

STATEMENT OF THE HONORABLE ERIC M. THORSON
INSPECTOR GENERAL
DEPARTMENT OF THE TREASURY
BEFORE THE HOUSE COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON DOMESTIC MONETARY POLICY AND TECHNOLOGY

JUNE 23, 2011

2:00 PM

Chairman Paul, Ranking Member Clay, and Members of the Subcommittee, thank you for the opportunity to appear before you this afternoon for the hearing entitled "Investigating the Gold: H.R. 1495, the Gold Reserve Transparency Act of 2011 and the Oversight of United States Gold Holdings."

My testimony will cover the audits that my office has and is conducting on the United States Mint's Schedule of Custodial Deep Storage Gold Reserves.

Before I discuss the details of the audits that are the topic of this hearing, I would like to make one point very clear – 100 percent of the U.S. Government's deep storage gold reserves in the custody of the Mint has been inventoried and audited. Furthermore, these audits have not found any noteworthy exceptions. I also want to make it clear that the physical security over the gold reserves is absolute. I can say that without hesitation because I have personally observed the gold myself. Accordingly, H.R. 1495, which calls for a full assay, inventory, and audit of gold reserves of the United States together with an analysis of the sufficiency of the measures taken for the security of such reserves, is redundant of audit work already done.

My office has been extensively involved in the audit of the Department's consolidated financial statements and related entities since the enactment of the Chief Financial Officer's Act of 1990. Since 1993, our financial statement audit work has included, and continues to include, independent annual audits of the U.S. Government's deep storage gold reserves held by the Mint. In fact, our fiscal year 2011 audit of those deep storage gold reserves is currently underway. As background, I will briefly describe what the Mint's custodial deep storage gold reserves include, provide a short history of the audits conducted over the gold

reserves from 1974 through 1986, and the annual audits performed by my office since 1993.

The Mint's Custodial Deep Storage Gold Reserves

The Mint maintains its custodial deep storage gold reserves at the United States Bullion Depository, Fort Knox, KY; the United States Mint, West Point, NY; and the United States Mint, Denver, CO. The Department's deep storage gold reserves are stored at these three locations, in 42 compartments. In all, these compartments hold 699,515 gold bars with fineness¹, or purity, ranging from 0.4701 to 0.9999 with an average fineness of 0.9006. Fort Knox houses 60 percent of the fine troy ounces of the deep storage gold reserves, Denver 18 percent, and West Point 22 percent. As of September 30, 2010, the audited quantity of custodial deep storage gold reserves held by the Mint was 245,262,897 **fine** troy ounces, over 9,300 tons, with a market value of \$320.6 billion.² Each gold bar weighs about 27 pounds and has an average value of about \$500 thousand.

All three of the deep gold storage facilities are highly secured. While it would not be appropriate for me to discuss the details of the security arrangements in place at these facilities, I can tell you that they are multi-layered and include substantial physical barriers, armed guards, cameras, and metal detectors.

Audits of the Mint's Custodial Deep Storage Gold Reserves Over the Years

In 1974, in response to public and Congressional inquiries, the General Accounting Office (GAO), known as the Government Accountability Office since July 2004, in cooperation with the Department of the Treasury, conducted an audit of about 21 percent of the gold bars stored at the United States Bullion Depository, Fort Knox, KY, and concluded that the gold stored at that facility agreed with the records of the depository. Auditors from the United States Mint, the Bureau of Government Financial Operations (BGFO),³ the U.S. Customs Service,⁴ and the Department of the Treasury's Office of the Secretary and GAO were part of a special audit committee established by the Director of the Mint to maintain physical control over the gold during the conduct of the inventory. In the report, *Accountability and*

¹ The fineness of a precious metal refers to the ratio of the primary metal to the total weight.

² Market value was based on the London Gold Fixing price for gold as of September 30, 2010. On that date, gold was priced at \$1,307.00 per fine troy ounce.

³ BGFO was established in 1974 as a bureau of the Treasury. In October 1984, BGFO was renamed the Financial Management Service.

⁴ The U.S. Customs Service was a bureau of the Treasury until March 2003 when it was transferred to the Department of Homeland Security.

Physical Controls of the Gold Bullion Reserves, FOD-75-10, GAO also recommended that the Secretary of the Treasury request the Director of the Mint to include, as part of each depository's annual settlement of accounts, a cyclical inventory of the Mint's custodial gold holdings.

It should be noted that the audit by GAO followed a Congressional visit to the Fort Knox facility. In this regard, the House Congressional Report for September 24, 1974, included the following statement by the Honorable John H. Roussetot:

"Mr. Speaker, the Congress can now be assured that there is gold bullion at the Fort Knox Depository. Several of us went there yesterday to try to make sure that many of these rumors and counterrumors were either correct or not correct. Members of the Committee on Banking and Currency and Senator Huddleston of Kentucky actually entered the Fort Knox Depository to check the validity of claims that U.S. gold bullion had been depleted. We can be assured that our civil servants are watching the gold at Fort Knox. It is there."

On June 3, 1975, the Secretary of the Treasury issued Treasury Department Order No. 234-1 (TDO 234-1), *Audit of Gold Stock*, authorizing and directing the Fiscal Assistant Secretary, with the cooperation and assistance of the Director of the Mint, to conduct a continuing audit of U.S. Government-owned gold for which the Department is accountable.⁵ Pursuant to TDO 234-1, the Committee for Continuing Audit of the U.S. Government-owned Gold performed annual audits of Treasury's deep storage gold reserves from 1975 to 1986, placing all inventoried gold that it observed and tested under Official Joint Seal.⁶ The Committee was made up of Internal Audit staff from the BGFO and the Mint, and the General Auditor staff from the Federal Reserve Bank of New York. The annual audits by the Committee for Continuing Audit of the U.S. Government-owned Gold ended in 1986, after 97

⁵ The Mint is directly responsible for safeguarding all of Treasury's deep storage gold reserves and working stock. Overall, the deep storage gold reserves account for about 94 percent and working stock about 1 percent of Treasury's gold holdings; the other 5 percent is held by the Federal Reserve Bank of New York. Treasury reports the value of its deep storage gold reserves held by the Mint and the Federal Reserve Bank of New York in its consolidated financial statements.

⁶ An Official Joint Seal is a pre-numbered document that includes wax seals. It is attached to an inventoried compartment door with tamperproof cloth tape. The pre-numbered document includes all relevant information of the compartment inventoried and audited, e.g., the number of gold bars, gross weight, and fine troy ounces). The document is signed by those present at the inventory of the compartment (a representative from the storage facility, a representative from the Mint headquarters, and an OIG/independent observer).

percent of the U.S. Government-owned gold held by the Mint had been audited and placed under Official Joint Seal. It should be noted that during the entire period of these audits, and up to today, no significant discrepancies have ever been found.

From 1986 to 1992, the Mint continued to perform an annual inventory and verification of the gold reserves in accordance with its own policies over those compartments that had not been placed under Official Joint Seal by the Committee for Continuing Audit of the U.S. Government-owned Gold. According to Mint officials, this was done to comply with the 1975 GAO recommendation discussed earlier.

My office began conducting annual audits of the Mint's Schedule of Custodial Deep Storage Gold Reserves in fiscal year 1993. Our audits are made pursuant to 31 U.S.C. § 5136, United States Mint Public Enterprise Fund, and the Government Management Reform Act (GMRA). In this regard, we are required to perform an annual audit of the Mint Public Enterprise Fund's financial statements, and those statements include the balances of custodial deep storage gold reserves held by the Mint. Under GMRA, my office is also responsible for the annual audit of the Department of the Treasury's consolidated financial statements. Those financial statements incorporate the balances of the custodial deep storage gold reserves. It should be noted that the Mint's financial statements and the Department's consolidated financial statements are audited by a contractor under our supervision -- the independent public accounting firm, KPMG LLP. KPMG has performed the audit of the Mint's financial statements since fiscal year 2005 and the Department's consolidated financial statements since fiscal year 2004. Starting with the fiscal year 2005 audit, KPMG has taken responsibility for our work on the custodial deep storage gold reserves when rendering its opinions on the Mint's and Treasury's financial statements. In order for KPMG to do that, they must satisfy themselves as to the independence, reputation, and qualifications of my audit staff. In addition, they must also satisfy themselves with the adequacy of the audit procedures performed. This has included, among other things, accompanying my auditors on a number of observations of the deep gold storage facilities. By doing this KPMG can express its opinion on the Mint's and Treasury's financial statements without making reference to us in their report. That also means that KPMG concurs with the amount and value of the gold as it is reported. The audit work performed by both my office and KPMG is done in accordance with government auditing standards established by GAO.

For each of the fiscal years under audit, we have rendered unqualified or “clean” opinions on the Mint’s Schedule of Custodial Deep Storage Gold Reserves. In addition, for each such fiscal year under audit, we have not identified any material weaknesses in internal control over financial reporting related to these schedules, nor have we reported any instances of noncompliance with laws and regulations.

When we assumed responsibility for the audit, reliance was placed on verification procedures performed by GAO and the Committee for Continuing Audit of the U.S. Government-owned Gold. Additionally, we relied on the intact Official Joint Seals that the Committee placed on the inventoried compartments that it observed and tested. If an Official Joint Seal had been tampered with, it would have been immediately evident as the wax on the seal would have been broken and the cloth tape used to attach it would have been detached. Since we assumed responsibility for the audit, my office has continued to directly observe the inventory and test the gold.

Furthermore, my auditors sign the Official Joint Seals placed on those compartments inventoried and tested in their presence. At the end of fiscal year 2008, all 42 compartments had been audited by either GAO, the Committee for Continuing Audit of the U.S. Government-owned Gold, or Treasury OIG, and placed under Official Joint Seals. There has not been any movement of the inventoried gold since that time. Furthermore, for all of the audit periods where compartment inventories were observed by my auditors, as part of our work, in addition to observing the Mint’s physical inventory of the gold, we selected and tested a statistically-valid random sample of gold bars using a 95 percent confidence level and found, without fail, that any differences between the fineness reported by the Mint in its inventory records and the fineness projected based on our independently obtained assay reports to be immaterial and negligible. For example, during our fiscal year 2008 audit, we sampled gold statistically representing inventory valued at \$75,036,352.12. Based on the independent assayer’s report on those samples, we projected the dollar value of the difference between the fine troy ounces determined by the independent assay report and the fine troy ounces recorded in the Mint’s inventory records to be \$3,819.84 or 0.005 percent (five thousandths of one percent) of the gold inventoried.

The annual audit work performed by my office to verify the existence, quality, and valuation of Treasury's deep storage gold reserves⁷ has included two parts:

Direct Physical Observation of the Gold Reserves in the Deep Storage in Compartments Inventoried - This included:

- Reviewing and evaluating internal control, to include the physical controls over the deep storage gold
- Verifying the existence of the gold bars in each compartment by
 - visually inspecting the gold bars
 - comparing the records for each compartment inventoried to the identifying information stamped into the gold bars
- Statistically selecting and testing a sample of the gold bars from the compartments inventoried for fineness
 - re-weighing the statistically selected bars
 - re-assaying the statistically selected bars (the selected bars are drilled, gold fragments are removed from the drilled hole, and those gold fragments are sent by us to an independent laboratory for assaying – the independent laboratory directly provides us with its reports)
- Comparing the fineness recorded in the inventory records to the fineness reported by the independent assayer for the sample of gold bars selected from the compartments inventoried (any differences are projected to the universe of the gold bars inventoried)
- Participating in the placement of an Official Joint Seal on each compartment inventoried by the Mint and tested by my auditors
- Verifying the mathematical accuracy of the inventory records

Visual Inspection of Official Joint Seals on Previously Inventoried Compartments - This includes:

- Reviewing and evaluating internal control, to include the physical controls over the deep storage gold
- Inspecting the Official Joint Seals used to control compartments containing previously inventoried gold to determine whether the seals have been altered or compromised in any way
- Preparing an Official Joint Seal Inspection Report that includes identifying the condition of the Official Joint Seal, determining if the signatures on the Seal agree with the signatures on the copy of the original Official

⁷ For the gold reserves held by the Federal Reserve Bank of New York (which are not part of the deep storage gold reserves), my office obtains relevant evidence supporting the existence and valuation of the gold through a signed third party confirmation (confirmations are a widely accepted audit procedure for purposes of placing reliance on the item being confirmed).

Joint Seal, and whether the Seal and lock had any evidence of tampering and whether the compartment door was locked

As discussed earlier, by the end of fiscal year 2008, all of the deep storage gold reserves in the Mint's custody had been 100 percent inventoried and audited. During our fiscal year 2010 and 2009 audits of the deep storage gold, our audit procedures consisted primarily of inspecting the Official Joint Seals on the previously inventoried compartments to determine whether they had been altered or compromised in any way. We found no exceptions.

More recently, the Mint decided to replace all of the previously-placed Official Joint Seals with new seals. The new seals are more durable, having a double security barrier seal that can only be removed by two cuts with a strong cable cutter.

The Mint replaced all of the previously-placed Official Joint Seals with new ones during fiscal year 2010.⁸ The seal replacement process consisted of two steps: (1) inspection of all previously-placed Official Joint Seals on all the compartments containing deep storage gold to determine whether they had been altered or compromised in any way, and (2) placement of a new Official Joint Seal. The seal inspection and replacement process was carried out for all 42 deep storage gold compartments, in the presence of a Treasury OIG auditor, by a Mint headquarter staff person, representing the Mint Director, and a Mint storage facility staff person, representing the facility's Plant Manager. For each Official Joint Seal removed, the Mint headquarters representative, the Mint storage facility representative, and the observing Treasury OIG auditor signed an inspection report; the same parties also signed the new Official Joint Seal that replaced the one removed.

In September 2010, I took part in that process at Fort Knox. At that time, I personally saw the deep storage gold reserves located there. During my visit, I witnessed, along with officials from the Mint and one of my auditors, the replacement of all previously-placed Official Joint Seals with new Official Joint Seals. I would also like to note that shortly after my visit to the Mint's Fort Knox facility I sent a letter to you, Doctor Paul, regarding my observations. A copy of that letter is provided as Exhibit 3.

In closing, based on the work performed by my office and my own personal observations, I can assure the Subcommittee, and anyone else for that matter, that both the quantities and value the U.S. Government's deep storage gold reserves

⁸ Pictures of the old and new Official Joint Seals are provided as Exhibits 1 and 2, respectively.

held and reported by the Mint are reliable and sufficiently audited. Therefore, I believe that the inventory and audit requirements proposed in *The Gold Reserve Transparency Act* of 2011, H.R. 1495, to be redundant of the work that my office and the Mint have and currently perform.

That concludes my prepared statement. I will be happy to answer any questions that you may have. Thank you.

Old Official Joint Seal

SEAL SERIAL NUMBER 932

UNITED STATES TREASURY DEPARTMENT
MINT BUREAU
OFFICIAL JOINT SEAL

COMPARTMENT CONTROL No. _____ VAULT J

GRIP LOCK SERIAL A13632 COMPARTMENT 2

UNITED STATES Mint Denver, Colorado September 2, 1982
(DATE SEALED)

WE, WHOSE SIGNATURES APPEAR HEREON, CERTIFY THAT THE ENTIRE CONTENTS OF THE SEALED COMPARTMENT ABOVE SPECIFIED HAVE BEEN PERSONALLY VERIFIED BY US IN THE MANNER PRESCRIBED FOR SUCH DUTY IN JOINT SEALING REGULATIONS AS DESCRIBED BELOW AND THAT THE CONTENTS ARE: "Accepted in accordance with Method 5 of the Official Joint Sealing Regulations, Official Joint Seal Serial No. 949 dated September 3, 1981. Relocated from Vault J, Compartment 19."

	Number of Bars	Gross Weight	Fine Ozs. Gold
Coin Gold Bars	4,243	3,615,544.89	3,253,472.469
Less Assay Samples	-0-	10.43	9.388
"Total covered by this seal."	4,243	3,615,534.46	3,253,463.081

REPRESENTING THE INSTITUTION:
Nora M. Bussery
George F. Bussery
John G. Peterson
George J. Toppan

REPRESENTING THE DIRECTOR OF THE MINT:
William H. Mason
Karl L. Bortchko (IG-B6FO)
Donald W. Thompson
Rod W. Schornagel (IG-B6FO)

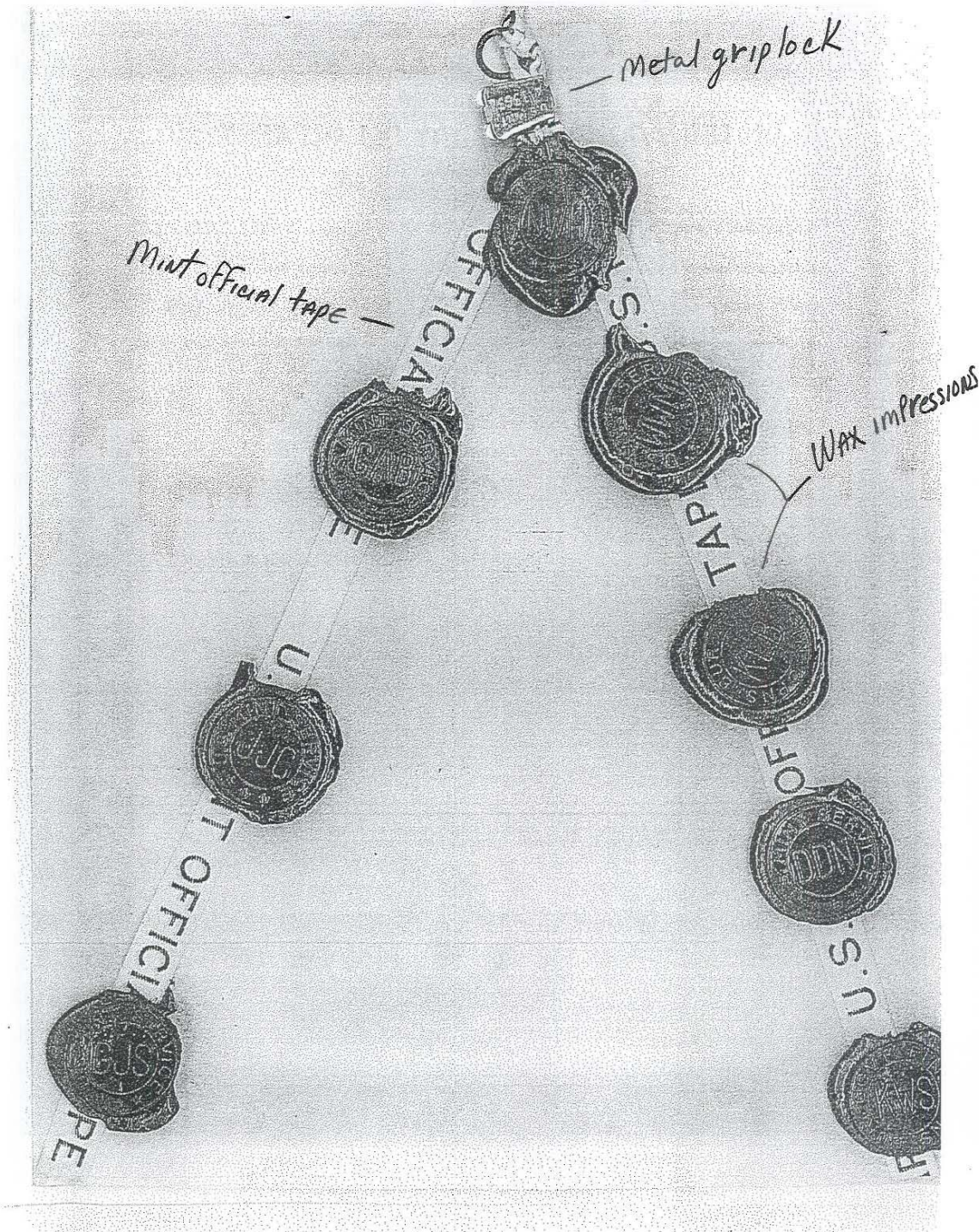
WE, WHOSE SIGNATURES APPEAR HEREON, BELOW, CERTIFY THAT WE HAVE INSPECTED THIS SEAL AND FOUND IT UNIMPAIRED AND HAVE THIS DAY REMOVED IT.

DATE OF REMOVAL 08.25.2010 PURPOSE REPRODUCTION W/ NEW TYPE SEAL

REPRESENTING THE INSTITUTION: *Jack [Signature]*

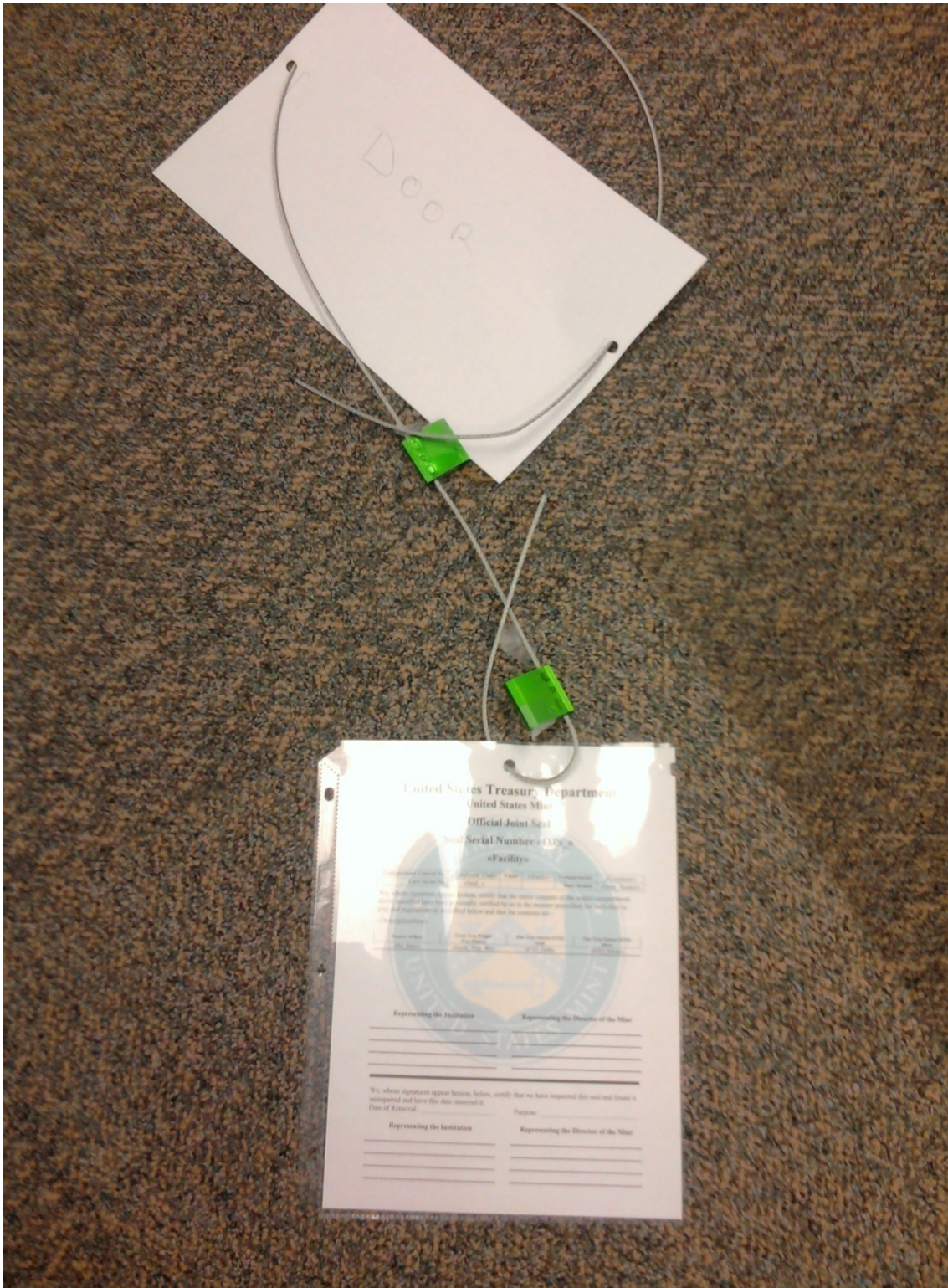
REPRESENTING THE DIRECTOR OF THE MINT: *Patrick J. [Signature]*
A-5 DE T. OIG

Old Official Joint Seal



2

New Official Joint Seal



Inspector General Thorson Letter to the Honorable Ron Paul



INSPECTOR GENERAL

DEPARTMENT OF THE TREASURY
WASHINGTON

September 24, 2010

The Honorable Ron Paul
U.S. House of Representatives
203 Cannon House Office Building
Washington, D.C. 20515

Dear Mr. Paul:

Recent media reports have indicated that you have concerns about the United States Government's gold reserves and plan to introduce legislation to provide for an annual audit. As the Inspector General of the Department of the Treasury – with the statutory responsibility of auditing all Treasury programs except for the Internal Revenue Service, I want to assure you that the gold reserves have been independently audited by my office on an annual basis since 1993. In fact, I visited Fort Knox earlier this week as part of the Fiscal Year 2010 audit where I personally observed the gold reserves located in each of the deep storage compartments.

My office, on an annual basis, directly observes the gold inventory by reviewing and evaluating internal control and physical security surrounding the gold storage, verifying the inventory of gold bars in each compartment and placing an Official Joint Seal on the compartment inventoried. In addition, we verify the mathematical accuracy of the inventory records, compare the inventoried gold to the Mint's records and compare the quantities on the Mint's records to the accounts for gold maintained by the Financial Management Service. We also visually inspect the Official Joint Seals on previously inventoried compartments.

During my visit, I witnessed, along with U.S. Mint officials, the current operation to replace the original Official Joint Seals on all the compartments containing deep storage gold with a new seal. I can tell you unequivocally that the gold reserves do exist in the amounts reported and the controls over it ensure absolute security.

I would be happy to answer any questions that you might have and can be reached at (202) 622-1090.

Sincerely,

A handwritten signature in blue ink, appearing to read "Eric M. Thorson", with a long horizontal flourish extending to the right.

Eric M. Thorson
Inspector General