provide a full competitive array of financial services; and (4) an expert, highly motivated, and diverse workforce.

Over the last 3 years the banking and thrift industries have sustained strong growth marked by record earnings, profits, and capitalization. National bank earnings have remained at historically high levels for a decade. Since 2003, national banks have exceeded earnings milestones. National banks continue to set new records for both return on equity and return on assets.

[9] These holding companies owned approximately 450 thrifts with total assets of $1.2 trillion, accounting for nearly 80 percent of total thrift industry assets.

The banking industry ended the first quarter of 2006 with record earnings of $37.3 billion, benefiting from higher fee income and lower loss provisions which offset a continuing trend of lower net interest margins. Higher earnings in turn contributed to a corresponding increase in the industry's capital base as of the first quarter of 2006. The evolving asset mix of banks toward higher-yielding assets, combined with significantly higher trading activities in derivatives was the primary driver of income during the first quarter of 2006.

OCC reported that earnings remained high in national banks at the beginning of 2006. Non interest income was the most significant contributor to earnings growth, with the gains at a few of the largest banks driving the results. Loan quality remained very strong in all segments of the commercial banking system except credit cards. OTS reported that during the first quarter of 2006 strong earnings and profitability, solid loan growth, and healthy asset quality characterized the thrift industry. Capital measures for the thrift industry continue to be strong, stable, and well in excess of minimum requirements.

Besides financial performance, traditional measures and indicators of safety and soundness have also reflected the industry's continued healthy performance. Problem banks and thrifts -- those with composite examination CAMELS ratings[10] of 4 or 5 – totaled 16 as of June 30, 2006. Additionally, FDIC reported there were no bank failures in 2005.

Safety and soundness risks facing the banking industry include rising interest rates, the proliferation of non-traditional mortgage products, and the slowdown in the real estate market. Rising interest rates can adversely affect institutions' financial net interest margins, where interest earned on loans made by the institutions do not keep pace with the rising interest payments made on their deposits and require changes in risk management by financial institutions. Non traditional mortgage products[11] accounted for an estimated one-third of total U.S. mortgage originations in 2005 and expose banks to losses from home foreclosures and liquidations if homeowners are unable to make payments on their mortgages due to rising interest rates. In addition, the slowdown in the real estate market has led to overall declines in mortgage lending, as home loan applications measured during the last week of July 2006 were at their lowest level in four

[10] Financial institution regulators use the Uniform Financial Institutions Rating System to evaluate an institution's performance. CAMELS is an acronym for the performance rating components: Capital adequacy, Asset quality, Management administration, Earnings, Liquidity, and Sensitivity to market risk. Numerical values range from 1 to 5, with 1 being the highest rating and 5 representing the worst rated banks.

[11] Non-traditional mortgage products include option Adjustable Rate Mortgages, Interest-Only mortgages, and sub-prime mortgages. Sub-prime mortgages are mortgages that have higher interest rates due to deficiencies in either the credit history or the financial health of the borrower.

years. This is a potentially significant development since real estate loans at the end of 2005 accounted for approximately one third of commercial banking assets.

Another emerging event in the banking industry is the adoption of Basel II. Basel II is an effort by international banking supervisors to update the original international bank capital accord (Basel I), which has been in effect since 1988. Basel II aims to improve the consistency of capital regulations internationally, make regulatory capital more risk sensitive, and promote enhanced risk-management practices. The Federal Reserve Board, OTS, OCC, and FDIC have proposed to make the new Basel II rules mandatory for the nation's largest, most internationally active banking organizations—those with $250 billion of assets or exposure to foreign markets above $10 billion. This would include about a dozen of the largest banks and thrifts in the U.S. Smaller banking companies will have the option to adopt either Basel II, another proposed capital framework commonly referred to as Basel 1A, or to remain under the existing capital rules. Basel 1A is intended to improve on the risk sensitivity of the existing framework but does not require the advanced systems needed for Basel II. We will be following OCC's and OTS's efforts in moving towards adoption of Basel II, and monitoring its impact on safety and soundness.

Derivatives have become an integral part of the financial markets because they can be used to reduce business risks, expand product offerings to customers, trade for profit, manage capital and funding costs, and alter the risk-reward profile of a particular item or an entire balance sheet. They are used by banks, businesses and hedge funds among others. In the banking industry, the growth in derivative holdings of banks over the past 10 years has been rapid, increasing the risk to OCC's and OTS's supervisory activities.

Significant pricing variability in the sub-prime market has increased concerns about the fairness of creditor decisions. For the first time in 2004, Home Mortgage Disclosure Act (HMDA) data included information concerning the annual percentage rate charged borrowers on higher-cost home loans. The higher priced segment of the home loan market, a segment virtually nonexistent a decade ago is now a substantial part of the market. The growth of this market segment, while affording some consumers greater access to credit, has been accompanied by concerns about abusive lending practices. The same data, collected under the requirements of the also detail several aspects of the loan transaction and the identity of the borrower, including race, ethnicity, sex, and income. Recent data disclosed by banks shows that minority borrowers have been far more likely to receive such loans raising concerns over possible discriminatory and predatory lending.

Another area of growing concern has been the reoccurring incidences of customer financial privacy and identity theft. A study issued by the Identity Theft Resource Center found that banks were involved in 12 percent of identity theft incidents in the first half of 2006. One of the largest bank security breaches occurred in 2005 when it was discovered that account information for more than 670,000 customers was stolen from four large banks. To address identify theft, the federal banking regulators issued a joint notice of proposed rulemaking in July 2006 which proposes that banks, credit unions, credit card companies, and other financial services businesses form identity theft programs that involve issuing red flags when an account could be at risk.

Potential problems in the environment over the next 5 to 10 years are likely to be associated with inadequate safeguards in the use of technology. Consolidation and increased non bank ownership of fund transfer networks may expose banks to new operational risks and outsourcing certain functions will involve business continuity and security risks.

Another key OIG concern deals with Treasury's role in ensuring that our nation's financial infrastructure is able to maintain continuity of operations and avoid disruptions due to national disasters or terrorist attacks. The OIG will continue audit oversight of critical infrastructure protection issues as provided under Homeland Security Presidential Directive 7, *Critical Infrastructure Identification, Prioritization and Protection.*

The *OIG Fiscal Year 2007 Annual Plan* attempts to address the major challenges affecting the Department, OCC, and OTS ability to effectively carry out their respective strategic objectives and core mission as well as potential integrity risks. The following planned audits were developed taking into account emerging risks, recent industry developments, the President's Management Agenda as applicable, weaknesses previously reported by the OIG, and audit issues reflected in OIG audit plans for the other federal banking regulators (i.e., the OIGs of FDIC, the Federal Reserve, and the National Credit Union Administration). It should be noted one key area of risk dealing with bank and thrift compliance with the BSA and critical infrastructure are provided for in another section of the audit plan dealing with Terrorist Financing, Money Laundering, and Foreign Assets Control.

Potential Integrity Risks We believe there are potential risks stemming from inappropriate conduct by examiner staff as well as from such staff's real or perceived conflicts of interest. Credibility is essential to both OCC and OTS in order for them to effectively supervise and maintain the safety and soundness of the banking industry. In the performance of their duties, OCC and OTS examiners should maintain objectivity and integrity, be free of conflicts of interest, and not subordinate their judgment to others.

In Progress and Planned Fiscal Year 2007 Projects

Material Loss Reviews of Failed Financial Institutions

Background The Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) requires our office to review a failed financial institution supervised by OCC or OTS if the loss to a deposit insurance fund exceeds $25 million or 2 percent of the institution's total assets.

Audit Objective In the event an OCC- or OTS-regulated institution fails during fiscal year 2007 that results in a material loss, we will conduct an MLR to: (1) determine the cause(s) of the failure; (2) assess the supervision exercised over the institution, including the use of the Prompt Corrective Action provisions of FDICIA; and (3) as applicable, make recommendations to prevent similar losses in the future. A material loss review typically requires 5,000 hours.

OCC/OTS Supervisory Response to the 2005 Hurricane Season (In Progress)

Audit Objective To determine the regulators preparedness for the 2005 hurricanes with respect to financial institutions and their customers. We plan to issue separate reports on OCC and OTS. We anticipate that this project will require 400 hours to complete in fiscal year 2007.

OCC Use of Home Mortgage Disclosure Act Data

Audit Objective To determine if OCC (1) was making effective use of HMDA data; and (2) taking appropriate action to address possible discriminatory lending practices based on HMDA data. We anticipate that this project will require 2,000 hours.

OCC/OTS Assessment of Interest Rate Risk

Audit Objective To evaluate how OCC and OTS are evaluating interest rate risk. We anticipate that this project will require 2,400 hours at each regulator.

OTS's Supervision of the International Activities of Bank Holding Companies

Audit Objective To determine if OTS is effectively supervising thrifts with international operations and their holding companies and affiliates. We anticipate that this project will require 2,400 hours.

OCC/OTS Examination Coverage of Privacy and Identity Risks When National Banks Outsource Functions to Third Party Service Providers

Audit Objective To determine if OCC and OTS examinations provide adequate coverage of banks' third party service providers when they are provided customer financial information subject to the Financial Privacy Act. We anticipate this project will require 2,000 hours at each regulator.

Protecting the Financial Services Sector Critical Infrastructure

Audit Objective To determine the effectiveness of the coordination efforts by Treasury, as the sector-specific agency for the banking and finance sector, with private sector entities to protect this portion of the nation's critical infrastructure. Also, to determine the effectiveness of the Financial Service's Information Sharing Analysis Centers in establishing open communication and information sharing between the various entities in the financial services sector with Treasury and the federal government. We anticipate this project will require 1,600 hours.

Projects Under Consideration for Future OIG Annual Plans

OCC/OTS Examiner Safeguards Over Bank Sensitive Information

Audit Objective To determine whether examiners adhere to safeguarding polices and procedures over financial institutions and or customer bank sensitive information. We anticipate that this project will require 2,000 hours at each regulator.

OCC/OTS Examiner Coverage of Non-Conventional Home Mortgage Loan Risk

Audit Objective To (1) determine whether regulators give adequate weight to non-conventional loans in assessing the related risk to the institution's loan portfolio and in assessing an institution's CAMELS rating; (2) ensure that examination procedures provide a level of testing of non-conventional loans that is commensurate with the adverse effects that higher interest rates could have on the loan portfolio, and consequently on the institution's safety and soundness; and (3) determine whether the examiners ensure that the institution's Allowance for Loan and Lease Losses appropriately reflects the higher risks associated with certain non-conventional loans. We anticipate each project will require 1,600 hours at each regulator.

OCC/OTS Risk Management of Derivatives at Financial Institutions

Audit Objective To determine if OCC and OTS are effectively monitoring the risk that derivatives pose to financial institutions. We anticipate that this project will require 2,400 hours at each regulator.

OCC/OTS Examinations Coverage of Identity Theft Risk

Audit Objective Determine the effectiveness and adequacy of examinations to ensure banks and thrifts have sufficient controls to prevent or mitigate identity theft. We anticipate that 2,400 hours will be required for this project at each regulator.

Impact of Basel II Capital Accord on OCC and OTS Supervisory Abilities

Audit Objective To determine what actions OCC and OTS are taking to analyze the impact of the change in capital requirements under Basel II on their supervisory activities. We anticipate that this project will require 2,000 hours at each regulator.

OCC Examinations of Large Banks

Audit Objective Assess the effectiveness and adequacy of OCC's examinations of banks with assets exceeding $100 billion relative to OCC's four-pronged strategic goals. This would include areas such as staffing, subject matter expertise, aggregate and unit risk assessments, compliance, fraud, examiner rotation, and reliance placed on internal/external auditors work. We anticipate that this project will require 2,400 hours.

Adequacy of OCC and OTS Exams of Financial Institutions Non-Banking Related Activities

Background National bank subsidiaries and savings and loans holding companies can be engaged in significant non-banking related business activities such as insurance and securities brokerage. As part of their supervisory approaches, both OCC and OTS coordinate with other regulators to avoid regulatory duplication, however, OCC and OTS remain responsible for evaluating the risk to the banking activities stemming from non-banking activities.

Audit Objective To determine the adequacy and effectiveness of examinations by OCC and OTS of national bank subsidiaries, and savings and loan holding companies, respectively. We anticipate this project will require 2,400 hours at each regulator.

Revenue Collection and Industry Regulation

Office of Audit Contact: Donald P. Benson, Director of Audit (617) 223-8640
Office of Investigations Contact: Gerry Garren, Special Agent in Charge, Financial Crimes

Issue Area Discussion

The Office of Tax Policy assists the Secretary of the Treasury in developing and implementing tax policies and programs; provides the official estimates of all Government receipts for the President's budget, fiscal policy decisions, and Treasury cash management decisions; establishes policy criteria reflected in regulations and rulings and guides preparation of them with IRS to implement and administer the Internal Revenue Code; negotiates tax treaties for the United States and represents the United States in meetings and work of multilateral organizations dealing with tax policy matters; and provides economic and legal policy analysis for domestic and international tax policy decisions. By Treasury Order, the Assistant Secretary (Tax Policy) is exclusively authorized to make the final determination of the Department's position with respect to issues of tax policy arising in-connection with regulations, published Revenue Rulings and Revenue Procedures, and tax return forms and to determine the time, form and manner for the public communication of such position.

Reporting to the Office of Tax Policy, TTB is the primary focus of our office in the issue area of revenue collection and industry regulation. TTB is responsible for the regulation of the alcohol and tobacco industries, and the collection of alcohol, tobacco, firearms and ammunition excise taxes. TTB ensures that alcohol and tobacco beverages are properly labeled, advertised, and marketed; facilitates the importation and exportation of alcohol beverages and non-beverage products; promotes tax compliance, and collects excise tax revenue. TTB administers and enforces: (1) the Internal Revenue Code pertaining to the excise taxation and authorized operations of alcohol and tobacco producers and related industries; (2) the Federal Alcohol Administration Act; (3) the Alcohol Beverage Labeling Act; and (4) the Webb-Kenyon Act, which prohibits the shipment of alcoholic beverages into a state in violation of the state’s laws. TTB is headquartered in Washington, D.C., and has 10 district field offices. The TTB Office of Field Operations is comprised of four units: (1) National Revenue Center (NRC) in Cincinnati, Ohio; (2) Risk Management Staff; (3) Trade Investigations Division (7 field offices); and (4) Tax Audit Division (10 field offices). TTB also has alcohol and tobacco laboratories in Maryland and California.

<u>Collecting the Revenue</u> In fiscal year 2007, TTB expects to receive and review more than 400,000 tax returns and operational reports and more than 4,000 applications for permits to enter the alcohol and tobacco industries. TTB collects excise taxes from the alcohol, tobacco, firearms, and ammunition industries, as well as permit and license fees. During fiscal year 2006, TTB collected $14.8 billon in excise taxes and other revenue, refunded $356 million to taxpayers, and provided $367 million in “cover over” (taxes collected on rum products) to the governments of Puerto Rico and the U.S. Virgin Islands.

One of the taxes TTB has collected over the years is known as the Special Occupational Tax (SOT). This tax has been collected from those businesses engaged in alcohol and tobacco industries at the manufacturing, wholesale/importing, and retailing levels (excluding tobacco retailers). The American Job Creations Act of 2004 (H.R. 4520) suspends this tax for certain businesses for the 3-year period July 1, 2005 through June 30, 2008. SOT will no longer be required from producers, wholesalers, importers, and retailers of alcoholic beverages, or from manufacturers of non-beverage products. SOT will continue to be due from tax-free alcohol users and specially denatured alcohol users and dealers, as well as tobacco products manufacturers and tobacco export warehouse proprietors.

Recently, TTB has been establishing a number of new initiatives to allow the electronic filing of tax returns, reports, applications, claims, and other related information. TTB has also been encouraging voluntary compliance by taxpayers through an approach that audits large taxpayers (about 400 taxpayers account for 98 percent of the tax collections) and audits the remaining tax payers on the basis of risk and random sampling. For 2007 to 2009, TTB plans to continue to use a risk based approach to audit a combination of large, medium, and small excise taxpayers, focusing on areas where there is a significant "risk to revenue."

Protecting the Public Another important role for TTB is to protect the public by ensuring that alcoholic beverages are produced, labeled, advertised, and marketed in accordance with Federal law. TTB reviews labels and formulas for domestic and imported beverage alcohol products and maintains public access to approved Certificates of Label Approval (COLA). COLAs are required for every alcoholic beverage. In fiscal year 2005, TTB received over 106,000 COLA applications and approved close to 80,000. TTB laboratories test alcoholic products to ensure integrity. TTB further ensures that only qualified applicants enter the regulated alcohol and tobacco industries by requiring applicants to apply for and receive permits.

Prior Audit Work Due to other priority audit work, we completed only two audits of TTB in the last 4 years.

- A fiscal year 2006 audit of the Tax Audit Division's targeting of taxpayers for audit found that the Tax Audit Division, after developing a risk assessment model to use in selecting taxpayers for audit, abandoned use of the model. TTB decided to use only revenue as a risk factor and to audit the top 400 taxpayers who account for 98 percent of the excise tax revenue. The audit found that the model TTB developed contained inaccurate and incomplete data, which affected the overall rankings. The audit also found taxpayer account balances maintained at the

National Revenue Center were not always accurate because electronic payments had been posted to the wrong taxpayer accounts.

- An audit completed in 2004 was followed-up on prior OIG audits that found significant vulnerabilities in the controls over excise tax waivers associated with exported alcohol and tobacco products. The prior audits, conducted in fiscal years 1999 and 2000, found missing documentary support at the NRC for these waivers that raised questions about whether the products were actually exported and the waivers appropriate. The waivers provided tax exemptions in the hundreds of millions of dollars. Despite improvements in controls, the 2004 follow-up audit found continuing problems with documentation not being available at the NRC to support the exportation of these products. In response, TTB has revised the process. Now, rather than having all supporting documentation submitted to NRC for administrative review, TTB requires the manufacturers and importers to maintain documentary support at their premises for review by the Tax Audit Division during on-site audits.

Our most recent audit work in the area of industry regulation was conducted in the years 1999 through 2001 and found control weaknesses in a number of areas. For example, a program to sample beverages for product compliance lacked clear and measurable goals and did not conduct statistically valid sampling that would allow the bureau to make better use of the results. An audit of the alcohol and tobacco laboratory found many of the test results were unused by requesting managers. Another audit found inconsistent handling of applications for approval of product labels.

<u>Customs Revenue Functions</u> The Office of Tax Policy also oversees certain revenue functions of the Department of Homeland Security's Customs and Border Protection. The Homeland Security Act of 2002 (HSA) transferred the former U.S. Customs Service from Treasury to the Department of Homeland Security in March 2003. However, as provided by HSA, Treasury retained the sole authority to approve any regulations concerning import quotas or trade bans, user fees, marking, labeling, copyright and trademark enforcement, and the completion of entry or substance of entry summary including duty assessment and collection, classification, valuation, application of the U.S. Harmonized Tariff Schedules, eligibility or requirements for preferential trade programs, and the establishment of related recordkeeping requirements.

<u>Potential Integrity Risks</u> We believe the major integrity risk regarding revenue collection and industry regulation is the failure by industry members to pay all taxes due, either intentionally or otherwise, coupled with the concurrent failure of TTB to detect this underpayment. Intentional failure to pay all taxes due would likely require deceit or fraud on the part of taxpayers as well as attempts to corrupt TTB employees through bribery or other means. Similarly, fraudulent manufacturers or distributors could create a risk for

consumers by placing unsafe or deceptively advertised products into the marketplace, particularly if TTB's protective programs are not functioning well enough to detect these products. With respect to formulating tax policy, regulations, and rulings, there is also a risk of undue influence by impacted parties who could potentially benefit from Treasury positions on tax matters.

In Progress and Planned Fiscal Year 2007 Projects

Based on current resource levels, mandated work, and risk relative to other OIG Issue Areas, no audits of TTB programs and operations are planned for fiscal year 2007.

Formulation of Tax Policies, Regulations, and Rulings

Audit Objective To determine the process and related controls within the Office of Tax Policy for formulating the Department's tax-related policies, regulations, and rulings. We estimate this project will require 2,000 hours. (PMA Initiative Supported: Improved Financial Performance)

Projects Under Consideration for Future OIG Annual Plans

TTB Alcohol and Tobacco Permit Program

Audit Objective To determine if effective controls are in place to ensure that alcohol and tobacco permits are only issued to qualified persons and businesses. The audit will review the types of controls in place and whether these controls consider the implications of possible terrorist involvement in the marketplace. We estimate this project will require 2,000 hours.

TTB Safeguards Over Taxpayer Information

Audit Objective To determine whether TTB has adequate safeguards over the security of taxpayer returns and return information. We anticipate that this project will require 1,600 hours.

TTB Background Investigations

Audit Objective To determine if TTB staff with access to sensitive tax return data have up-to-date background investigations. We anticipate that this project will require 2,000 hours.

TTB On-Line Certificate of Label Approval

Audit Objective To determine if there have been user problems with the on-line certificate and label approval system and, if so, what has TTB done to correct the problems. We anticipate that this project will require 1,600 hours.

Alcohol and Tobacco Laboratories

Audit Objective To determine if TTB alcohol and tobacco laboratories are providing timely and responsive service to TTB program units. We anticipate that this project will require 2,000 hours.

Manufacturer Non-Beverage Drawback Program

Audit Objective To determine whether TTB is adequately protecting excise tax revenue through its review of non-beverage product manufacturers and their claims for drawback (refund). We anticipate that this project will require 1,600 hours.

TTB Designation of American Viticultural Areas

Background An American Viticultural Area is a delimited grape-growing region recognized by TTB that is distinguishable by geographical features. A viticultural area designation should be based on features that affect the growing conditions of the area (climate, soil, elevation, physical features) and may extend across political boundaries. However, the entire area should possess a unifying feature that distinguishes it from surrounding areas, and evidence must be provided to TTB that shows this contrast.

Audit Objective To determine if adequate controls are in place over TTB's program to designate American Viticultural Areas. We anticipate that this project will require 1,600 hours.

TTB Controls Over Payments to Vendors Who Lost Products to Natural Disasters

Audit Objective To determine if effective controls are in place to ensure that claims presented to TTB for excise tax refunds for alcohol and tobacco products lost or destroyed in natural disasters are legitimate and accurate. We estimate this project will require 1,200 hours.

TTB Collection Procedures

Audit Objective To determine whether TTB has effective collection procedures for delinquent accounts, and is using these procedures to ensure prompt payment. We estimate this project will require 1,600 hours. (PMA Initiative Supported: Improved Financial Performance)

Protecting the Revenue by the Use of Collateral

Audit Objective To determine whether TTB has established sufficient pledged collateral or bond amounts to protect against loss of excise tax revenue. We estimate this project will require 800 hours. (PMA Initiative Supported: Improved Financial Performance)

TTB Approval to Share Winemaking Facilities and Obtain Wine Tax Credits

Background TTB has established requirements for the sharing of wine making facilities known as “alternating proprietorships” and for the small domestic producers' wine tax credit (a reduced effective excise tax rate to producers of less than 250,000 gallons of wine a year) for which certain alternating proprietors may be eligible. An “alternating proprietorship” is an arrangement whereby two or more persons take turns using the physical premises of a winemaking facility. In most situations, the “host” proprietor agrees to rent space and equipment to a new “tenant” proprietor. This allows existing wineries to use excess capacity and gives new entrants to the wine business an opportunity to begin on a small scale without investing in equipment.

Audit Objective To determine whether TTB has adequate controls to ensure that applicants for these arrangements are legitimate, qualified, and eligible for wine credits. We anticipate that this project will require 1,600 hours. (PMA Initiative Supported: Improved Financial Performance)

Bill and Coin Manufacturing, Marketing, and Distribution Operations

Office of Audit Contact: Thomas E. Byrnes, Director of Audit (202) 927-5904
Office of Investigations Contact: William H. Sterling, Acting Special Agent in Charge, Procurement Misconduct Branch, (202) 927-1084

Issue Area Discussion

This issue area focuses on the programs and operations of BEP and the Mint.

BEP produces U.S. currency and many other security documents issued by the federal government. For 111 years, the Bureau produced U.S. postage stamps for the U.S. Postal Service; but in mid-2005, the Bureau ceased U.S. postage stamp production. Its other activities include engraving plates and dies; manufacturing certain inks used to print security products; purchasing materials, supplies and equipment; and storing and delivering products in accordance with requirements of customers. In addition, BEP provides technical assistance and advice to other federal agencies in the design and production of documents, which, because of their innate value or other characteristics, require counterfeit deterrence. The bureau audits cash destruction and unfit currency operations at Federal Reserve Banks, and it is responsible for the accountability and destruction of internally generated security waste products. BEP also processes claims for the redemption of mutilated paper currency. BEP's production facilities are located in Washington, D.C., and Fort Worth, Texas.

In 2005, BEP delivered 8.6 billion Federal Reserve Notes to the Federal Reserve System. This resulted in revenue of $525 million and an excess of expenses over revenue of $28.8 million. When setting currency prices for 2004, the BEP chose to fund the additional costs incurred to prepare for the production of next generation currency through working capital and productivity improvements rather than price increases.

The Mint's principal mission is to produce the nation's circulation coinage for trade and commerce. Along with the Mint's headquarters in Washington, D.C., there are four production facilities (Philadelphia, West Point, Denver, and San Francisco) and the bullion depository at Fort Knox. During fiscal year 2005, the Mint manufactured 14.2 billion coins for the Federal Reserve System.

In fiscal year 1996, the Mint Public Enterprise Fund (PEF) was created to enable the Mint to operate as a revolving fund. All receipts deposited into the PEF are available for Mint operations and the cost of safeguarding government assets in the Mint's custody without fiscal year limitations. The Secretary of the Treasury must annually determine the amount of excess funds in the PEF that are not needed for Mint operations and programs. That excess is transferred to the Treasury General Fund for deposit as a miscellaneous receipt. For fiscal year 2005, the Mint transferred $775 million to the Treasury General Fund. Even though the Mint is not dependent on appropriated funds, its spending authority is approved each fiscal year.

Potential Weaknesses Because their operations are financed through revolving funds, BEP and the Mint are subject to less Congressional oversight scrutiny through the federal budget process than appropriated agencies. The PEF legislation also accorded the Mint with greater flexibilities in conducting its procurement and personnel activities. For example, the Mint is exempt from following the Federal Acquisition Regulation (FAR). In a 2002 audit, we noted weaknesses in the Mint's use of the PEF authority to acquire leased space for its headquarters operations, including acquiring space in excess of its needs. In 2001, the Department reviewed the Mint's procurement operations, also noting significant weaknesses. Continued prudent use of its PEF authority flexibilities is necessary to ensure a maximum return to the Treasury General Fund from the Mint's operations.

Two recent OIG audits noted various weaknesses in BEP security matters. In fiscal year 2003, we reported that among other things, employees did not always have the level of security clearance commensurate with their work assignments (OIG-03-004). In fiscal year 2004, we reported that the dual reporting structure for security operations at its two currency facilities have resulted in inconsistent policies and practices. We also reported weaknesses with BEP police officer training and firearms re-qualifications and security system (OIG-04-025).

Emerging Issue Impacting BEP In November 2006, a federal judge ruled that the Department's failure to design, produce and issue paper currency that is readily distinguishable to blind and visually impaired people violated federal law. The ruling is under appeal.

Potential Integrity Risks In addition to the weaknesses identified above, we believe there are several potential integrity risks associated with Treasury's manufacturing operations. Potential integrity risks exist from external personnel—contractors or consultants, terrorists and hackers; and internal personnel—employee who can be disgruntled, unethical, untrained. For example, these personnel can (1) disrupt Treasury functions, (2) violate laws, (3) award contracts for less than best value, (4) receive bribes or kick-backs, (5) steal or reveal sensitive data, and (6) cost the taxpayer money through the theft of: (a) materials and machinery, (b) finished products, and (c) mutilated products. Over the past 2 years, major thefts occurred at both BEP manufacturing facilities. In addition, human resource factors exist that can impact select bureaus manufacturing operations environment. For instance, both BEP and the Mint have undergone senior management changes. Also, the Mint has recently replaced its Bureau Procurement Chief, while BEP continually loses experienced contracting officers. Furthermore, the Mint is exempt from the FAR and continues to down size its operations.

In Progress and Planned Fiscal Year 2007 Projects

BEP Internal Controls Over Currency Operations (In Progress)

Audit Objective To determine (1) the internal control failures that allowed the thefts at BEP manufacturing facilities to be perpetrated and (2) whether BEP has enhanced internal controls to prevent and detect the occurrence of such thefts in the future. We plan to issue separate reports on each facility. We anticipate that this project will require 2,000 hours.

Mint Procurement Operations

Audit Objective To determine whether the Mint follows logical and prudent business practices when procuring goods and services. We anticipate that this project will require 2,400 hours. (PMA Initiative Supported: Improved Financial Performance)

BEP Continuity of Operations Planning

Audit Objective To determine whether BEP has comprehensively developed and tested continuity of operations plans for its currency production should a major disruption occur at one or both its manufacturing plants. We anticipate that this project will require 2,400 hours.

Mint Controls Over the Sales of Limited Production Coins

Audit Objective To determine whether the Mint has adequate controls to ensure the broadest and most fair access to its products. We anticipate that this project will require 2,000 hours.

Mint Manufacturing and Inventory Initiative

Audit/Investigative Objective To determine if the Mint has established adequate controls over its inventory of raw materials and finished products. As part of the initiative, we plan to review the controls over the disposition of scrap, as well as the disposal of coin dies after they have been used in production.

Projects Under Consideration for Future OIG Annual Plans

Mint Production Scheduling

Audit Objective To determine whether the Mint identifies its production requirements to meet customer needs in an effective manner. As part of this project, we plan to follow up on our prior report OIG-02-066, *MANUFACTURING OPERATIONS: The Mint Suspends Its FY 2002 Planned Production of Golden Dollar Coins*. We anticipate that this project will require 2,000 hours. (PMA Initiative Supported: Improved Financial Performance)

BEP Controls Over Background Investigations (Follow-Up)

Audit Objective To determine if BEP has implemented recommendations from our October 2002 report. We anticipate that this project will require 1,600 hours.

BEP Capital Investment Program

Audit Objective To determine whether BEP's capital investment program ensures that all capital needs are being identified and sufficient funds are being allocated to meet current and future capital needs. We estimate this project will require 1,600 hours.

BEP Controls Over Security (Follow-Up)

Audit Objective To determine what actions BEP has taken in response to our 2004 report to ensure consistent training and firearms re-qualification policies are followed at its two production facilities. We anticipate that this project will require 800 hours.

Mint Leasing Practices

Audit Objective To determine whether the Mint followed logical procurement procedures and prudent business practices when it procured leased space for its operations. As part of this audit, we will follow up on the recommendations in OIG-02-074, *GENERAL MANAGEMENT: The Mint Leased Excessive Space for Its Headquarters' Operation*. We anticipate that this project will require 1,600 hours.

Domestic and International Assistance Programs

Office of Audit Contact: Donald R. Kassel, Director of Audit (202) 927-6512
Office of Investigations Contact: Gerry Garren, Special Agent in Charge, Financial Crimes

Issue Area Discussion

Treasury plays an important role in a number of domestic and international assistance programs that have a significant impact on the economy. Domestic programs range from those that enhance the availability of financial education and of credit, investment capital, and financial services to communities around the U.S., to programs that assist in coping with the after-effects of the September 11th terrorist attacks. International programs address the role of international financial institutions and promote economic stability and growth in other countries.

Domestic Assistance Treasury provides assistance to promote economic growth and raise the standard of living in distressed communities in the U.S. by increasing the availability of business capital and financial services. CDFI, for example, works to increase economic growth and create jobs in distressed urban and rural communities by providing an array of community development financial services through CDFIs and Community Development Entities. The New Markets Tax Credit (NMTC) Program, one of the more recent initiatives in this arena, provides for a total of $16 billion in tax incentives to help spur investments in low-income communities. During the first four award cycles, the CDFI Fund has designated 233 Community Development Entities and made available $12.1 billion in tax credits. This includes $1 billion for use specifically in the Hurricane Katrina Gulf Opportunity Zone. Other CDFI Fund programs provided over $48 million in awards to 164 organizations during fiscal year 2005.

Executive Order 12870 established the membership and duties of the Trade Promotion Coordination Committee (TPCC) whose membership includes 21 Federal agencies. According to recent GAO testimony[12] on the TPCC, the Departments of Commerce (lead agency), Agriculture, State and Ex-Im Bank account for more than 90 percent of TPCC member agencies' combined budget authority related to trade promotion. Treasury accounts for a minor share of the combined budget at approximately $3 million annually. The TPCC is intended to provide a unifying interagency framework to coordinate U.S. export promotion activities and to develop a government wide strategic plan. TPCC member agencies' activities include providing training, market information, advocacy, trade finance, and other services to U.S. companies, especially small- and medium-sized businesses seeking to export their products.

[12] *Export Promotion: Trade Promotion Coordinating Committee's Role Remains Limited* GAO-06-66T (April 26, 2006)

International Assistance A prosperous world economy serves the U.S. in many ways, including creating markets for U.S. goods and services, and promoting stability and cooperation among nations. Treasury focuses on preventing crises and minimizing the impact of those that occur. International financial institutions (IFI), such as the International Monetary Fund and the multilateral development banks, such as the World Bank, play a key role in enabling global economic growth and stability.

Treasury's Office of International Affairs oversees U.S. interests in IFIs. The U.S. participates in IFIs to support poverty reduction, private sector development, the transition to market economies, and sustainable economic growth and development; and thereby to advance U.S. economic, political, and commercial interests abroad. Treasury has the responsibility for ensuring that these institutions appropriately use the resources the U.S. contributes, and for this reason systematically reviews how IFIs use the money the U.S. government has invested in them. Improving the effectiveness of the Multilateral Development Banks has been a high priority for the Administration. Accordingly, Treasury has been pursuing a reform agenda that emphasizes raising living standards and reducing poverty; measuring the results of U.S. contributions; and strengthening efforts to stimulate private-sector investment, promote good government and the rule of law, and fight corruption.

Potential Integrity Risks We believe Integrity risks for domestic and international assistance programs include the potential (1) unauthorized release of sensitive or classified data; (2) the falsification of applications or statements; (3) misuse or mismanagement of federal funds—including irregularities in the award of contracts and misallocation of grant proceeds or federal tax credits; and (4) failure to deliver on promised services. As the success of CDFI's programs are based upon the truthfulness of the certifications made by individual applicants reflecting their full disclosure of information, falsification of documents presents a significant risk leading to the unauthorized use of funds. Of particular concern would be contracts that may be let, or grants or tax credits that may be awarded, without following standard operating procedures. This may occur when there is adjudication within limited time frames due to war or natural disasters. In addition, we recognize that program risks could exist that include the failure to (1) promote economic growth within financially underserved areas of the U.S.; or foster economic stability in other nations. There may also be a corresponding loss of credibility with taxpayers in this country or a loss of U.S. credibility on an international level if these Treasury programs do not function as intended.

In Progress and Planned Fiscal Year 2007 Projects

Survey of Treasury's Trade Promotion Coordination Committee Activities

Audit Objective At the request of Representatives Donald Manzullo, Sue Kelly, and John Mica, U.S. House of Representatives, we plan to survey Treasury's trade facilitation operations under the auspices of the Trade Promotion Coordinating Committee. Our survey will focus on, but not be limited to, the Office of International Affairs' Office of Trade and Investment Policy with the objectives of identifying (1) the Office's mission and partners in carrying out its mission, (2) how the Office promotes U.S. exports, (3) how the Office measures and reports the results of its trade promotion efforts, and (4) the annual expenditures made for promoting U.S. exports. We also plan to identify whether other offices within Treasury have a U.S. export promotion role and perform similar work at those offices. We anticipate that this project will require 1,600 hours.

OIA Oversight of Multilateral Development Banks' Anti-Corruption Programs

Audit Objective To determine the effectiveness of OIA's efforts to promote and monitor anti-corruption programs at MDBs. We anticipate that this project will require 2,000 hours.

Single Audit Act Activities (On-going)

Audit Objective To ensure action is taken on findings related to Treasury programs identified by Single Audits of state and local governments. We anticipate this project will require 200 hours. (PMA Initiative Supported: Improved Financial Management)

Projects Under Consideration for Future OIG Annual Plans

CDFI Fund Award Process and Compliance Monitoring of the New Market Tax Credit Program

Background The legislation authorizing the NMTC program requires GAO to report to Congress on the program by January 31, 2004, 2007, and 2010. In January 2004, GAO reported that, according to CDFI Fund officials, not many NMTC projects were started by the end of 2003, and that they were unlikely to know the status of projects until early 2005. GAO also reported that the CDFI Fund and IRS have made progress in identifying data to use in monitoring NMTC compliance with allocation agreements and tax laws, respectively, and in developing and implementing systems to collect these data. However, many details remain to be settled on how these data will actually be used to monitor compliance. Additionally, in terms of evaluating the NMTC program, the CDFI Fund has decided to contract for an evaluation. GAO recommended that the CDFI Fund and IRS develop plans, including milestones, to ensure that compliance-monitoring processes are in place when needed.[13]

Audit Objective To determine the effectiveness of the NMTC Program's application and allocation procedures, allocation of shares of available tax credits, and monitoring of compliance with the allocation agreements. As part of this project, we plan to assess the CDFI Fund's actions to address the prior GAO recommendations. We anticipate this project will require 2,000 hours.

CDFI Fund Post-Award Grant Administration Initiative

Audit/Investigative Objective To determine whether the CDFI's post-award grant administration process effectively ensures that financial institutions are carrying out their activities in accordance with the grant agreements. As a part of this project, we will follow up on recommendations in our prior report, *FINANCIAL MANAGEMENT/ COMPLIANCE WITH THE FEDERAL FINANCIAL MANAGEMENT IMPROVEMENT ACT: Community Development Financial Institutions Fund Post-Award Administration Process* (OIG-02-122; issued September 24, 2002).

OIA Use of Funds for Tropical Forest Conservation Act Activities

Background The purpose of the Tropical Forest Conservation Act (TFCA) program is to facilitate greater protection of tropical forests by providing for the alleviation of debt in countries where tropical forests are located, thus allowing the use of additional resources to protect these critical resources and reduce economic pressures that have led to deforestation. Assistance is provided to selected countries through negotiated agreements in the form of debt reduction, debt swap, or debt buy back. For fiscal year 2003, this assistance ($20 million for the fiscal year) was initially allocated to the U.S. Agency for International Development (USAID) and transferred to Treasury. Once the agreements with the selected countries are negotiated, Treasury obligates the subsidy cost of the debt reduction for use by USAID or the U.S. Department of Agriculture. This allows for the "re-direction" of debt payments by the beneficiary country for tropical forest conservation. P.L. 108-323 reauthorized TFCA through fiscal year 2007, with $25 million authorized for fiscal year 2006. The reauthorization also included a provision authorizing $200,000 each year to carry out audits and evaluations of the TFCA programs.

[13] *NEW MARKETS TAX CREDIT PROGRAM: Progress Made in Implementation, but Further Actions Needed to Monitor Compliance*; GAO-04-326.

Audit Objective To determine whether Treasury has administered its responsibilities for TFCA funds in accordance with the Act. As part of this project, we will review plans by OIA to establish a mechanism with USAID to fund independent audits of TFCA activities. We anticipate that this project will require 800 hours.

APPENDIX A:

OFFICE OF AUDIT FISCAL YEAR 2007 RESOURCE ALLOCATION

Our planned OIG audit staff resource utilization by the three priority areas for fiscal year 2007 is shown in the following table:

Audit Priority	Percent of Planned Audit Resources
Products mandated by law	28
Products supporting the PMA	27
Products addressing known deficiencies and emerging risks	45
Total	**100**

Our planned OIG audit staff resource allocation by OIG Issue Area is shown in the following table:

OIG Issue Area	Percent of Planned Audit Resources
Treasury general management and infrastructure support:	
Financial management	19
Information systems security	12
General management	19
Terrorist financing, money laundering, and foreign assets control	23
Government-wide financial services and debt management	5
Safety, soundness, and accessibility of financial services	11
Revenue collections and industry regulation	1
Bill and Coin manufacturing, marketing, and distribution operations	6
Domestic and international assistance programs	4
Total	**100**

APPENDIX A:

OFFICE OF AUDIT FISCAL YEAR 2007 RESOURCE ALLOCATION

Our planned OIG audit staff allocation by Treasury headquarters operational component and bureau is depicted in the following table:

Treasury Component	Percent of Planned Audit Resources
Departmental Offices:	
Office of the Assistant Secretary for Management and Chief Financial Officer	15
Office of the Chief Information Officer	6
FFB	Less than 1
TFI	6
OFAC	2
TEOAF	1
Office of Tax Policy	1
CDFI Fund	1
Office of International Affairs	5
Bureaus:	
FinCEN	20
FMS	9
BPD	3
OCC	8
OTS	8
TTB	1
BEP	7
Mint	7
Total	**100**

Appendix B: Index of Fiscal Year 2007 In Progress and Planned New Audits by Issue Area

Treasury General Management and Infrastructure Support

Terrorist Financing, Money Laundering, and Foreign Assets Control

APPENDIX B: INDEX OF FISCAL YEAR 2007 IN PROGRESS AND PLANNED NEW AUDITS BY ISSUE AREA

Government-wide Financial Services and Debt Management

Safety, Soundness, and Accessibility of Financial Services

Revenue Collection and Industry Regulation

Bill and Coin Manufacturing, Marketing, and Distribution Operations

Domestic and International Assistance Programs

APPENDIX C:
INDEX OF FISCAL YEAR 2007 IN PROGRESS AND PLANNED NEW AUDITS BY BUREAU/OFFICE

Multi Bureau

Departmental Offices

Office of Foreign Assets Control

Appendix C:
Index of Fiscal Year 2007 In Progress and Planned New Audits by Bureau/Office

APPENDIX D:
INDEX OF OFFICE OF AUDIT PROJECTS UNDER CONSIDERATION FOR FUTURE ANNUAL PLANS

Treasury General Management and Infrastructure Support

Information Systems Security

General Management

Terrorist Financing, Money Laundering, and Foreign Assets Control

APPENDIX D: INDEX OF OFFICE OF AUDIT PROJECTS UNDER CONSIDERATION FOR FUTURE ANNUAL PLANS

APPENDIX D: INDEX OF OFFICE OF AUDIT PROJECTS UNDER CONSIDERATION FOR FUTURE ANNUAL PLANS

Bill and Coin Manufacturing, Marketing, and Distribution Operations

Domestic and International Assistance Programs

ABBREVIATIONS

AIGA	Assistant Inspector General for Audit
AIGI	Assistant Inspector General for Investigations
ARC	Administrative Resource Center
BEP	Bureau of Engraving and Printing
BPD	Bureau of the Public Debt
BSA	Bank Secrecy Act
CDE	Community Development Entities
CDFI	Community Development Financial Institutions Fund
CFIUS	Committee on Foreign Investments in the United States
CFO	Chief Financial Officer
CIO	Chief Information Officer
COLA	Certificate of Label Approval
CTR	Currency Transaction Reports
DCIA	Debt Collection Improvement Act of 1996
DoD	Department of Defense
DO	Departmental Offices
DOJ	Department of Justice
DNI	Director of National Intelligence
EEOC	Equal Employment Opportunity Commission
EO	Executive Order
ESF	Exchange Stabilization Fund
EVMS	Earned Value Management System
FAR	Federal Acquisition Regulation
FAIR Act	Federal Activities Inventory Reform Act
FATF	Financial Action Task Force
FBI	Federal Bureau of Investigation
FDIC	Federal Deposit Insurance Corporation
FDICIA	Federal Deposit Insurance Corporation Improvement Act of 1991
FECA	Federal Employees' Compensation Act
FFB	Federal Financing Bank
FFIEC	Federal Financial Institutions Examination Council
FFMIA	Federal Financial Management Improvement Act of 1996
FinCEN	Financial Crimes Enforcement Network
FISMA	Federal Information Security Management Act
FIU	U.S. Financial Intelligence Unit
FMS	Financial Management Service
FOIA	Freedom of Information Act
GAO	U.S. Government Accountability Office
GMRA	Government Management Reform Act
HR	Human Resources
HRCPO	HR Connect Program Office
HMDA	Home Mortgage Disclosure Act

ABBREVIATIONS

HSA	Homeland Security Act of 2002
HSPD-12	Homeland Security Presidential Directive 12
IFI	International Financial Institution
IG	Inspector General
IOB	Intelligence Oversight Board
IPA	Independent Public Accountant
IPP	Internet Payment Platform
IPv	Internet Protocol version
IRS	Internal Revenue Service
IT	Information Technology
MCA	Managerial Cost Accounting
Mint	U.S. Mint
MLR	Material Loss Review
MOU	Memorandum of Understanding
MSB	Money Services Businesses
MSPB	Merit Systems Protection Board
NDAA	National Defense Authorization Act for Fiscal Year 2006
NMTC	New Markets Tax Credit
NRC	National Revenue Center
OCC	Office of the Comptroller of Currency
O/DNI	Office of the Director of National Intelligence
OFAC	Office of Foreign Assets Control
OI	Office of Investigations
OIA	Office of International Affairs
OIG	Office of Inspector General
OMB	Office of Management and Budget
OTS	Office of Thrift Supervision
PART	Program Assessment Rating Tool
PCIE	President's Council on Integrity and Efficiency
PEF	Public Enterprise Fund
PMA	President's Management Agenda
SAR	Suspicious Activity Report
SHARE	Safety, Health, and Return-To-Employment
SOT	Special Occupational Tax
TCE	Treasury Communications Enterprise
TCIS	Treasury Check Information System
TD	Treasury Directive
TEOAF	Treasury Executive Office for Asset Forfeiture
TFCA	Tropical Forest Conservation Act
TFI	Office of Terrorism and Financial Intelligence
TFIN	Treasury Foreign Intelligence Network
TFTP	Treasury Finance Tracking Program

ABBREVIATIONS

TIGTA	Treasury Inspector General for Tax Administration
TOP	Treasury Offset Program
TPCC	Trade Promotion Coordination Committee
Treasury	Department of the Treasury
TTB	Alcohol and Tobacco Tax and Trade Bureau
USAID	U.S. Agency for International Development
WCF	Working Capital Fund
WebEFDS	Web-Based Electronic Fraud Detection System

Contact Us

Headquarters
Office of Inspector General
1500 Pennsylvania Avenue, N.W.,
Room 4436
Washington, D.C. 20220
Phone: (202) 622-1090; Fax: (202) 622-2151

Office of Audit
740 15th Street, N.W., Suite 600
Washington, D.C. 20220
Phone: (202) 927-5400; Fax: (202) 927-5379

Office of Investigations
740 15th Street, N.W., Suite 500
Washington, D.C. 20220
Phone: (202) 927-5260; Fax: (202) 927-5421

Office of Counsel
740 15th Street, N.W., Suite 510
Washington, D.C. 20220
Phone: (202) 927-0650; Fax: (202) 927-5418

Office of Management
740 15th Street, N.W., Suite 510
Washington, D.C. 20220
Phone: (202) 927-5200; Fax: (202) 927-6492

Eastern Field Audit Office
408 Atlantic Avenue, Room 330
Boston, Massachusetts 02110-3350
Phone: (617) 223-8640; Fax (617) 223-8651

Treasury OIG Hotline
Call Toll Free: 1.800.359.3898

Treasury OIG Web Page

OIG reports and other information are now available via the Internet. The address is http://www.treas.gov/offices/inspector-general