



Alcohol and Tobacco Tax and Trade Bureau  
**ANNUAL REPORT**



FISCAL YEAR 2010

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## Introduction

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In these economic times, when every dollar counts, the U.S. Government owes it to the American taxpayers to demonstrate the value of the programs and services it provides. Within the Annual Report for fiscal year (FY) 2010, the Alcohol and Tobacco Tax and Trade Bureau (TTB) combines program performance and financial data to account for how effectively the Bureau translates its program dollars into quality service, responsible management practices, consumer protection, and increased tax revenue.

TTB elects to present this data annually in an effort to communicate relevant performance and financial information. As part of the performance and budget cycle, this report grants the Bureau an opportunity to inform stakeholders of its successes and explain any shortfalls.

The report defines the Bureau's mission, strategic goals, and major programs, and summarizes its progress in meeting its objectives, as stated in TTB's five-year strategic plan. Also included is valuable financial information that discusses how TTB expended its budget on its major programs, and accounted for tax collections from the alcohol, tobacco, firearms, and ammunition industries.

This information is presented in four parts:

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

## Message from the Administrator

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The Alcohol and Tobacco Tax and Trade Bureau (TTB) has a broad mission that involves both tax collection and consumer protection. Our responsibilities under this mission ensure a fair marketplace and a level playing field in the industries we regulate. In carrying out our mission, we believe in producing results that are germane and add value to the lives of Americans in the most efficient and cost effective way. This mindset has been at the core of TTB's culture since our formation in 2003. The current fiscal crisis simply makes our business approach all the more compelling, and reinforces our commitment to administer our jurisdiction in a way that matters to Americans and reassures them that their investment in us is well spent.

Borrowing from the private sector, TTB holds itself accountable by tracking its return on investment for its revenue collection operations.

In fiscal year 2010, we exceeded our performance goal, and returned \$478 to the public coffers for every \$1 we expended on tax collection activities.

Like a successful business, this Bureau has a proven record of adapting and responding to changes in our operating environment. When Congress enacted the Children's Health Insurance Program Reauthorization Act of 2009 (CHIPRA), TTB employees quickly adjusted operating plans and priorities to implement the statute and enforce the new tax and regulatory requirements for those operating in the tobacco industry within the short timeframes provided. In addition to permit requirements, tax increases, and other changes imposed upon the tobacco industry, CHIPRA provided for a one-time tax upon tobacco products already in the market pending sale to the consumer. This provision introduced approximately 400,000 new and unidentified taxpayers to TTB's enforcement responsibilities. Using innovative enforcement strategies, and with no increase to our resources, we far exceeded expectations in our collection efforts, collecting \$1.2 billion in FST receipts to date.

Strategic deployment of our resources, and ever more sophisticated targeting techniques in our tax verification program, ensured that we could meet these new demands without detracting from our core mission work of ensuring alcohol and tobacco taxpayers comply with Federal regulations and timely pay their taxes. In FY 2010, our ongoing education and enforcement efforts helped sustain a 94 percent compliance rate from alcohol, tobacco, firearms, and ammunition taxpayers.

Our efforts to maintain compliance from TTB taxpayers are focused on ensuring that the tax that is due in our industries is collected and available to fund Americans' priorities; fair and lawful trade in these industries is integral to that objective. This objective is undermined when the criminal element infiltrates the legitimate alcohol and tobacco products trade. Tax evasion in these industries, which we call

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“diversion,” not only thwarts revenue collection that is intended to fund important American priorities but it also threatens public safety, both since the profits from these activities have been found to fund organized crime and terrorist organizations and since the products illegally introduced to the public evade regulatory controls.

As a means to assess the revenue lost from illegal diversion in tobacco, a provision of CHIPRA required the Department of the Treasury to study the illicit tobacco trade and quantify its impact upon Federal tax receipts. TTB partnered with the Department in conducting this study, which was submitted to Congress in February 2010. Using current tax rates, the study determined that the diversion of cigarettes costs the Federal government an estimated \$4.5 billion annually. Recognizing the significant drain on the Federal revenue, and the public health risk posed by alcohol and tobacco products illegally produced and sold to consumers, Congress earmarked \$3 million in funding in FY 2010 to be spent over two years to support the hiring of TTB special agents to address this threat.

In effectuating this mandate, TTB entered into an agreement with the Internal Revenue Service (IRS) Criminal Investigation office to contract criminal enforcement agents to serve as TTB special agents. Under this agreement, TTB will reimburse the IRS for both the special agents and the entire infrastructure associated with supporting the special agents. This approach is consistent with TTB’s longstanding business model of leveraging available resources to maximize our reach and effectiveness in meeting our broad mission with the least possible cost. In the year ahead, we will work with the IRS to evaluate this approach and determine if it can be a mutually feasible and cost effective way to enforce our criminal jurisdiction.

The Bureau also continued its civil enforcement efforts in bringing individuals and businesses illegally importing tobacco products without a Federal permit into compliance. For example, for the third year, TTB examined U.S. Customs and Border Protection’s international trade database to identify and address the illegal importation of tobacco products, and found that 15 percent of tobacco product importers did not have a permit to operate. As a known point of diversion, addressing importer permit violations is crucial to deterring criminal activity. In this respect, this measure has proven to be a valuable enforcement tool to address the revenue and safety threat presented by this activity.

TTB’s public protection mission also requires that we timely process applications to operate in the industries we regulate, which ensures that those who are qualified to operate receive their permits without undue delay. At the National Revenue Center (NRC), our tax and permit processing hub, we implemented improved management tools and a new triaging procedure for handling applications to reduce processing times. These efforts helped TTB keep application processing times at 65 days during a period when submissions increased by 4 percent. To ensure that our processing activities continue to facilitate industry requirements in the long-term, TTB is preparing to deploy an electronic filing system for permit applications—Permits Online. We expect this system to produce tangible benefits for both TTB and the industries we regulate, thus facilitating free and unobstructed commerce in these industries, and revenue collected for the American public.

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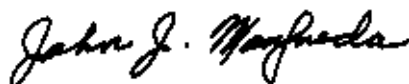
Other electronic filing solutions already in place at TTB continue to gain wider use. The COLAs Online system, which enables industry to file their application for alcohol beverage label approval, has eased the burden of compliance for industry and supported the Department's goal of eliminating paper transactions with the public. At the close of FY 2010, alcohol beverage manufacturers and importers submitted 79 percent of label applications electronically, a rate that is unparalleled in government and speaks to the value of the system.

The filing solutions online today, as well as those slated for release in FY 2011, should lead to increased customer satisfaction for those we regulate. In our minds, if our customers are satisfied, then we have done our job to facilitate lawful commerce. A survey of those customers who filed for an original or amended permit or who submitted a refund claim reported an 89 percent satisfaction rate. We believe that the investment we have made in automating our business processes will pay dividends in terms of customer satisfaction in the years ahead.

Meeting our performance goals, as well as responding to the demands placed on the Bureau by the CHIPRA legislation, did not come without a price. The satisfaction of our employees declined as a result of increased workloads and stagnant or reduced staffing levels. Restoring the Bureau's previous place among the top rated agencies in Government will require the concerted attention of the TTB leadership team. As we have proven time and again in times of adversity, we will come together as a Bureau to find solutions that work in concert to meet the needs of our people and our customers.

In the year ahead, we will continue to pursue greater accountability and transparency in all areas of our operations. We will leverage our resources through effective partnerships and technology enhancements to accomplish our mission and improve service to those we regulate. Our efforts will focus on assuring our workforce is satisfied and engaged in the mission, and that the American taxpayer is satisfied with the return that they see on their investment in this agency.

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



John J. Manfreda

Administrator

## Vision, Mission, and Values

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### Vision

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

### Mission

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

### Values

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

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



## TTB Strategic Goals and Objectives

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### Goal: Collect the Revenue

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

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

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

### Goal: Protect the Public

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

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

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

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

### Goal: Management and Organizational Excellence

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

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

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

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

## Part I: Management's Discussion and Analysis

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### Profile of a Bureau

The mission of the Alcohol and Tobacco Tax and Trade Bureau (TTB) is to collect alcohol, tobacco, firearms, and ammunition excises taxes that are rightfully due the Federal government and to protect the consumer of alcohol beverages from unsafe or improperly labeled products and from unfair competitive practices in the trade of alcohol.

The Bureau was formed in January 2003, under the Homeland Security Act of 2002, but its history began more than 200 years ago as one of the earliest Federal tax collection agencies. Today, TTB operates under the authorities of the Internal Revenue Code of 1986 (IRC)<sup>1</sup> and the Federal Alcohol Administration Act (FAA Act)<sup>2</sup>, including the Alcoholic Beverage Labeling Act of 1988 (ABLA)<sup>3</sup> and the Webb-Kenyon Act<sup>4</sup>. These laws put in place strict requirements and controls related to alcohol and tobacco products and regulate who can and cannot make, sell, and distribute these commodities.

TTB is the Federal agency that authorizes trade in the alcohol and tobacco industries, since it issues permits that are required to operate in these industries and is authorized to revoke those permits based upon violations of law. TTB's work reaches industry activities from initial qualification, production, and distribution, through taxation and, in dire cases, revocation of a permit.

Because of its broad jurisdiction, and its position as a bureau of the Department of the Treasury, TTB takes quite seriously its role to administer the law in a way that protects the public and the revenue while at the same time facilitating a healthy economy in the alcohol and tobacco trades.

In this regard, TTB consistently coordinates with other agencies whose jurisdictions impact the alcohol and tobacco industries to ensure a coherent, logical, and non-redundant application of Federal law insofar as these industries are concerned. For example, TTB facilitates other Federal and State agencies in the enforcement of their respective jurisdictions, whether the matter involves the authorized use of pesticides as administered by the U.S. Environmental Protection Agency (EPA), the Food and Drug Administration (FDA), and U.S. Department of Agriculture (USDA); the safe use of ingredients or depiction of alcohol products in menus as administered by FDA; the enforcement of the Master Settlement Agreement between the respective State Attorneys General and tobacco manufacturers; the Tobacco Buyout Program

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

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

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

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

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as administered by the USDA; the labeling of organic claims on food products as administered by the USDA; trade policy as negotiated through the Office of the United States Trade Representative (USTR); or State tax law as administered by the respective States, to name a few.

TTB operates like a business, ensuring that it delivers a relevant, important, and efficient product to the taxpayer by administering its jurisdiction in a most logical and meaningful way while presenting the least necessary cost upon the industry. In broad terms, TTB conducts its mission work in two areas—"Collect the Revenue" and "Protect the Public"—to produce identifiable outcomes in terms of the nation's financial and economic interests.

### Collect the Revenue

TTB is the third largest tax collection agency in the U.S. Government, behind the Internal Revenue Service (IRS) and U.S. Customs and Border Protection (CBP). TTB's effective administration of its collections duties supports the Department of the Treasury's strategic objective to ensure that the Federal Government has the cash resources needed to operate.

The Bureau's collection activities are administered under two primary programs—the Alcohol and Tobacco Program and the Firearms and Ammunition Excise Tax (FAET) Program. TTB directs a majority share of its Collect the Revenue budget resources to the Alcohol and Tobacco Program, as these industries constitute more than 98 percent of the Bureau's revenue collections.



*TTB taxes and regulates the alcohol and tobacco industries, providing a revenue stream for the Federal Government, a fair marketplace for those operating in the alcohol beverage trade, and reassurance to American consumers that the alcohol beverages at retail outlets are properly labeled and meet food safety standards.*

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

The National Revenue Center (NRC) is responsible for collecting and accounting for the excise taxes due to TTB. At the NRC, tax specialists reconcile the tax returns against the industry members' operational reports to verify that proper payment was made on the products removed for sale. The NRC also processes claims, computes penalties and interest, and issues notice and demand letters to taxpayers who missed or are late in filing payments. In certain cases where an industry member fails to comply with various laws and regulations, TTB may determine that the best course of action to take to recover lost tax revenue, plus interest and penalties, is to negotiate of an Offer-in-Compromise.

TTB intelligence analysts collect and analyze data to develop leads for further investigation or audit and to identify potential diversion cases. Using referrals, government databases, and other external sources, TTB is able to identify trends and schemes used to facilitate tax fraud and diversion so that the Bureau's auditors and investigators can address unlawful activity as early as possible.

The risk model that drives the Bureau's enforcement strategy is designed to maximize the reach and effectiveness of its resources. TTB field personnel conduct targeted compliance audits and investigations based on risk and random factors. Working on taxpayer premises, TTB auditors and investigators review the production records and tax returns of industry members to ensure compliance with Federal tax and regulatory requirements. Field personnel also develop intelligence and pursue leads suggesting unlawful operations in violation of the tax, permit, and other requirements enforced by TTB.

In FY 2010, TTB's enforcement profile was enhanced by a Congressional directive to add special agents to its field operations in order to address illicit activity in the alcohol and tobacco industries. Pursuant to the FY 2010 Consolidated Appropriations Act, TTB was authorized \$3 million, expendable over two years, to hire, train, and equip special agents to enforce its criminal jurisdiction. TTB completed that directive in October 2010, and has deployed those agents to pursue criminal enforcement cases on its highest priority cases, in anticipation of reporting measurable results in FY 2011.

### **Civil Tax Enforcement**

Prior to FY 2008, tax receipts for TTB and its predecessor agency, the Bureau of Alcohol, Tobacco, and Firearms (ATF), totaled between \$14 billion and \$15 billion annually. In FY 2010, for the second consecutive year, TTB collected more than \$20 billion in alcohol, tobacco, firearms, and ammunition excise taxes. Total collections for FY 2010 were \$23.8 billion—an increase of 15 percent over FY 2009 collections.

The year-to-year revenue increase of \$3.2 billion is mostly attributable to increased receipts from the tobacco industry. With the passage of the Children's Health Insurance Program Reauthorization Act (CHIPRA) in February 2009, Congress imposed significantly increased tax rates on cigarettes and other tobacco products. The Federal excise tax on cigarettes increased from \$0.39 per pack to \$1.01 per pack, an increase of more than 150 percent. CHIPRA also introduced requirements for permits and taxes on products that had not previously been taxed or regulated.

One such statutory provision included a new permit requirement for those engaged in the business of manufacturing and importing processed tobacco. No associated tax upon processed tobacco was imposed. In FY 2010, TTB granted more than 200 permits to manufacturers and importers of processed tobacco, with additional applications for such permits pending. TTB also required, pursuant to regulation, that manufacturers and importers of processed tobacco notify TTB of any sales of processed tobacco to non-permittees so that the Bureau can detect persons who operate outside of the legal requirements. The submitted reports are critical to ensuring that unauthorized individuals are prevented from operating or that their illicit activity is stopped.

CHIPRA also levied a floor stocks tax (FST), a one-time excise tax placed on a commodity undergoing a tax increase, on all tobacco products held for sale as of April 1, 2009. The FST is equal to the difference between the new tax rate and the previous rate. The FST added approximately 400,000 new taxpayers to TTB's enforcement responsibility. In FY 2010, TTB continued its FST enforcement efforts based, in part, on findings that many wholesalers failed to report or underreported their tobacco inventory and associated tax payments in the prior fiscal year.

In enforcing the FST, TTB combined technology, outreach to Federal and State agency stakeholders, and sophisticated targeting techniques to not only discover the identities of these new taxpayers but also to develop an audit plan consisting of those entities that intelligence data indicated had likely not filed or under-filed FST payments. By employing a short field examination program, TTB auditors and investigators completed more than 250 visits to the premises of manufacturers, wholesalers, importers, and retailers to verify FST payment. On these visits, TTB identified an average underpayment of \$40,000. In the second year of collections, TTB's field work resulted in the identification and collection of approximately \$10 million and \$7.2 million in additional FST, respectively. Total FST collections to date are \$1.2 billion.

The strategic risk-based approach used to deploy limited staff resources enabled TTB to leverage its field presence to cover a wide universe of potential FST taxpayers without adversely impacting TTB's other

### TTB Enters Agreement with IRS for Special Agents



*In FY 2010, TTB completed work on a reimbursable agreement with the Internal Revenue Service Criminal Investigation (IRS CI) unit to provide agents and the infrastructural support necessary to conduct law enforcement operations. TTB agents reported on October 1, 2010, and in the fiscal year ahead will pursue criminal cases involving the illegal manufacture and distribution of alcohol and tobacco products.*



*In October 2010, TTB completed its initial training for its special agents regarding TTB's criminal jurisdiction. TTB auditors, investigators, attorneys, and regulatory specialists provided to the TTB agents the comprehensive instruction necessary to carry out enforcement activities in FY 2011.*

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audit and investigation priorities. In FY 2010, in addition to the FST examinations, the Bureau assured overall tax compliance by completing targeted audits for 145 industry members. This work resulted in the identification and collection of \$7.4 million and \$1.7 million, respectively, in additional tax, penalties, and interest. TTB collected another \$6.6 million related to open audit issues from prior years. Going forward in FY 2011, TTB will continue to audit non-filers and high risk under-filers of FST.

Before the Bureau can determine tax liability, a tax class must be assigned to alcohol and tobacco products based on regulatory standards. For alcohol beverages, classification requires that the Bureau review the formula of certain products before they enter the market. For example, if an examination of the formula were to disclose that an imported sake, which is made from fermented rice and is classified and taxed as wine, contains added spirits, then the product is then classified and taxed as a distilled spirit. This type of formula review, known as a pre-import approval, can have significant tax implications, as wine is subject to a lower tax rate than spirits products. In FY 2010, TTB processed nearly 6,700 formulas, lab analysis reports, and pre-import evaluations to ensure Federal production standards were met and that producers and importers paid the appropriate amount of excise tax.

TTB also conducts post-market product evaluations to check for proper tax classification. As an example, TTB receives numerous samples of cigar products from manufacturers and importers seeking verification that the product is a cigar rather than a cigarette. In classifying such a product under the IRC, TTB evaluates the product's wrapper, the type of tobacco used in the filler, the product's appearance, and the product's packaging and labeling to verify that the represented tax class meets the statutory criteria.

In FY 2010, TTB performed post-market product evaluations on a broadening range of non-traditional products, such as products commonly referred to as "electronic" cigars, cigarettes, or pipes, and products marketed as "tobacco free" tobacco product alternatives. One important initial factor for evaluating these products is verifying that the products contain tobacco, which subjects them to taxation. To do so, the TTB Tobacco Laboratory developed a method to confirm the presence of tobacco in these unconventional products. Misclassification of such products would have a significant consequence on excise tax collection. Further, the tobacco verification determinations are also relevant to States, which defer to TTB for such determinations, and other Federal agencies, such as FDA.

Prior to the enactment of CHIPRA, TTB faced a challenge in distinguishing between cigars and cigarettes, particularly between small cigars and small cigarettes. Due to the tax rate differential on these tobacco products, assigning an appropriate tax class had significant revenue implications. The tax on small cigars was just under \$1.83 per 1,000 sticks, while the tax on small cigarettes was \$19.50 per 1,000 sticks. At that time, TTB was evaluating analytical methods to establish an objective standard to distinguish between the two products for tax purposes and to minimize potential revenue losses from misclassification.

As a result of CHIPRA, the tax on small cigars and small cigarettes was made equivalent, at \$50.33 per 1,000 sticks. While the tax issue was resolved by this parity, the need for appropriate classification of these products remains, since other laws make a distinction between cigars and cigarettes, and impose more

stringent regulatory restrictions over cigarettes but not cigars. For example, the Jenkins Act, recently amended by the Prevent All Cigarette Trafficking (PACT) Act, applies restrictions on delivery and Internet sales of cigarettes and smokeless tobacco products and on mailing such products through the U.S. Postal Service (USPS), but these restrictions do not apply to cigars. In this case, and in all instances where cigarettes are more restrictively regulated than cigars, the incentive for industry to misclassify these products remains.

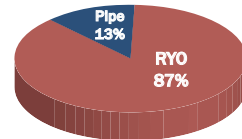
TTB recognizes this and, moving forward, the Bureau intends to complete rulemaking to set forth objective, analytical standards for distinguishing between these products for Federal excise tax purposes. In FY 2010, TTB continued its work on a final rule to address the concerns raised in response to a notice published in October 2006 in the Federal Register (71 FR 62506). This notice proposed a set of standards to distinguish between cigars and cigarettes for tax purposes based on, among other characteristics, scientific analysis of the filler tobacco and physical features, such as the presence of an integrated filter. Work on this regulatory project will continue into FY 2011.

Since the enactment of CHIPRA, a number of changes in the tobacco products industry have occurred, apparently in response to the new incentives created by the different tax rates imposed on the tobacco product categories. For example, prior to CHIPRA, the tax rates on pipe tobacco and roll-your-own (RYO) tobacco were the same at just under \$1.10 per pound. As a result of CHIPRA, the tax on pipe tobacco was increased to just over \$2.83 per pound, while the tax on RYO tobacco was increased to \$24.78 per pound. Because the tax rate on RYO increased so significantly, a dramatic shift has ensued in the volume of pipe tobacco and RYO tobacco reported as removed by domestic manufacturers from their manufacturing premises for sale in the United States.

## Effect of CHIPRA on Taxable Removals of Tobacco Products

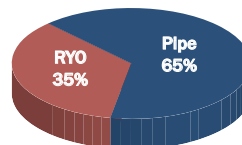
*Payment of excise tax is due from tobacco manufacturers at the time the product is removed for sale from the manufacturing premises. Since the enactment of CHIPRA, significant shifts in the tobacco products industry have surfaced.*

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



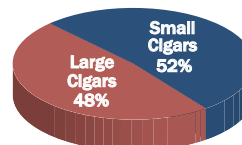
Total Removals of 23.0 Million Pounds

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

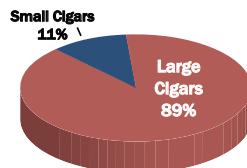


Total Removals of 22.9 Million Pounds

**Pre-CHIPRA Reported Removals of Small and Large Cigars**



**Post-CHIPRA Reported Removals of Small and Large Cigars**



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

Because of the lack of clear standards in the tax code to differentiate pipe tobacco from RYO tobacco, and the consequent potential for misclassification and erroneous tax payment on these products, TTB initiated a laboratory study to evaluate analytical methods and objective standards that would provide a basis for differentiating between these two products for tax purposes. In July 2010, TTB published a notice in the Federal Register (75 FR 42659) seeking comment upon classification standards regarding these products.

Additionally, the TTB Tobacco Laboratory is participating in a collaborative study with 12 other laboratories in 9 countries on the cut width of the tobacco in certain tobacco products. This study will provide insight into inter-laboratory variations in the measurement of tobacco cut width, and will offer valuable experience to TTB's Tobacco Laboratory for tobacco product classification. TTB submitted its analytical results to the principal investigator of the study in Germany and the results of this international collaboration will be submitted to the International Organization of Standardization (ISO) committee for review and approval as an official ISO method for the measurement of the cut width of RYO and pipe tobacco products.

TTB also has seen a notable shift in the cigar market since the passage of CHIPRA. There may be a number of reasons for this shift and, in FY 2011, TTB will continue to study these shifts to determine the role played by tax rate and product classification to ensure against inappropriate tax engineering by those permitted to operate in the tobacco industry.

### **Criminal Enforcement**

Tax fraud in the alcohol and tobacco industries, whether through unlawful product diversion or other means, poses a high risk to Federal revenue collection as well as a lucrative funding source for criminal or terrorist organizations.

Diversion refers broadly to the movement of alcohol and tobacco products into domestic commerce without the payment of taxes due. The trade of these products outside the legal distribution system subverts Congressional intent in taxing these commodities, and threatens to reduce the Federal revenue stream, which is \$23.8 billion annually. Diversion activity also undermines Federal and State tax interests in promoting fair competition within interstate commerce.

Additionally, since 2000, organized criminal groups have become increasingly active in the diversion of tobacco products, particularly cigarettes, and are running larger scale and more complicated diversion schemes. The schemes have included the use of counterfeit tax stamps, counterfeit cigarettes, shell companies, and money laundering. Federal investigations also have revealed that some criminal organizations are using the proceeds from tobacco diversion to fund other criminal activities, including



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*Under CHIPRA, Congress imposed new Federal controls on the tobacco industry by introducing a permit requirement for manufacturers of processed tobacco. TTB is the Federal agency responsible for issuing these permits.*

drugs, weapons, identity theft, and various types of fraud. For example, Federal investigations have uncovered criminals engaged in diversion activities to fund the Hezbollah terrorist organization and its activities.<sup>5</sup>

Diversion activity also undermines public health by allowing the introduction of illegally manufactured or distributed products into the marketplace at reduced prices, thereby opening up access to these products that tax schemes seek to limit. Consequently, non-taxpaid alcohol and tobacco products offer a cheap alternative to price-sensitive consumers who might otherwise abstain.

CHIPRA directed the Secretary of the Treasury to conduct a study concerning the magnitude of illicit tobacco trade in the United States and to submit to Congress recommendations for the most effective steps that the Department of the Treasury can take to reduce such illicit tobacco trade. The Department of the Treasury issued its Report to Congress on Federal Tax Receipts Lost Due to Illicit Trade and Recommendations for Increased Enforcement on February 4, 2010.

In this report, the Treasury Department estimated the Federal tax loss on cigarettes due to diversion for 2007 to be in the range of \$500 million to \$1.5 billion. Applying the new tax rate, Federal losses range between \$1.5 billion and \$4.5 billion. TTB will continue to conduct this study to determine the post-CHIPRA revenue loss once cigarette consumption rates for 2009 and 2010 become available.

As directed, the Report set forth several recommendations for reducing Federal revenue loss as a result of diversion and suggested additional areas for consideration after post-CHIPRA revenue figures become available, to determine whether these figures justify the additional controls that are offered. In particular, the Report recommended enhancing the traceability of tobacco products; evaluating existing criminal and civil penalty provisions applicable to tobacco diversion to determine whether they should be increased; and allowing enforcement officials to pay investigative expenses with proceeds gained through undercover operations.

Certain of the recommendations contained in the Report have been substantially recognized in recently passed or pending legislation. The PACT Act, enacted in March 2010, imposed additional controls that addressed concerns regarding consumer purchases of tobacco products over the Internet or through other means of delivery sales as these products, delivered directly to the consumer, may not be appropriately taxpaid. In addition, the Smuggled Tobacco Prevention Act of 2010 (STOP Act), if enacted, would substantially address the majority of the Report's remaining recommendations and issues. That is, the STOP Act authorizes a track and trace system, increases penalties for smuggling related offenses, and substantially closes the tobacco distribution system through the imposition of permit and records requirements.

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

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To date, addressing criminal activity in the industries TTB regulates has required coordination with other law enforcement agencies to effect the Bureau's criminal jurisdiction. TTB has criminal enforcement authority over the commodities it taxes and regulates, but has had to rely on the availability of other agencies to supply law enforcement resources to pursue criminal tax cases. During FY 2010, to address the threat that diversion activity poses to the Federal revenue stream, TTB carried out 36 joint investigations with various Federal, State, and local law enforcement agencies. These investigations resulted in the seizure of more than 3,000 cases of alcohol beverage products and nearly 100,000 cartons of cigarettes having an estimated Federal and State tax liability of approximately \$30 million. As a result of these activities, TTB assessed or collected roughly \$1.9 million in taxes owed.

Congress recognized the need to address this revenue issue in FY 2010 in its earmark of \$3 million in two-year appropriations for TTB to hire, train, and equip special agents to effect the Bureau's criminal jurisdiction. In December 2010, following the enactment of the FY 2010 omnibus spending bill, TTB engaged a Criminal Enforcement Task Force to implement the Congressional directive to establish an agent cadre at the Bureau. The task force completed a thorough analysis of the resource needs and policy decisions that would be required for TTB to create its own criminal enforcement division. After intense study, TTB determined that the most effective way to establish a criminal enforcement arm would be to enter into a reimbursable agreement to use the resources of an existing law enforcement agency for the immediate future. This decision and subsequent interagency coordination resulted in a reimbursable agreement with IRS Criminal Investigation (IRS CI) as the best option to expend the two-year appropriation. The agreement, signed September 30, 2010, provides for both infrastructural support, such as training, vehicles, weapons, and medical testing, and for the provision of special agents themselves.

The Bureau is currently involved in multiple ongoing criminal investigations of illegal activity in the alcohol and tobacco industries. In developing additional criminal case leads, TTB has incorporated into its audit plan selected target audits of industry segments and specific industry members that are at high risk for the diversion of taxable alcohol and tobacco commodities. These include alcohol and tobacco importers and export warehouse proprietors, and other entities referred from the TTB Intelligence Division based on suspected illegal activity. The results of this criminal enforcement initiative will be released in the fiscal year ahead.

### Protect the Public

The TTB Protect the Public strategic goal has broad meaning and is inclusive of activities that directly impact American consumers, such as product safety testing and the verification of labeling claims, as well as work that indirectly benefits the American taxpayer by ensuring vitality and fair competition in the alcohol beverage trade. In essence, TTB's public protection responsibilities align with two principal outcomes for the American people: economic growth and consumer protection.

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

and tobacco products, the integrity of the products themselves, and the integrity of the market in which these businesses operate.

TTB operates these programs under the authority of the IRC and the FAA Act. The FAA Act grew out of Prohibition, and provides for regulation of those engaged in the alcohol beverage industry and for protection of U.S. consumers. The FAA Act includes provisions to require a permit for those who engage in the business as a producer, importer, or wholesaler of alcohol beverages. The IRC includes similar permitting requirements for tobacco manufacturers, importers, and export warehouses. To ensure the integrity of the industry, TTB permit specialists screen applicants to prevent persons who are not likely to operate in accordance with the law from entering the trade. Based on risk factors, certain applications are referred to TTB investigators for a field inspection. TTB investigators also perform field investigations on a statistical sample of applicants who received a permit to ensure that the proprietor is eligible to operate within the TTB regulated industries and to verify that the business' operations comply with Federal law. If TTB determines that a business is violating the conditions of its Federal permit, TTB may suspend or revoke its permit to operate.

Further, to protect consumers, TTB carries out provisions of the FAA Act to ensure that labeling and advertising of alcohol beverages provide adequate information to the consumer concerning the identity and quality of the product and to prevent misleading labeling or advertising that may result in consumer deception regarding the product. TTB also reviews alcohol beverage label applications to fulfill the statutory requirement that bottlers and importers of alcohol beverages have an approved Certificate of Label Approval (COLA) or an exemption certificate before the product may be sold in the United States.

TTB investigators also enforce the FAA Act provisions which preclude unfair trade practices. These provisions regulate the marketing and promotional practices concerning the sale of alcohol beverages, and regulate trade practices such as exclusive outlets, tied house arrangements, commercial bribery, and consignment sales.

### Trade Practices Prohibited by the FAA Act

*Federal law defines the alcohol beverage marketing practices that are allowed and those that are prohibited for alcohol beverage manufacturers, importers, wholesalers, and retailers. The objective of these trade practice standards is to promote fair competition in the alcohol beverage industry. Following are the trade practices prohibited under Federal law:*

**Exclusive outlet** - *An exclusive outlet is a practice by which an industry member requires a retailer to purchase its alcohol beverages.*

**"Tied house"** - *A "tied house" is a practice whereby an industry member induces a retailer to purchase its alcohol beverages.*

**Commercial bribery** - *Commercial bribery is a practice whereby an industry member induces a wholesaler or retailer to purchase its alcohol beverages.*

**Consignment sales** - *Consignment Sales is a practice whereby an industry member sells, offers for sale, or contracts to sell to any trade buyer (wholesaler or retailer) or for such trade buyer to purchase, offer to purchase or contract to purchase any such alcohol beverages on consignment, or with the privilege of return or any other type of consignment sale noted in Section 105(d) of the FAA Act and 27 Code of Federal Regulations 11.21.*

## Business Integrity

TTB facilitates growth in the U.S. economy by enabling qualified applicants to enter business as an alcohol producer, wholesaler or importer, or as a tobacco products manufacturer, importer or exporter. The number of applicants filing for an original permit or registration with TTB has grown 30 percent between FY 2004 and FY 2010. Today, the Bureau regulates 52,670 industry members, an increase of 37 percent over the 38,563 permit holders in FY 2004.

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

As part of these efforts to support the Bureau's business integrity objectives, TTB monitors compliance with Federal permit requirements among tobacco product importers by comparing the import records in CBP's International Trade Data System to the permit records on file in the TTB Integrated Revenue Information System (IRIS)—the Bureau's integrated tax and permit database. TTB intelligence analysts were able to identify 190 entities (15 percent of active tobacco importers in FY 2010) importing product illegally through this comparison, and responded by issuing cease and desist letters to the culpable individuals. These efforts to address compliance violations have proven effective, as all of the importer entities notified by TTB have come into compliance or ceased operations. CBP is the Federal agency responsible for collecting taxes and duties due on these imported products. The tax value of these imports as declared to CBP is \$500,000.

TTB performance data indicates that since the Bureau began this enforcement strategy, the rate of non-permitted importers has declined. Since FY 2008, the level of illegal importers fell from 22 percent to 15 percent in fiscal years 2009 and 2010. As external factors, such as the increased excise tax rate, significantly contribute to non-compliance, TTB is evaluating other methods of measuring its effectiveness in this enforcement activity. In FY 2011, TTB will continue to monitor imports of tobacco products by non-permitted entities, placing special emphasis on enforcing the PACT Act. TTB will coordinate with



*Those who apply for a Federal permit to operate in the alcohol and tobacco industries are screened by TTB to ensure they are qualified and likely to adhere to the conditions of their permit.*

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the USPS and other common carriers to provide enforcement assistance for the relevant provisions of the PACT Act. Finally, though TTB has no way of discerning how much of the revenue loss from its tobacco diversion study is attributable to imports, the Bureau has formed a task force with CBP to enhance its diversion enforcement efforts with respect to imported products.

Efficiency in permit processing is equally critical to the Department of the Treasury's goal of improved economic opportunity. In addition to ensuring a lawful marketplace by preventing diversion, improving turnaround time for permit application processing enables those who are qualified to hold a permit in the alcohol and tobacco industries to begin operating businesses sooner, facilitating U.S. economic growth in a fair marketplace. In FY 2010, as part of its long-term management objective to automate the Bureau's key business processes, TTB undertook a major software development effort that will allow industry members to electronically submit new and amended permit applications for approval. The Permits Online system will provide a secure, Web-based system to support the online submission, routing, and processing of original and amended permit applications.

The NRC, the Bureau's tax and permit processing hub, currently processes application packets for more than 20 types of permits or registrations for the alcohol, tobacco, firearms, and ammunition industries. New or existing alcohol and tobacco industry members file these packets to request permission to commence a new regulated industry operation, or to update critical industry member information such as trade names on an existing business. Over the past several years, the volume of paper applications has increased, making it difficult to maintain current service levels. With the workload increasing at the same time the Bureau's workforce is shrinking, this IT initiative is critical to improving present turnaround times.

TTB made a strategic investment in FY 2009 in a commercial off-the-shelf system to automate the submission and processing of permit applications. In FY 2010, TTB developed and customized the software package, and has nearly completed the testing phase. Once testing is completed, Permits Online will be a turning point in terms of how TTB interacts and provides service to the industry.

The first phase of Permits Online is scheduled to be released in the second quarter of FY 2011, and will reduce processing times for the largest applicant groups—alcohol importers, alcohol wholesalers, and wineries. In phase two, TTB will add additional permit types to the system in increments of one until all permit applicants can use the system to electronically file for an original or amended permit. The testing for phase two will be completed in the fourth quarter of FY 2011, and system updates will continue through FY 2012.

Permits Online will substantially improve TTB specialists' ability to timely screen and authorize applicants to operate alcohol and tobacco businesses. TTB expects that the release of Permits Online will result in improved customer satisfaction and significantly reduced turnaround times on permit applications, since the application process will be easier and faster. In advance of Permits Online, the NRC implemented a Balanced Scorecard initiative to ensure the processing time for permit applications did not extend beyond the 72-day target for FY 2010. Going forward, TTB has set a target of 70 days for the processing of original permit applications. TTB will monitor its performance related to the cycle time for original permit applications as industry members adapt to this new filing method and usage rates for the system increase.

## Market Integrity

TTB is charged with assuring that the alcohol marketplace is free from practices that would stifle competition and act as a barrier to trade.

As part of its Trade Facilitation Program, TTB has reinvigorated FAA Act trade practices activities to investigate acts that violate Federal law relating to alcohol beverage marketing practices. Unlawful trade practices threaten fair competition because such practices undermine healthy small business activity and limit consumer choices by allowing influential producers to unlawfully interfere with the supply chain.

In FY 2010, TTB continued its long-term nationwide investigation of some of the largest suppliers in the United States that the Bureau has found to be committing slotting fee violations in order to receive preferred shelf and warehouse space with a large casino chain. In this investigation, TTB found that retailers expect suppliers to pay product support dollars in order to guarantee product placement and thus exposure. Such payments, or “slotting fees,” place smaller industry members that cannot afford to pay these fees at a competitive disadvantage. TTB expects to conclude the investigation in FY 2011 through a settlement agreement and acceptance of Offers-in-Compromise. Barring such an agreement, TTB will move forward with its investigation and could pursue permit suspensions against these industry members.



*TTB hosted the delegation of Chinese officials on March 18 through March 23, 2010, and the itinerary included a stop at the TTB Compliance Laboratory in Walnut Creek, California.*

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

As international trade in alcohol beverages increases, TTB must seek innovative and efficient ways to achieve its consumer protection and revenue collection mission. Specifically, TTB’s expansion of international agreements has fostered a global network of regulators in the alcohol and tobacco industries that ensure markets remain open and illegal activity in the global trade is addressed promptly.

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In FY 2010, TTB made significant progress on international agreements with multiple counterpart agencies in Brazil, Italy, the Republic of Georgia, and France. Each of these agreements facilitate trade by increasing mutual understanding of each country's alcohol and tobacco production, labeling, and licensing requirements, and by providing a process for the exchange of regulatory information that has the potential to impact trade, compliance, and product safety.

In FY 2010, TTB signed Memoranda of Understanding (MOU) with two of its counterpart regulators in Italy—the Guardia di Finanza (GdF) and Istituto Agrario di San Michele all'Adige (IASMA). The MOU with the GdF establishes a consistent channel of communication on issues of mutual concern, including product integrity, smuggling, counterfeit, and diversion issues. TTB has already cooperated extensively with the GdF to prevent mislabeled Brunello di Montalcino wine from entering the U.S. market. Additionally, the MOU with IASMA, a private agricultural research laboratory, promotes product integrity by enhancing TTB's development of methodologies to characterize wine and grape varieties and detect pesticide residues in wine.



*TTB Administrator John Manfreda and Assistant Administrator for Headquarters Operations William Foster with officials from the Guardia di Finanza at the MOU signing in November 2009.*



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TTB also furthered relationships with its ongoing MOU partners, China's General Administration of Quality Supervision, Inspection, and Quarantine (AQSIQ) and Georgia's Department of Vine and Wine of the Ministry of Agriculture (SAMTREST). In FY 2010, TTB met with AQSIQ officials for technical exchanges on laws, regulations, standards, and functions of the import/export system. In Georgia, TTB met with SAMTREST officials to discuss wine trade issues, including Georgia's becoming parties to the World Wine Trade Group, efforts to improve the technical capabilities of the Georgian Wine Laboratory, and product integrity for Georgian wines in the United States. Such information sharing supports compliant trade in alcohol beverages, protecting the public and increasing revenue collection.

In addition, TTB continued its negotiations for an MOU with France's General Directorate for Competition Policy, Consumer Affairs and Fraud Control (DGCCRF), which is responsible for market competition regulation, consumer economic protection, and consumer safety, with an emphasis on wine. TTB has been collaborating with DGCCRF to prevent fraudulent pinot noir from entering the U.S. market, by requiring that U.S. industry members obtain a declaration from the Government of France certifying the wine. TTB expects to sign the MOU with DGCCRF during FY 2011, furthering an open exchange of information to protect against consumer fraud.

TTB also works to address barriers in the international marketplace by participating with other Federal agencies in the negotiation of international trade agreements related to alcohol and tobacco products on behalf of the U.S. Government. In FY 2010, TTB commenced work on an interagency project with the USTR, the USDA-Foreign Agricultural Service, the U.S. Department of Commerce, and the U.S. Department of State to establish an Asia-Pacific Economic Cooperation (APEC) Wine Regulatory Forum (WRF) in support of expanding markets for U.S. exports.

APEC is the premier forum for facilitating economic growth, cooperation, trade, and investment in the Asia-Pacific region. It is the only inter-governmental grouping in the world operating on the basis of non-binding commitments and open dialogue. Unlike the World Trade Organization or other multilateral trade bodies, APEC has no treaty obligations required of its participants. Decisions are reached by consensus and commitments are undertaken on a voluntary basis. The 20 APEC members are: Australia, Brunei Darussalam, Canada, Chile, the People's Republic of China, Hong Kong, Indonesia, Japan, the Republic of Korea, Malaysia, Mexico, New Zealand, Papua New Guinea, Peru, the Republic of the Philippines, Russia, Singapore, Chinese Taipei, the United States, and Vietnam. Many of the APEC member countries are emerging export markets for the U.S. wine industry.

Australia, New Zealand, and the United States are co-sponsoring a project to establish an APEC WRF. The WRF would be a forum to support open and free trade and eliminate technical barriers to trade issues. In the fiscal year ahead, the U.S. interagency consortium will reach out to the U.S. wine industry to support the project, and then will meet with U.S. co-sponsors to create the necessary project documentation in order to secure funding. If the project is funded, the United States will propose having the first WRF meeting as part of the APEC Subcommittee on Standards and Conformance meeting to be held in California in FY 2011.

Similarly, in FY 2010, TTB assisted the U.S. Department of Commerce and USDA in preparing an MOU on Cooperation of Wine-Related Businesses with the Hong Kong Commerce and Economic Development



### TTB Holds Wine Export Seminar



*Consistent with the President's National Export Initiative, which aims to "enhance and coordinate Federal efforts to facilitate the creation of jobs in the United States through the promotion of exports, and to ensure the effective use of Federal resources in support of these goals," TTB held its first "How to Export Wine" seminar for State winery association leaders in October 2009.*

*The seminar, geared toward small wineries, provided an outline of Federal wine export resources and gave State representatives practical tools to better assist wineries in exporting their products.*

*TTB arranged for officials from the Department of Commerce, the Department of Agriculture, the Small Business Administration, the Export-Import Bank, and the Office of the United States Trade Representative (USTR) to make presentations to the representatives on the export resources of their respective agency.*

Bureau. Specifically, TTB provided comments regarding counterfeiting and smuggling issues, and was designated as responsible for addressing issues related to combating counterfeit wine and smuggling. This agreement will support the marketing and promotion of U.S. wines in Hong Kong and elsewhere in Asia.

In FY 2011, in support of the Trade Facilitation Program, TTB will continue to expand its international agreements with foreign regulators. The Bureau intends to finalize MOU with Canada and Italy, two countries that are among the top five importers of malt beverages, wine, or distilled spirits to the United States. These MOU are representative of the Bureau's broad objective of ensuring that all imported products are properly labeled and safe for consumption.

### **Product Integrity**

Consumer confidence is essential to ensuring that U.S. and world economies perform at their full economic potential. TTB is the Federal agency responsible for assuring the integrity of alcohol beverage products in the U.S. marketplace so that consumers are adequately informed in their purchasing decisions and are protected from health hazards.

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

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In November 2009, the FDA notified nearly 30 manufacturers of certain alcohol beverages containing added caffeine of its intent to look into the safety and legality of their products. The FDA also issued a news release titled, "FDA to Look Into Safety of Caffeinated Alcoholic Beverages," and posted on its Web site, [www.fda.gov](http://www.fda.gov), additional information about recent FDA activity regarding alcohol beverages to which caffeine is added. These actions followed a meeting held in August 2009, when several State Attorneys General met in TTB headquarters with both TTB and FDA to express their view that caffeinated alcohol beverages pose health and safety hazards to consumers.

The FDA announcement and the letters to producers of caffeinated alcohol beverages generated a number of inquiries to TTB. TTB has been working with and consulting FDA on caffeinated alcohol beverages for a number of years, and continued this collaboration in response to the State Attorneys General inquiry.

While TTB regulates the labeling of alcohol beverages, it is FDA's responsibility to evaluate the safety of ingredients added to alcohol beverages, pursuant to FDA's authority under the Federal Food, Drug, and Cosmetic Act (FFDCA). If the FDA deems caffeinated alcohol beverage products to be adulterated under the FFDCA, then TTB would consider them to be mislabeled under the Federal Alcohol Administration Act, making it a violation for industry members to sell or ship the products in interstate or foreign commerce.

Following an FDA determination as to the suitability of added caffeine in the identified alcohol beverage products, TTB will continue its coordination with FDA to ensure that any alcohol beverage products that pose a public health or safety problem are removed from the marketplace.

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

The number of applications for label approval that TTB receives increased steadily between fiscal years 2004 and 2008, with an overall growth rate of 27 percent. After a 6 percent decline in FY 2009, which may be attributable to the economic downturn, the number of label filings trended up in FY 2010, nearly matching filing rates from FY 2008. Again in FY 2010, the significant majority of label applications received were for wine products. The wine industry submitted 84 percent of the label applications processed by TTB in FY 2010.

Once alcohol beverages enter the marketplace, TTB monitors labeling compliance through the Alcohol Beverage Sampling Program (ABSP). This involves examining a statistically-valid sample of domestic and imported wine, spirits, and malt beverage products to determine if the labels meet Federal requirements, and if the contents of the bottle match the label description. This process includes a chemical analysis of selected products by the TTB Laboratory for identification and product safety purposes. In the first two cycles, the ABSP focused on distilled spirits and malt beverage products. The third cycle of the ABSP was undertaken in FY 2010 and focused on wine. The ABSP program results found that, given a 95 percent

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confidence level, the wine industry is 96 percent compliant ( $\pm 3$  percent) with Federal production and labeling requirements. The ABSP results are incorporated into the TTB risk model to direct enforcement resources, and findings of non-compliance are addressed by TTB analysts and investigators. The results of this sampling program will provide a baseline for the level of compliance from this industry segment, and will enable TTB to assess its progress in assuring the integrity of products offered for sale to U.S. consumers.

In FY 2011, TTB will expand the ABSP, as part of a strategic shift to a more market-based approach to consumer protection. In the year ahead, TTB will expand its ABSP to include all three alcohol beverage commodity types of spirits, wine, and malt beverages, and will add a field investigation component to verify label claims made on alcohol beverages, such as grape varietal and vintage.

TTB also reviews advertisements for alcohol beverage products under the Alcohol Beverage Advertising Program. A representative sample of ads from television, radio, the Internet, and other ad sources are collected and reviewed for compliance with Federal regulations. This year's program centered on wine advertisements and, based on the findings, TTB estimates the compliance rate with Federal regulations for all wine advertisements is 81 percent ( $\pm 4$  percent). The results of the ABAP also pointed to the fact that advertising on the radio and in print appears to have the most compliance issues, while TV and Internet advertising appear to be the most compliant. Because of a limited sample size for this program, TTB could not make a statistically based conclusion for outdoor advertising compliance.

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

In FY 2010, following the TTB Laboratory's identification of unauthorized pesticides in certain imported wines, TTB developed a pesticide residue program that involved sampling wine in the marketplace for analytical testing. The program includes product tests to determine the presence of unauthorized pesticides and to ensure that authorized pesticides that are present are within the limits prescribed by the FDA and EPA. In addition, in March 2010, TTB issued guidance to domestic producers and to importers via an industry circular which clarifies how the Bureau will respond to findings of pesticides in wine. TTB also established an intra-agency Pesticides, Adulterants, and Contaminants Critical Task Force to clearly define the steps and procedures TTB will take in response to unsafe ingredients, pesticides, or hazards in any beverage product that TTB regulates.

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

In FY 2010, TTB responded to a scandal involving the fraudulent labeling of wine imported as pinot noir from France. Significant investigations were conducted to determine if U.S. importers and bottlers were

complicit in the illegal activity. At this stage, TTB has found no evidence in its interviews or review of source documents that would indicate the U.S. industry took part in planning or executing the fraud. The Bureau's work has prevented approximately 2 million bottles of mislabeled pinot noir wine from reaching U.S. consumers in the marketplace. Going forward, TTB will continue to deploy its enforcement resources based upon a risk model that includes risk and random factors. This approach ensures that the Bureau's enforcement efforts reflect a responsiveness to the greatest threats of noncompliance and remain agile enough to respond to pressing intervening issues.

Under its FY 2011 investigative operating plan, TTB will expand its marketplace sampling of alcohol beverage products to assess product compliance for spirits, wine, and malt beverage products. The Bureau's investigations and regulation of domestic industry has been the basis to ensure the integrity of our products, both in the view of U.S. consumers and TTB's international counterparts, and has been critical to ensuring market access to U.S. exporters in foreign venues.

### Voluntary Compliance

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

The Bureau also sponsors seminars and workshops to educate the industry on Federal requirements in the areas of manufacturing, marketing, importing and exporting, and paying tax on alcohol and tobacco products, and firearms and ammunition. In FY 2010, TTB sponsored 15 wine industry and Federal compliance seminars across the country. Moving forward, TTB intends to leverage the TTB.gov site and other Web-based capabilities to provide online seminars and tutorials so that industry members will have additional on-demand resources and options to answer questions related to tax and regulatory compliance.



*TTB hosted compliance seminars throughout the U.S. in FY 2010 to assist industry in meeting Federal requirements related to the production and distribution of alcohol beverages.*



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TTB also strives to reduce the burden of compliance on industry by providing clear regulatory guidance. The statutes and regulations that the Bureau administers have not kept up with the ever-evolving changes in the industries that TTB regulates. For example, brewers increasingly wish to make products using non-traditional ingredients that the regulations do not currently allow in the manufacture of malt beverages. TTB also is challenged by enforcing regulations on the alcohol fuel industry that has outgrown a regulatory framework created almost 30 years ago for a much smaller industry. In the years ahead, TTB will work to modernize its regulations to make positive changes to the regulatory framework and significantly influence how well TTB accomplishes its “collect the revenue” and “protect the public” mission.

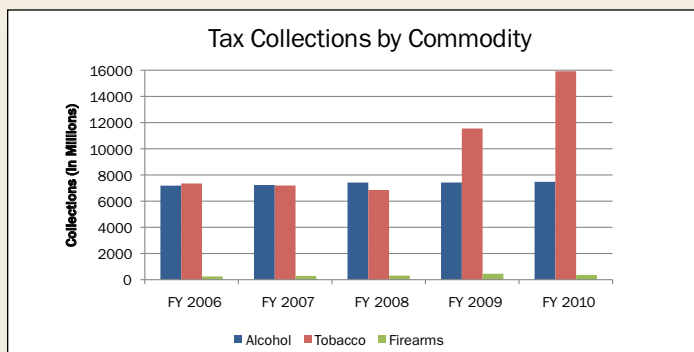
## Performance Summary

### Collect the Revenue

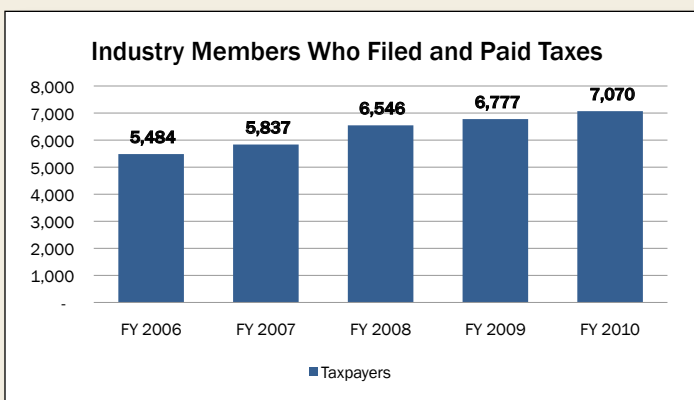
TTB met all of its performance measures under the *Collect the Revenue* activity. A detailed summary of TTB performance is discussed in Part II of this report, Program Performance Results.

Investments in the Collect the Revenue mission resulted in the following accomplishments in FY 2010:

- TTB collected \$23.8 billion in excise taxes and other revenues from approximately 7,070<sup>6</sup> taxpayers in the alcohol, tobacco, firearms, and ammunition industries. The recent rise in excise tax collections for tobacco resulted in a return on investment for the Collect the Revenue program of \$478 for every \$1 expended on collection activities. The return on TTB tax collection activities increased by 12 percent over FY 2009.
- TTB expanded its e-filing capability to allow all excise taxpayers to file and pay taxes, and file monthly operational reports, electronically through the Pay.gov system. The total number of Pay.gov registrants increased by 30 percent in FY 2010, bringing the total to over 6,400.



*In February 2009, Congress enacted an historic tax rate increase on tobacco products in the Children’s Health Insurance Program Reauthorization Act (CHIPRA). In the first full year of collections at the new tax rate, TTB collections totaled \$23.8 billion, a year-to-year increase of 15 percent, collected from a taxpayer base that grew just 5 percent. Since 2008, tobacco revenues have increased 132 percent.*



*Of the TTB permit holders, only a small percentage file a return and pay taxes in a given fiscal year. This is due in large part to the fact that alcohol importers and wholesalers—the largest classes of permittees—do not pay taxes to TTB. Still, the number of taxpayers has increased 29 percent since FY 2006.*

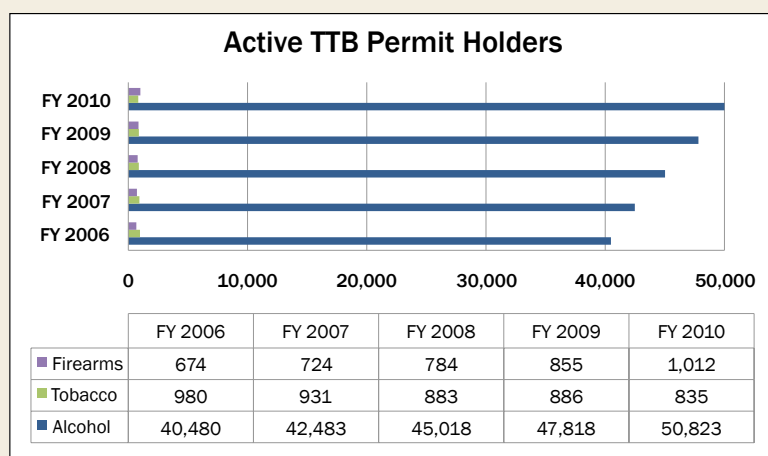
<sup>6</sup> About 11,200 TTB permittees were subject to file a tax return and pay excise taxes this fiscal year; however, many operations do not result in the taxable removal of product from bonded premises. Therefore, in FY 2010, a total of 7,070 permittees had operations that required them to file a tax return and pay excise tax.

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- In measuring voluntary compliance, TTB reported a compliance rate of 94 percent in filing timely tax payments among its taxpayers who pay \$50,000 or more annually. TTB's educational outreach efforts at industry seminars and on manufacturer's premises, as well as enhanced online training tools and guidance, proved successful in maintaining the compliance rate achieved in fiscal years 2008 and 2009.
- TTB processed cover-over payments of \$387 million to Puerto Rico and the Virgin Islands. Cover-over payments to the Virgin Islands increased 3 percent, while payments to Puerto Rico decreased 20 percent. Federal excise taxes collected on rum produced in Puerto Rico and the Virgin Islands and subsequently imported into the United States are "covered over" (or paid into) the treasuries of Puerto Rico and the Virgin Islands. Year-to-year, cover-over payments can vary.
- TTB processed \$298 million in drawback claims, an increase of 11 percent in refunded tax money compared to FY 2009. Under current law, persons who use nonbeverage alcohol in the manufacture of medicines, food products, flavors, extracts, or perfume and other non-potable products may be eligible to claim drawback of excise taxes paid on distilled spirits used in their products. To assess drawback claims, the TTB Laboratory analyzed 8,660 formulas and samples in FY 2010.
- TTB also analyzes nonbeverage and beverage alcohol samples to assign or verify a tax classification. For this purpose, TTB chemists processed 2,050 nonbeverage product specially denatured alcohol formulas and samples to support tax-free alcohol claims. TTB analyzed another 1,060 beverage alcohol samples associated with pre-import evaluation, the 5010 tax credit, and enforcement activities, as compared to 1,020 samples in FY 2009. Pre-import evaluations also serve to protect consumers, as the analytical tests also analyze products for limited or prohibited ingredients.
- The Tobacco Laboratory analyzed 375 tobacco samples in support of tobacco tax classification, regulatory projects, audits, investigations, and in the development of protocols for counterfeit tobacco product authentication. TTB chemists developed protocols for processing tobacco samples, which include the microscopic and chemical analysis of packaging, chemical analysis of tobacco fillers, physical properties of tobacco products (e.g., moisture content and weight), and airflow through tobacco product wrappers. Further, the Tobacco Laboratory is assembling Diversion Kits to use in performing quick screenings of suspected counterfeit tobacco products in the field. Overall, mission work related to analyzing tobacco samples increased 42 percent over FY 2009.
- In FY 2010, TTB completed 145 targeted audits, and completed audit fieldwork on 94 percent of its revised audit plan. These audits resulted in the identification of \$7.4 million and the collection of \$1.7 million in additional tax, penalties, and interest. During FY 2010, TTB has also collected an additional \$6.6 million in tax, penalties, and interest related to outstanding audit issues from prior fiscal years. TTB also conducted approximately 340 revenue-related investigations. Many of these investigations related to the enforcement of the tobacco floor stocks tax (FST), as well as the operations of small alcohol beverage producers and tobacco product manufacturers. This work resulted in the identification of an additional \$500,000 in underpaid taxes. In total, these closed cases resulted in the identification of additional revenue of more than \$8 million.

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- TTB auditors continued to enforce the collection of the tobacco FST from the manufacturers, importers, wholesalers, and retailers who held tobacco products for sale at the time of the tax rate increase imposed by CHIPRA. TTB completed more than 250 field visits to verify FST payment which identified an average underpayment of \$40,000. This field work resulted in the identification of \$10.2 million in FST due to the Federal government. Total FST collections to date are more than \$1.2 billion.
- TTB has criminal enforcement authority over the commodities it taxes and regulates. Tax fraud in these industries, whether through unlawful product diversion or other means, poses a high risk to Federal revenue collection. Diversion includes tax evasion, theft, distribution of counterfeit products, and distribution in the United States of products marked for export or for use outside the U.S. In the February 2010 report to Congress regarding the illicit trade of tobacco products released by the Department of the Treasury, TTB estimated annual losses in Federal receipts prior to the tobacco tax rate increase at up to \$1.5 billion. At the new tax rate, annual revenue losses could range between \$1.5 billion and \$4.5 billion. In FY 2010, Congress earmarked \$3 million in two-year appropriations to hire, train, and equip special agents to address tax evasion and other criminal activity related to alcohol and tobacco. TTB entered into a reimbursable agreement with the Internal Revenue Service Criminal Investigations office, signed September 30, 2010, to provide agents to address this significant revenue issue.



*The total number of active TTB permit holders in the alcohol, tobacco, and firearms industries has increased 25 percent since FY 2006. The average annual increase in permit holders is 6 percent. Alcohol and firearms permittees have displayed a steady rising trend, while the number of tobacco permittees continued a negative trend in FY 2010. Active tobacco permit holders have fallen by 15 percent in 5 years.*



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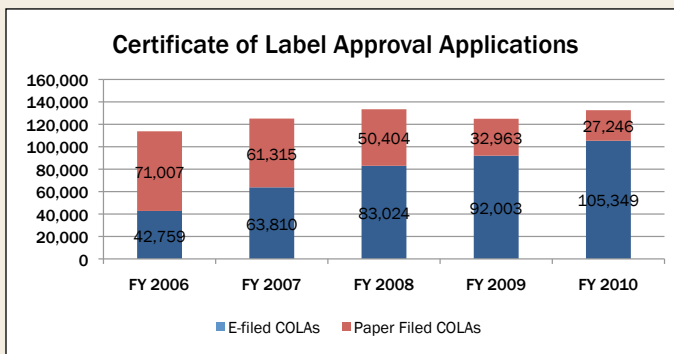
- During FY 2010, TTB partnered with other law enforcement agencies to conduct criminal investigations. TTB carried out 43 joint investigations with various Federal, State, and local law enforcement agencies, resulting in the seizure of more than 3,000 cases of alcohol beverage products and nearly 1 million cartons of cigarettes. TTB closed 36 investigations involving diversion of products having an estimated tax liability of more than \$30.3 million. As a result of these activities, TTB assessed or collected roughly \$1.9 million in taxes owed. TTB also is involved in multiple ongoing criminal investigations of illegal activity in the industries TTB regulates, and has incorporated into its audit plan selected target audits of industry segments and specific industry members that are at high risk for the diversion of taxable alcohol and tobacco commodities. These include alcohol and tobacco importers and export warehouse proprietors, and other entities referred from the TTB Intelligence Division based on suspected illegal activity.
- TTB collaborated with several Federal agencies, international organizations, and other stakeholders in ensuring that the revenue due on imported alcohol and tobacco products is collected. Through its partnership with U.S. Customs and Border Protection (CBP), and by effectively leveraging data available to TTB from CBP's International Trade Data System, TTB identified 190 entities (15 percent of those who imported cigarettes or other tobacco products in FY 2010) as having imported tobacco products without a Federal permit. TTB notified each entity to cease their illegal operations, and all have stopped importing or obtained a permit to import tobacco products. CBP is the Federal agency responsible for collecting taxes and duties due on imported products. The tax value of these imports as declared to CBP is \$500,000.
- TTB participated with CBP and Immigration and Customs Enforcement on the Fraud Investigative Strike Team (FIST). The FIST initiative addresses smuggling and fraud activity along United States' borders. The purpose is to determine compliance with laws and regulations at Foreign Trade Zones and Customs bonded warehouses and, where violations are found, to investigate and prosecute illegal operators. TTB field personnel participated in FIST operations in six U.S. cities with ports or international borders. Through these efforts, TTB identified regulated industry members for comprehensive audits and identified more than \$250,000 of additional excise tax liability based on these examinations.

## Protect the Public

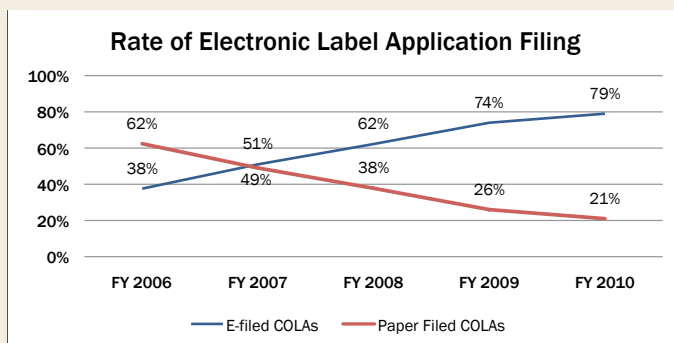
TTB met all of its performance measures under the *Protect the Public* activity. A detailed summary of TTB performance is discussed in Part II of this report, Program Performance Results.

Investments in the Protect the Public mission resulted in several achievements during FY 2010:

- TTB approved 102,500 (77 percent) of the 132,600 COLA applications received; the remaining 30,100 (23 percent) were either rejected, returned for correction, withdrawn, expired, or surrendered. The number of COLA applications received increased by 6 percent from 2009. Of those label applications, 79 percent were submitted through COLAs Online, the Bureau’s system for the electronic filing of label applications. TTB was successful in increasing the rate of e-filing by 5 percent over the previous fiscal year, which corresponds to a 15 percent increase in the number of e-filed applications. The increase in online applications is due in large part to outreach efforts by TTB through educational workshops, improvements to online information, and one-on-one demonstrations to large paper filers.



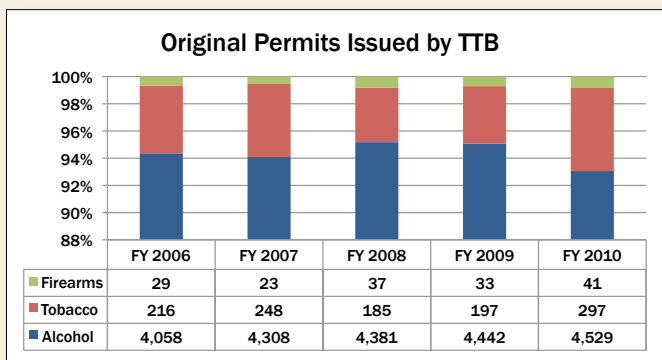
Between fiscal years 2006 and 2010, the number of alcohol beverage label applications submitted to TTB increased nearly 17 percent. After a decline in total COLA applications in FY 2009, the number of Certificate of Label Approval (COLA) applications submitted by the alcohol beverage industry and processed by TTB returned to FY 2008 levels.



Through TTB-sponsored seminars and targeted education efforts, the Bureau was successful in increasing usage rates for the electronic label filing system by 5 percent in just one year. The promotion and education strategy employed over the last seven years has resulted in the COLAs Online usage rate increasing from 38 percent in FY 2006 to 79 percent in FY 2010.

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- TTB issues original and amended permits to persons who are engaged in the alcohol and tobacco industries. TTB processed approximately 5,770 original and 18,230 amended permits, or approximately 4 percent and 3 percent more than in FY 2009, respectively. TTB also issued nearly 7,000 pieces of correspondence related to permit issues, an increase of 20 percent over FY 2009. In FY 2010, TTB processed original applications in an average of 65 days, which resulted in the issuance of nearly 4,870 original permits to qualified applicants.
- As illicit activity in the alcohol and tobacco industries has the potential to be highly lucrative, it is crucial that TTB prevent organized crime and terrorists from commencing operations through its permit investigation process. In support of this objective, TTB initiated approximately 360 permit investigations to verify that applicants were qualified and not prohibited from engaging in business activity in the alcohol and tobacco industries, and that those operating in these industries were properly permitted and operating in compliance with Federal regulations. As a result of TTB's application investigations, 11 applications were withdrawn or abandoned by the applicant and 7 were recommended by investigators for denial. Of the total permit investigations, TTB conducted nearly 100 investigations into businesses suspected of operating without a permit, and 60 investigations into recently permitted entities as part of its post-application verification program. The post-application investigations involve the random selection of permit applications that were approved in the previous year for an in-depth review of the permittee's activities to determine if the information supplied on their application was accurate and if they are conducting compliant operations. In total, TTB permit and revenue investigations resulted in the voluntary surrender of 30 permits and the surrender of 19 permits in-lieu of adverse action.
- In FY 2010, TTB investigators closed more than 310 field investigations into the integrity of alcohol beverage products, and continue work on 160 in-progress investigations. Total product integrity investigations opened by TTB declined slightly compared to FY 2009, and reflects the revision TTB made to its investigation operating plan in FY 2010. The plan directed investigator time and resources to more complex and long-term investigations to increase program effectiveness. This model required that TTB reduce its caseload to enable more in depth reviews of civil violations to determine if criminal conduct is involved. Further, the flexibility built in to the new operating plan enabled TTB to redirect resources to address a scandal involving the fraudulent labeling of wine imported as Pinot Noir from France. TTB's work has prevented nearly 2 million bottles of mislabeled Pinot Noir wine from reaching U.S. consumers in the marketplace.



*In five years, the total number of original permits and registrations approved by TTB has grown 13 percent. Between fiscal years 2009 and 2010, the total number of original permits issued increased by 4 percent. Firearms registrations approved by TTB increased 24 percent over the prior year, and the number of tobacco permits issued increased 51 percent. In the last three fiscal years, the number of tobacco permits issued has trended up.*

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- As part of its active program to ensure the safety of alcohol beverages, TTB evaluates alcohol beverages for a number of potentially harmful adulterants or contaminants, including heavy metals and pesticide residues. In FY 2010, TTB developed a pesticide residue program that involves sampling wine in the marketplace for analytical testing to determine the presence of unauthorized pesticides and to ensure that authorized pesticides that are present are within the limits prescribed by the Food and Drug Administration and Environmental Protection Agency. In FY 2010, TTB issued guidance to domestic producers and to importers via an industry circular which clarifies how the Bureau will respond to findings of pesticides in wine.
- In FY 2010, the TTB laboratories analyzed more than 1,000 product samples for product integrity, tax compliance, and the Alcohol Beverage Sampling Program. Of these products, 326 (32 percent) were non-compliant with Federal standards. TTB also responded to 23 consumer complaints related to alcohol beverages. After collecting samples and testing the suspect products, TTB found that none posed serious health risks to consumers.
- In assuring the integrity of alcohol beverage products offered for sale to U.S. consumers, TTB analyzed and reviewed for compliance 415 alcohol beverage samples as part of the Alcohol Beverage Sampling Program (ABSP). The ABSP uses statistically valid sampling of products in the marketplace to validate that they are properly labeled to protect consumers. This program enables TTB to be proactive rather than reactive to potential labeling issues or threats to the food supply. In FY 2010, the ABSP focused on wine, and preliminary data indicates that, given a 95 percent confidence level, the wine industry is 96 percent compliant (+/- 3 percent) with Federal production and labeling requirements. The ABSP results are incorporated into the TTB risk model to direct enforcement resources, and findings of non-compliance are addressed. In FY 2011, TTB will expand its ABSP to include all three alcohol beverage commodity types, and will add a field investigation component to verify alcohol beverage label claims, such as grape varietal and vintage.
- TTB's Trade Facilitation program helps to strengthen the U.S. economy by facilitating import and export trade in alcohol and tobacco products, while administering the consumer protection standards under its jurisdiction. TTB has made progress on international agreements with multiple counterpart agencies in China, Italy, the Republic of Georgia, and France. These agreements are designed to facilitate trade by increasing mutual understanding of each country's alcohol and tobacco production requirements and labeling and licensing standards, and provide a process for the exchange of regulatory information that has the potential to enhance protection of the revenue or impact product trade, compliance, and safety. TTB also provides technical support to Federal agencies, including the Office of the United States Trade Representative (USTR), in their development of international agreements that promote U.S. exports. TTB is joining the USTR in a project to establish an Asia-Pacific Economic Cooperation (APEC) Wine Regulatory Forum (WRF). APEC is the premier forum for facilitating economic growth, cooperation, trade, and investment in the Asia-Pacific region, and member countries are emerging export markets for the U.S. wine industry. The WRF would be a forum to support open and free trade and eliminate technical barriers to trade.

## Financial Summary

### Federal Excise Tax Collections

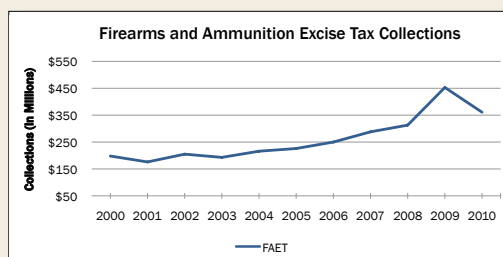
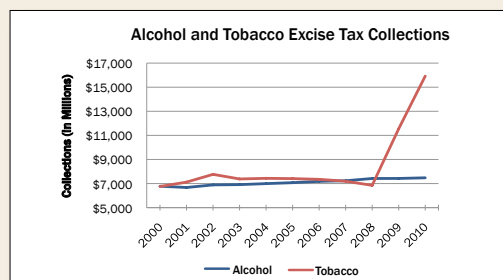
TTB collects excise taxes from the alcohol, tobacco, firearms, and ammunition industries. In addition, the Bureau collects Special Occupational Tax (SOT) from certain alcohol and tobacco businesses. During FY 2010, TTB collected \$23.8 billion in taxes, interest, and other revenues.

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

In February 2009, Congress passed the Children’s Health Insurance Program Reauthorization Act. This law imposed significantly increased tax rates on tobacco products, swept into the statutory regime requirements for permits and taxes for products which had not previously been taxed or regulated, and levied a floor stocks tax (FST) on all tobacco products held for sale as of April 1, 2009. TTB identified \$10.2 million in underpaid FST in FY 2010 and, to date, has collected \$1.2 billion of FST. Further, TTB collected an additional nearly \$16 billion in tobacco excise taxes in FY 2010.

#### FY 2010 Excise Tax Collections:

Alcohol	\$7,476,789,000
Tobacco	\$15,913,479,000
FAET	\$360,813,000
SOT	\$300,000
FST	\$8,558,000
Other	\$180,000
<b>TOTAL</b>	<b>\$23,760,119,000</b>



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

After trending downward for five consecutive years, tobacco tax revenues in FY 2010 were at 132 percent of pre-CHIPRA totals. Effective tax administration resulted in total TTB collections increasing by 16 percent.

Since TTB assumed the responsibility for administering the FAET in 2003, collections have increased 87 percent. After reaching a high in FY 2009, revenue collections trended down in FY 2010; however, FAET collections remain 15 percent above FY 2008.

Note: On July 2, 2005, legislation was enacted that suspended SOT for most alcohol taxpayers, mainly retail distributors. The law repealed SOT for all alcohol taxpayers effective July 1, 2008. However, the SOT relating to tobacco permittees (manufacturers, importers, and export warehouses) remained intact.

## Refunds and Other Payments

During FY 2010, TTB issued \$713,200,000 in refunds, cover-over payments, and drawback payments.

### Cover-over Payments

Federal excise taxes are collected under the Internal Revenue Code of 1986, 26 U.S.C., on certain articles produced in Puerto Rico and the Virgin Islands, and imported into the United States. In accordance with 26 U.S.C. 7652, such taxes collected on rum imported into the U.S. are “covered over,” or paid into, the treasuries of Puerto Rico and the Virgin Islands, less the collection expenses incurred by TTB. During FY 2010, cover-over payments totaled \$387 million.

### Drawback Payments

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

During FY 2010, drawback payments totaled \$298 million. In the case of distilled spirits on which the tax has been paid or determined, a drawback is allowed on each proof gallon at the rate of \$1 less than the rate at which the distilled spirits tax had been paid or determined. The refund is due upon the claimant providing evidence that the distilled spirits on which the tax has been paid or determined is unfit for beverage purposes, or was used in the manufacture of medicines, medicinal preparations, food products, flavors, flavoring extracts, or perfume. The claimant must submit a product formula to the TTB laboratory for analysis and approval of the nonbeverage claim.

Refunds and Other Payments	
Alcohol and Tobacco Excise Tax Refunds	\$28,232,000
Cover-over Payments: Puerto Rico	\$378,186,000
Cover-over Payments: Virgin Islands	\$8,871,000
Drawbacks on MNBP Claims	\$297,596,000
Interest and Other Payments	\$315,000
<b>Total</b>	<b>\$713,200,000</b>

## FY 2010 Bureau Budget

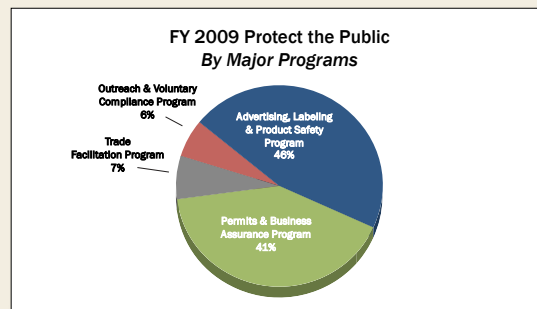
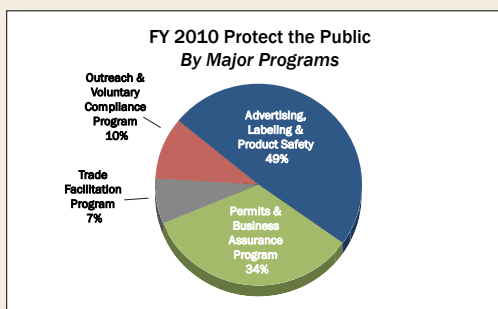
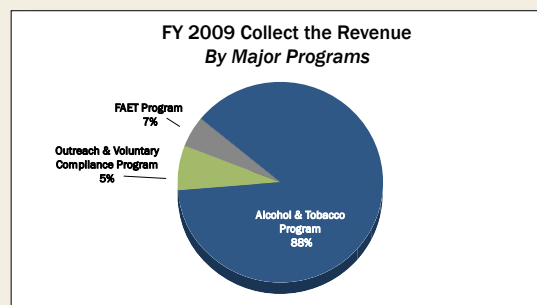
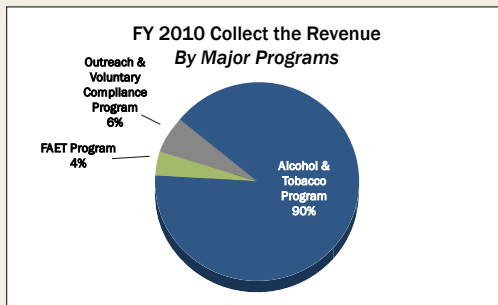
### Direct Appropriations (Salaries & Expense Account)

The FY 2010 TTB budget for salaries and expenses was \$103,000,000. Of that amount, \$3,000,000 was set aside by Congress for the hiring, training, and equipping of special agents. The funds to support the agents in addressing alcohol and tobacco diversion activity is to remain available until September 30, 2011. The authorized full-time equivalent (FTE) staffing level for direct positions was 535, and includes 10 FTE for the agents. TTB elected not to hire the agents directly, but to enter into an interagency agreement with the Internal Revenue Service Criminal Investigation office to conduct criminal investigations into violations of the tax laws TTB enforces.

### Offsetting Collections and Reimbursable Accounts

During FY 2010, the Bureau realized offsetting collections in the amount of \$4.2 million. Those funds originated from multiple sources including recoveries from the operation of the cover over program and other enforcement activities in Puerto Rico, and funding from the Department of the Treasury's Executive Office of Asset Forfeiture to cover critical investments in the TTB Tobacco Laboratory and diversion training for TTB auditors and investigators. They also included funding from the Community Development Financial Institutions Fund (CDFI) for reimbursement of information technology support services.

### Obligations and Expenditures



*The expenditures by TTB major programs remained relatively constant between FY 2009 and FY 2010.*

### Audit of TTB's FY 2010 Financial Statements

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

TTB's Annual Report includes audited FY 2010 and FY 2009 balance sheets, and audited FY 2010 statements of net cost, changes in net position, budgetary resources, and custodial activity, including reports on the Bureau's internal controls over financial reporting and compliance with laws and regulations.

### Management Assurances

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

During FY 2010, TTB applied its custom risk management tools to its Revenue Accounting Section to identify risks in the accounting and tracking of TTB's annual Federal excise tax collections, and to the National Revenue Center, with a focus on its key business processes. Those tools disclosed that TTB has adequate internal controls in place to mitigate risk to operations, and that the overall risk of fraud, waste, and abuse is characterized as "LOW."

In addition, TTB underwent its first independent full scope financial statement audit for FY 2010, and received an unqualified opinion. As a result of this audit, a material weakness in internal controls was identified and reported on the expensing of capital assets and prepaid expenses. Weaknesses identified during the FY 2009 audit, related to the valuation of fixed assets and estimates for accrued liabilities and allowances for doubtful accounts, were corrected during the year.

### Bureau Challenges

TTB is implementing improvements designed to address the deficiency identified from the audit regarding the expensing of capital assets and prepaid expense. To address that matter, TTB is developing a technical reference guide for staff to help determine: 1) what property items should be considered for capitalization, 2) what costs related to the purchase and installation of the property should be capitalized, and 3) how the costs should be coded in the procurement and accounting systems. The guide and internal training should be completed during the first quarter of FY 2011. TTB is confident that this change will strengthen controls on this activity.



## Part II: Program Performance Results

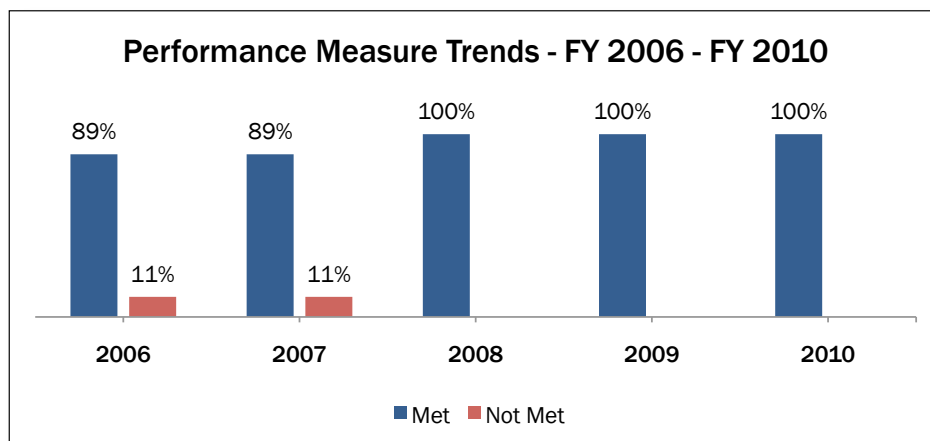
### Performance Overview

TTB revised its suite of measures in FY 2008 to better reflect operating conditions within the industry and method improvements established by TTB program offices. TTB now reports its performance in terms of six metrics that represent its ability to supply satisfactory service to its customers in the industry, foster compliance from taxpayers, employ technology to meet its public protection mission, and return value to the Nation for its investment in TTB programs.

TTB exceeded the performance targets for all six measures reported to its stakeholders in FY 2010. Based on external factors and the results achieved this fiscal year, TTB reviewed its FY 2011 performance targets and updated those in which TTB significantly exceeded its intended performance. To meet its performance goals in FY 2011, TTB will implement an aggressive strategic agenda that integrates new technology, human capital management techniques, and targeted efforts in both outreach and enforcement. All performance results are subject to management review and periodic audit by the Department of the Treasury.

#### FY 2010 Performance Measure Status

Performance Targets Met	6
Performance Targets Not Met	0
Baseline	0
<b>Total Performance Measures</b>	<b>6</b>



## Summary of Collect the Revenue Performance

**Table 1.1**

Performance Measure	FY 07 Actual	FY 08 Actual	FY 09 Actual	FY 10		FY 11 Target	FY 10 Target Met?	% of Target Reached
				Target	Actual			
Amount of revenue collected per program dollar	-	\$313	\$427	\$400	<b>\$478</b>	\$410	Y	120%
Percentage of voluntary compliance from large taxpayers in filing timely tax payments (in terms of revenue)	-	94%	94%	92%	<b>94%</b>	94%	Y	102%
Percentage of total tax receipts collected electronically	98%	Discont'd	Discont'd	Discont'd		N/A	N/A	N/A
Percentage of voluntary compliance in filing timely and accurate tax payments in terms of revenue	86%	Discont'd	Discont'd	Discont'd		N/A	N/A	N/A
Percentage of voluntary compliance in filing timely and accurate tax payments in terms of the number of compliant industry members	75%	Discont'd	Discont'd	Discont'd		N/A	N/A	N/A
Unit cost to process an excise tax return	\$61	Discont'd	Discont'd	Discont'd		N/A	N/A	N/A
Resources as a percentage of revenue	.31%	Discont'd	Discont'd	Discont'd		N/A	N/A	N/A
Cumulative percentage of excise tax revenue audited over three years	16%	Discont'd	Discont'd	Discont'd		N/A	N/A	N/A

### Performance Discussion

TTB displayed effective performance in both its measure of how efficiently the Bureau conducts its tax collection activities and in its measure of the extent of voluntary compliance among taxpayers with significant annual tax liabilities.

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The Bureau surpassed by a considerable margin its targeted performance level for the measure: “Amount of revenue collected per program dollar.” In just two years, the return on investment for the TTB revenue collection program has increased by more than 50 percent, from \$313 in FY 2008 to \$478 in FY 2010. The increased rate of return is principally due to the increased Federal excise tax rate imposed on tobacco products by the Children’s Health Insurance Program Reauthorization Act (CHIPRA), enacted in February 2009. Tobacco excise tax collections nearly doubled between FY 2008 and FY 2009 and, in the first full year of collections under the new tax rate, tobacco revenues are up nearly 40 percent compared to the prior year.

TTB also implemented an aggressive annual audit plan, driven by a risk model refined annually according to data received from audits and investigations, statistical analysis, and intelligence received from internal and external sources. In enforcing the floor stocks tax (FST) levied by CHIPRA on all tobacco products held for sale by manufacturers, importers, wholesalers, and retailers as of April 1, 2009, TTB combined technology, outreach to Federal and State agency stakeholders, and sophisticated targeting techniques to develop an audit plan consisting of those entities that had likely not filed or under-filed FST payments. This field work resulted in additional FST collections of approximately \$7.2 million, bringing total FST collections to date to \$1.2 billion.

Firearms and ammunition excise tax (FAET) collections have also grown significantly in recent years. Since TTB assumed responsibility for administering the FAET tax program in 2003, collections have increased 87 percent. Consumer spending patterns contributed to a spike in FAET revenues in FY 2009, followed by a decline in collections of approximately 20 percent in FY 2010; however, FAET collections remain 15 percent above FY 2008 levels due to the enforcement efforts of TTB tax specialists and auditors. The FY 2011 targeted performance level for this measure reflects the estimated revenue impact of CHIPRA, as reported in January 2009 by the Joint Committee on Taxation. The committee report projected a downward trend in tobacco revenue collections after FY 2010.

In line with the Department of the Treasury’s high priority performance goal, TTB continued its efforts to promote voluntary tax compliance among industry members through various education and outreach strategies. Despite the prolonged economic downturn, TTB believes its outreach efforts were successful in maintaining the voluntary compliance rate of 94 percent achieved in fiscal years 2008 and 2009. In FY 2010, TTB conducted several Federal compliance seminars in various cities across the United States to provide instruction on tax and reporting requirements, as well as other statutory requirements related to the labeling and production of alcohol beverages.

The Bureau also fosters voluntary compliance through its electronic filing options and, in FY 2010, TTB continued its work to expand the electronic tax and operational report filing system, Pay.gov, to include all excise taxpayers. More than 6,400 TTB taxpayers are registered to use Pay.gov to pay excise taxes and to file excise tax returns and monthly operational reports. TTB increased the number of registered Pay.gov users by 30 percent over FY 2009.

### **Moving Forward**

In the first full year of collections under the new tobacco tax rates imposed by CHIPRA, TTB collection efforts resulted in year-to-year revenue increase of 15 percent. Targeted enforcement of high-risk taxpayers resulted in the collection of nearly \$16 billion in tobacco revenue alone. In effectively administering its tax jurisdiction, TTB collected \$2 billion more in tobacco excise taxes than projected by the Joint Committee on Taxation in its revenue impact report issued prior to the passage of CHIPRA in February 2009. Going forward, revenue collection activities will focus both on legitimate industry members, and those operating outside of legal distribution chains. TTB will continue to include in its audit plan a mix of comprehensive audits, limited scope audits, and examinations in order to maximize TTB's audit resources and provide broad industry coverage. TTB also plans to address revenue risk areas in FY 2011 through enhanced risk modeling and audit programs developed for specific industry member types determined to be at high risk for non-payment or underpayment of taxes.

To assure compliance in the importer community that TTB regulates, TTB will continue to participate in joint Federal agency initiatives designed to trace alcohol and tobacco product through the Customs bonded warehouse system to ensure alcohol and tobacco products moving into domestic commerce are properly taxpaid and meet packaging and marking requirements. TTB also is involved in multiple ongoing criminal investigations of illegal activity in the industries TTB regulates. Using an integrated enforcement approach, auditors will follow up on referrals provided by the TTB Intelligence Division to address suspected illegal activity. TTB auditors and investigators also will support TTB agents, contracted from the Internal Revenue Service Criminal Investigation unit, in effectuating TTB's criminal enforcement operations by providing leads and forensic auditing support for criminal cases.

In FY 2011, TTB will continue to employ both enforcement and education strategies to obtain tax compliance from TTB permittees. Sustaining or increasing the rate of compliance achieved will depend, in part, on continued efforts to promote industry member use of the online tax return and payment filing system, Pay.gov. Efforts to maintain voluntary industry compliance also will focus on educating industry of Federal requirements related to operating in the alcohol, tobacco, and firearms industries, both on premises through guidance provided by TTB auditors and investigators and through Web-based industry seminars. Going forward, online seminars will enable TTB staff to reach broad groups of users and provide advanced instruction on the reporting and payment of excise taxes and other regulatory requirements.

TTB also will further enhance its tax verification program, building on the Error Tracking Database (ETD) developed in FY 2010 to identify late filers, non-filers, and errant filings of operational reports. The ETD identifies more than 40 different types of errors on industry operational reports, and generates compliance letters to notify industry of the compliance issues. In FY 2011, the ETD will be expanded to include operational reports for all TTB-regulated commodity types. TTB also intends to create a module in the ETD to address missing and late excise tax returns.

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## Summary of Protect the Public Performance

**Table 1.2**

Performance Measure	FY 07 Actual	FY 08 Actual	FY 09 Actual	FY 10		FY 11 Target	FY 10 Target Met?	% of Target Reached
				Target	Actual			
Percent of electronically filed Certificate of Label Approval (COLA) applications	51%	62%	74%	78%	<b>79%</b>	81%	Y	101%
National Revenue Center (NRC) customer service survey results	-	90%	89%	85%	<b>89%</b>	85%	Y	105%
Average number of days to process an original permit application at the NRC	-	64	64	72	<b>65</b>	70	Y	110%
Percentage of importers identified by TTB as illegally operating without a Federal permit	-	22%*	15%	19%	<b>15%</b>	15%	Y	121%
Percentage of instances where the utilization of International Trade Data System (ITDS) results in identifying importers without permits as a percentage of total permits on file at TTB's NRC	-	15%**	Discont'd	Discont'd		N/A	N/A	N/A
Percentage of COLA applications processed within nine calendar days of receipt	42%	Discont'd	Discont'd	Discont'd		N/A	N/A	N/A
Percentage of permit applications (original and amended) processed by the NRC within 60 days	85%	Discont'd	Discont'd	Discont'd		N/A	N/A	N/A
Unit cost to process a Wine COLA	\$34	Discont'd	Discont'd	Discont'd		N/A	N/A	N/A

\* TTB revised this measure in September 2008, after the Treasury performance reporting cycle closed, but prior to fiscal year end. The result of 22 percent, reported by the Bureau in the FY 2008 TTB Performance and Accountability Report, was calculated using the new method and historic data for FY 2008 retrieved from ITDS.

\*\* To align with the Department's annual report, TTB is presenting the original measure and the FY 2008 result as reported in the FY 2008 Treasury Performance and Accountability Report, which was achieved using the initial calculation methodology, and marking it discontinued.

## Performance Discussion

TTB indicates its level of success in meeting its consumer protection mission through four measures of program performance. All of the Bureau's Protect the Public performance targets were exceeded in FY 2010.

The TTB National Revenue Center (NRC) conducted a customer survey to measure satisfaction with processing times and the level of service provided to the industry. The survey solicits feedback on how well TTB specialists assist applicants in filing for an original or amended permit and in how TTB serves industry members who file claims to recover taxes paid on nonbeverage alcohol or overpayments of tax. Based on responses captured by the NRC through telephone interviews, TTB earned a composite score of 89 percent for permits and claims processing. This result maintained customer satisfaction rates achieved in FY 2009, and remained 4 percent above the Bureau's goal of maintaining a satisfaction score of at least 85 percent.

Achieving high rates of efficiency and effectiveness in processing permit applications is critically important to both protecting the public and in facilitating market entry for new applicants to the regulated industries. TTB was able to achieve a 65-day turnaround time despite a 4 percent increase in the number of processed original permits through the effective use of management reporting tools to monitor work assignments and the implementation of a Balanced Scorecard initiative, which uses this integrated strategic planning and performance management system to tie employee performance to mission success. TTB exceeded its targeted turnaround time of 72 days for an original permit application by 10 percent.

Efficiency in permit processing is critical to the Department's goal of improved economic opportunity. Improving turnaround time for permit application processing enables alcohol and tobacco permit and registration holders to begin operating businesses sooner, facilitating U.S. economic growth. Effective issuance of permits means that unqualified applicants are prevented from obtaining a permit, a critical barrier to entry for those who seek to conduct illegal operations. Illicit activity in these industries has the potential to be highly lucrative, and proceeds from trade in non-taxpaid alcohol and tobacco have been connected to organized crime and terrorist activities. TTB works in partnership with domestic and international regulatory and law enforcement agencies to address the illicit market and to ensure that those operating in the regulated industries are qualified to operate.

To this end, TTB used the U.S. Customs and Border Protection's International Trade Data System (ITDS) to identify persons importing alcohol and tobacco without a Federal permit. Intelligence specialists compared permit data in TTB's tax system to the active importers in ITDS to determine who brought product into the United States without a Federal permit. In FY 2010, TTB issued 190 cease and desist letters to entities illegally importing tobacco products. By issuing cease and desist letters to entities operating without a permit, TTB has been successful in ensuring that these individuals either complied with TTB permit requirements, or their operations were stopped. Of the tobacco importers examined by TTB, 15 percent were found to be operating without a permit, 4 percent lower than the Bureau's projection

of 19 percent. TTB established this metric to serve as a starting point to gauge the threat to public safety and Federal revenue posed by illicit imports. TTB is reviewing additional methods to verify its effectiveness in the area of importer compliance.

TTB also was successful in increasing the rate of electronically filed alcohol beverage label applications. Usage rates for the COLAs Online label filing system have increased 76 percent in 7 years, from a starting point of 3 percent at the end of FY 2003 to 79 percent in FY 2010. Since the end of FY 2009, electronic filing rates increased 5 percent. These increases in online applications are due in large part to outreach efforts by TTB through educational workshops, one-on-one demonstrations to large paper filers, and system enhancements to improve the user experience. Based on the growing interest in and familiarity with the COLAs Online system, TTB established an aggressive FY 2011 target of 81 percent for electronic label applications. Reaching this milestone should result in improved processing times for industry as the Bureau becomes more efficient in processing label applications. Electronic applications streamline the review process, as those that must be returned for correction may be resubmitted by the industry member without the assignment of a new TTB identification number. Paper applications that require correction must be rejected by TTB, and resubmitted by the industry member under a new identification number.

### **Moving Forward**

TTB will continue working to improve processing times through the automation of its paper-based application processes and to encourage use of online filing systems already in place. Usage rates for its electronic filing system for alcohol beverage label applications have continuously increased due to outreach efforts and in response to faster turnaround times for e-applications versus paper applications. In FY 2011, TTB will continue to inform industry members of the benefits of e-filing, and will continue to provide system demonstrations and publish online guidance to the user community. The introduction of Formulas Online, the new e-filing system that enables the online submission of alcohol beverage formulas, will also support increased user rates for COLAs Online. The integration of Formulas Online with the existing COLAs Online system will streamline the process of obtaining both formula and label approval for those in the alcohol beverage trade.

Even during the economic contraction, applications to open new businesses in the alcohol and tobacco industries continued a steady rising trend. Original permit applications have grown 18 percent over the last five years, and 4 percent in the last fiscal year alone. To address growing workloads, TTB purchased a commercial product to enable the electronic submission and processing of original and amended permit applications. In FY 2011, TTB will begin its phased release of the new Permits Online system. The first phase will enable electronic filing for the three highest volume permit areas. With industry support and adoption of Permits Online, and following the release of the next phase of the system in FY 2012, TTB expects to significantly reduce processing times for both original and amended permit applications. Further efficiencies will be gained through a new triaging procedure for incomplete paper applications for

an original permit, and by updating the telephonic interview process for applicants according to a revised risk model. With the phased rollout of Permits Online scheduled during fiscal years 2011 and 2012, TTB anticipates increased customer satisfaction, as applicants experience faster response times and the ease of using the electronic filing system. Additionally, to streamline the permit application process, TTB created a task force to analyze and improve TTB bond forms and instructions, as well as internal business processes, to improve service to industry.

In its monitoring of the U.S. Customs and Border Protection's ITDS to assure tobacco importers are properly permitted, TTB has been able to bring entities illegally importing cigarettes and other tobacco products into compliance with Federal permit requirements or has ensured that operations were stopped. In FY 2011, TTB will continue to monitor imports of tobacco products by non-permitted entities, placing special emphasis on enforcing the Prevent All Cigarette Trafficking Act (S. 1147), legislation enacted in March 2010 to prevent tobacco smuggling and ensure the proper payment of all tobacco taxes. The method most commonly used to import tobacco products without a permit and without payment of the appropriate taxes is Internet and mail-order purchases. The PACT Act prohibits shipments of tobacco products via the U.S. Postal Service (USPS). In FY 2011, TTB will coordinate with the USPS and other common carriers to provide enforcement assistance. These efforts, in addition to current methods used to identify entities illegally importing tobacco products, will help reduce the number of entities circumventing Federal permit and tax requirements. Furthermore, under CHIPRA, all importers of processed tobacco are required to obtain an importers permit from TTB. In the year ahead, TTB will assess the number of legitimate importers of processed tobacco and ensure they apply for and obtain a permit, or cease importations.

### **Summary of Management and Organizational Excellence Performance**

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

The Bureau's objectives in the area of Management and Organizational Excellence align with the Administration's emphasis on automating processes to improve services and enhancing internal operations to be more efficient and effective. In FY 2010, the Bureau demonstrated its ability to enhance efficiency and reduce costs through its strategic management of human capital, IT enhancements to improve operations, and rigorous financial management practices.

### **Human Capital Management**

TTB continues to implement the strategic goals, strategies, and measures of results outlined in the Human Resources (HR) Division Strategic Plan. As the majority of TTB's human resource functions are operated



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through the Bureau of Public Debt Administrative Resource Center (BPD ARC), TTB establishes and updates, as appropriate, performance benchmarks and measures to monitor these outsourced functions. In FY 2011, TTB will undertake the planning process for its next five-year Human Capital Strategic Plan.

In FY 2010, TTB held three Labor/Management Partnership Council meetings with the National Treasury Employees Union (NTEU) under the provisions of the Collective Bargaining Agreement. These meetings have been instrumental in fostering the Bureau's labor management relations. In furtherance of improved labor management relations, TTB coordinated with the Federal Mediation Conciliatory Service to identify, design, and deliver Labor Management Training to the Labor Management Team.

TTB also conducted impact and implementation bargaining with the NTEU, and revised orders prior to publication, for a number of significant human resources policies during FY 2010. These included the TTB orders related to Training Management, Incentive Awards Program, Absence and Leave, and Alternative Dispute Resolution (ADR). The ADR order allows employees and managers to participate in a discussion mediated by a neutral party to settle issues in a manner that will create an acceptable solution for all parties. ADR has been effective in ultimately preserving working relationships and decreasing the time and cost associated with the EEO complaint process.

The TTB Office of Equal Employment Opportunity and Diversity Advancement (EEO/DA) held several focus groups in FY 2010 to identify areas of concern for TTB employees. EEO/DA developed an action plan to address employees concerns, and briefed TTB leadership on the findings and suggested corrective actions.

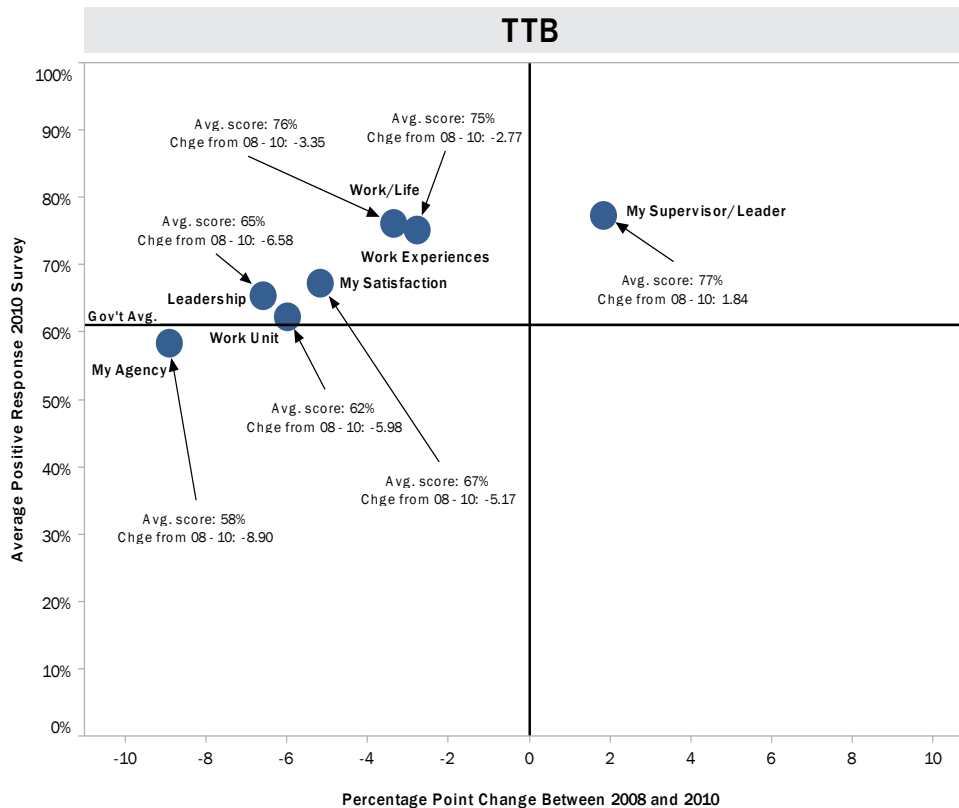
In addition, annual EEO training was developed and delivered to all TTB employees, and training that addressed specific topics and issues was developed and delivered to several TTB divisions. TTB also conducted Conflict Resolution training with the employees at the NRC.

In response to the Government-wide survey to obtain employee feedback, TTB developed an FY 2011 Employee Viewpoint Survey (EVS) Action Plan. The EVS (formerly the Federal Human Capital Survey) is an employee survey that is administered by the Office of Personnel Management biennially to measure the satisfaction of the Federal workforce.

Based on this survey data, the Partnership for Public Service determines rankings for Federal agencies. TTB ranked 83rd out of 224 sub-component agencies on the FY 2010 Best Places to Work in the Federal Government rankings, a decline from its 2008 ranking of 7th out of 216.

Though TTB scores trended down in most of the EVS survey categories, the positive response trend for all but one survey category, My Agency, remained at or above the Government-wide average. In the EVS category of My Supervisors/Leader, the positive response rate for FY 2010 remained well above the Government average, and trended up.

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Through a series of focus group meetings held at the NRC and TTB Headquarters in FY 2010, TTB spearheaded an effort to solicit feedback from both employees and managers. The purpose of these sessions was to offer a forum where employees could freely share information, express concerns, and to offer suggestions on how to improve the work environment for all TTB employees. The focus group sessions were supported and facilitated by EEO and human resources personnel.

During FY 2010 and through FY 2011, various TTB program offices were given responsibility for completing the following representative actions:

- Facilitate cross-training on topics related to specific commodities TTB regulates and TTB’s legal authorities;
- Provide a quarterly report to inform employees of important events or issues;
- Draft an order that revises TTB policy regarding Individual Development Plans;
- Establish an employee suggestion box for employees to provide input to TTB leadership;
- Collect and broadcast detail opportunities throughout the Bureau semi-annually; and
- Hold quarterly focus group sessions in FY 2011 at the National Revenue Center (NRC) and TTB Headquarters.

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Implementing these and other initiatives on the FY 2011 EVS Action Plan will produce increased communication to employees, ensure a highly talented and well-developed staff, and enhance employee engagement.

As a knowledge-intensive organization, TTB requires a highly trained workforce to fulfill the responsibility to protect the public and collect the revenue within a dynamic and global environment. During FY 2010, TTB used a variety of human capital policies and programs for recruiting and attracting talent to ensure qualified people with the necessary skills are in the right positions, and to continue to retain those professionals in the future. Successful strategies included partnerships with a diverse range of universities across the country, use of the Student Educational Experience Program, Federal Career Intern Program (FCIP), and the Presidential Management Fellows (PMF) Program. During FY 2010, TTB was also especially successful with the use of the Student Volunteer Program, creating partnerships and hosting arrangements for 4 volunteers in two areas of expertise: legal research and knowledge management.

In addition, TTB expanded its use of the PMF Program, with several TTB offices participating in the annual PMF recruitment and job fair hosted by OPM. As a result, one PMF was hired to support the regulatory area. Also, during this past year, TTB hired 4 interns through college recruitment efforts, the use of online classifieds advertising, and the FCIP authority in the auditor occupation series.

Succession planning is a strategic priority for the Bureau, especially as it relates to TTB's mission-critical positions. One in five TTB employees are eligible to retire in FY 2011. To mitigate the loss of expertise and close skill gaps in mission-critical occupations, TTB continues to use the personnel interventions identified in the Pay Demonstration Program—a successful pay-for-performance pilot project established in 1999—to enable the Bureau to improve its capacity to recruit, develop, and retain high-caliber employees. TTB uses tailored approaches designed and implemented specifically for the Bureau's continuing and evolving needs in order to meet mission requirements and remain competitive for highly skilled talent.

In anticipation of increased diversion cases, TTB developed a new training protocol to build on its Basic Diversion Training program and prepare its audit and investigative staff with the skills necessary to support criminal cases. The Advanced Diversion Training course, held in May 2010, offered real-world examples and hands-on exercises to TTB auditors and investigators, and culminated with the students presenting their training cases to an Assistant U.S. Attorney. TTB also sponsored a class in August 2010, which concentrated on forensic auditing and criminal investigation techniques. Fifty students attended the course, which provided instruction on tracing funds tied to illicit activity, handling money laundering violations, and presenting cases to prosecutors.

Also in the area of training and professional development, TTB developed an online course deployed through the Treasury Learning Management System (TLMS) on Performance Management for General Schedule (GS) Employees. This training material was deployed to all employees and supervisors in August 2010, consistent with TTB's internal requirement to provide training on a biennial basis. This training is now set up to be easily administered and tracked through TLMS providing a refresher

for all applicable supervisors and employees which can be deployed at any time. In addition, all Pay Demonstration (PD) Program employees and supervisors received instructional guidance on their responsibilities relative to their pay for performance management program. This material was provided in August 2010. All training material for both the GS and PD employees and supervisors was deployed just-in-time for the end of the performance appraisal cycle and start up of a new performance cycle.

TTB also designed and delivered a Web-based management training course focusing on the generational differences that exist in today's workplace. Federal managers are managing workgroups composed of four distinct generations—the Silent Generation (born between 1920-1945), the Baby Boomers (born between 1946-1964), Generation Xers (born between 1965-1980), and the Millennials (born between 1981-2000). Each of these groups bring their own unique perspectives to the workplace. The Web-based training was designed to highlight these differences and to emphasize how these differences can be used to obtain the best results.

In FY 2010, TTB continued its Emerging Leader's Program (ELP), established in FY 2009, and selected its third class of the ELP. This leadership development initiative offers three unique certificate programs for non-supervisors, first-level supervisors, and second-level managers at TTB. The three-year program series supports TTB's succession planning strategies, and prepares participants with the competencies critical for higher levels of leadership responsibility. With the FY 2011 participants, 45 employees are enrolled in the ELP (8 percent of the TTB workforce), all of whom are up to date on certificate requirements. The program has proven to be successful, with positive feedback from participants and an increase in applicants for the 2011 program. Participants have formed a community of practice that includes monthly meetings to discuss leadership principles from current literature and leadership development forums.

### Financial Management

TTB established and monitored key performance standards to ensure that its business activities covering financial accounting and reporting operate in a highly effective and efficient manner. In FY 2010, TTB, in collaboration with its shared service provider at BPD ARC, achieved all of its financial management performance metrics.

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

- Paying vendor invoices on time (Prompt Payment Rate) greater than 98 percent;
- Incurring interest on late payments less than .02 percent;
- Achieving an Electronic Fund Transfer Compliance Rate of greater than 96 percent;
- Completing timely and accurate Cash/Fund Balance reconciliations within 15 days after the end of the accounting period;
- Reconciling Cash/Fund Balance to 100 percent of the proper balance;

- Clearing suspense accounts within 60 days;
- Ensuring prompt deposits and recording of tax collections;
- Providing timely and useful financial management data;
- Providing excellent customer service; and
- Maintaining an account code structure that captures and measures costs of TTB programs.

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

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

In FY 2010, the Bureau was able to conduct timely reviews of financial information so that program offices were afforded the data necessary to make efficient use of the Bureau's annual appropriation, and fulfill TTB's tax collection and regulatory responsibilities as outlined under the budget plan. By closely monitoring the Bureau's financial status, TTB was successful in making a number of key investments in support of its mission. These financial reviews were not limited to the current year's appropriation. TTB also conducted a review of prior year obligations. This endeavor led to the close out of accounts that no longer legally obligated TTB. As a result of this comprehensive effort, the Bureau was able to increase its FY 2009 unobligated balance, of which 50 percent, or \$256,000, was reapportioned for use in FY 2010 to support the implementation of the new electronic system for permit applications.

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

### Expansion of Technology Solutions

In FY 2010, TTB continued with business application development to improve internal operational efficiency and to reduce the regulatory burden on industry members. TTB developed several significant software updates to the Integrated Revenue Information System (IRIS)—the Bureau's central database of permit, tax, and operational report information. In September 2010, TTB completed the Tobacco Importer Historical Data upload. Using the previously developed Electronic Forms Acceptance and Processing

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Solution (EFAPS) system, TTB converted, validated, and uploaded historical operational report data from tobacco importers into IRIS from a separate database system, giving TTB personnel access to tobacco importer data from a single source. This project improves the effectiveness of implementing relevant provisions of the CHIPRA legislation that require industry to submit new permit applications after a year of inactivity, and will streamline the process by which TTB specialists determine the eligibility of tobacco importers.

TTB released two additional updates to IRIS in March and April 2010. These updates provided increased user functionality, improved reporting capabilities, and prepared the system for the deployment of the Permits Online system. In all, TTB decommissioned three legacy tax applications in FY 2010, all of which are now successfully integrated into IRIS. These system integration and consolidation efforts will reduce IT maintenance costs and achieves the final outcome of the IRIS development effort.

TTB also undertook a major software development effort in FY 2010 that will allow industry members to electronically submit new and amended permit applications for approval. The Permits Online system will provide a secure, Web-based system to support the online submission, routing, and processing of original and amended permit applications.

The NRC currently processes application packets for more than 20 types of permits or registrations for the alcohol, tobacco, firearms, and ammunition industries. New or existing alcohol and tobacco industry members file these packets to request permission to commence a new regulated industry operation, or to update critical industry member information such as trade names on an existing business. Over the past several years, the volume of paper applications has increased, making it difficult to maintain current service levels. With the workload increasing at the same time the Bureau's workforce is shrinking, this IT initiative is critical to improving present turnaround times.

Permits Online will allow TTB to screen and authorize applicants to operate alcohol and tobacco businesses under the Federal Alcohol Administration Act and the Internal Revenue Code. Permits Online will be implemented using Commercial Off-the-Shelf (COTS) software, purchased in FY 2009 and developed and tested in FY 2010. The system will substantially improve the Bureau's ability to timely process permit applications. Expediently processing permit applications also allows qualified persons to commence operations sooner, and contributes to the overall growth and health of the U.S. and global economy.

This e-Gov system will be released in phases, with phase one slated for release in January 2011, and a second phase scheduled for release at the end of FY 2011 or early FY 2012. The first phase includes the three highest volume permit types—wineries, alcohol importers, and alcohol wholesalers. Subsequent releases will expand the permit types that can be filed electronically. TTB expects to initiate internal testing for the first increment of new permit types in the phase two release of Permits Online in the third quarter of FY 2011.

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TTB made significant progress in the Formulas Online business application development project in FY 2010. This system will allow industry members to submit beverage and nonbeverage alcohol formula forms and documentation via the Web. For beverage alcohol formula filers, Formulas Online is integrated with the label filing system, COLAs Online. Some alcohol beverages require formula approval prior to the issuance of a Certificate of Label Approval (COLA), and the Formulas Online system will allow registered COLAs Online users to view their formula based on their TTB permit number. This development effort also enables industry members to register for both Formulas Online and COLAs Online via the Web. In addition, COLA applications and approved labels are linked to formulas and related data stored in Formulas Online. Alcohol beverage producers and importers will be able to research approved formulas associated with their label applications. This online filing solution is scheduled for release in FY 2011.

In its efforts to increase efficiencies and reduce operating costs, TTB was successful in enabling its auditors and investigators to voluntarily switch from wired broadband to mobile wireless broadband Internet connections. Previously, TTB's field personnel teleworking from home had used wired broadband connections, purchased through local area communication companies, to remotely access the TTB network. In adopting the mobile wireless technology, TTB was able to reduce the cost of Internet connectivity for its remote workforce. Moreover, auditors and investigators can use the mobile broadband devices to connect to the TTB network while on assignment in the field, giving them increased flexibility in performing their duties.

The National Revenue Center (NRC), TTB's tax and permit processing center, receives approximately 68,000 telephone calls and inquiries on an annual basis. In FY 2010, TTB developed and implemented an improved phone tree menu system for the main toll-free telephone number at the NRC to better direct calls related to routine questions to clerks or contractors, and evenly rotate incoming calls of a technical nature to specialists. This system ensures that specialists' time is reserved for more complex or specific questions. The new Voice over Internet Protocol (VoIP) phone system, implemented in FY 2009, also has enabled the automated monitoring of call volume to the various work units for planning and staffing purposes.

At the NRC, TTB also initiated an imaging project to convert paper permit files into an electronic data warehouse, or virtual file room. Presently, requests from auditors or investigators in the field for working files on permittees and taxpayers requires a specialist to physically retrieve the file from a file room at the NRC, copy the file, and mail the copy to the field. Once completed, this project will eliminate this manual process, and will give all TTB employees with appropriate permissions access to the files as needed.

In support of its efforts to operate in a "green" manner, TTB continued its use of a commercial product to virtualize its server environment. This process involves applying a software application to maximize use of server capability by dividing a single physical server into multiple isolated virtual environments. To date, TTB has virtualized more than 50 percent of its Windows server environment and about 20 percent of its other server environment. Server virtualization reduces the cost of infrastructure refresh and reduces the

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cost of space, power, and cooling in TTB data centers. Further, to reduce infrastructure hardware and labor costs in the future, TTB implemented a virtual desktop solution that allows its employees to access all TTB applications from anywhere in the world on a host of low-cost devices. This will result in savings as employee equipment ages and requires replacement.

In FY 2010, TTB supported the Government-wide move toward cloud computing, and assumed certain IT infrastructure hosting services for another Treasury entity, the Community Development Financial Institutions Fund (CDFI). TTB collaborated with CDFI personnel and the Treasury CIO and developed a solution that will save the Department millions of dollars in equipment refresh costs over 4 to 5 years. The solution involves TTB acting as an IT “cloud” provider of infrastructure services, which allows for the elimination of a substantial amount of IT equipment currently used to run CDFI operations. In July 2010, the first phase in the transition of CDFI to the TTB “cloud” was completed. CDFI has since requested to move all of its users to this system in the next phase. Although this equipment procurement savings does not accrue to the TTB budget, it represents a savings to the Treasury Department and to the American taxpayers.

TTB also released an updated version of its performance dashboard, which leverages available Web technologies to provide an on-demand business analytics tool for management to keep a pulse on key workload and performance metrics. The performance dashboard provides a consistent and efficient means of calculating, collecting, and maintaining key agency performance metrics and makes the results readily available to TTB managers through an online portal. This system automates the reporting and presentation of metrics related to collections, permit and label application processing times, and customer service. The new release improves upon the metric accuracy, adds new performance and workload reports, and provides more historical data for trend analysis to facilitate strategic decision making.

The TTB Internet site, TTB.gov, serves as a primary means of communicating with the public and with those whom TTB regulates. TTB draws its direction for Web enhancements from customer feedback provided by the American Customer Satisfaction Index (ACSI) survey—an online survey provided at random to TTB.gov visitors. In FY 2010, TTB continued to concentrate on improving the look and feel of the site and other usability enhancements, including improved search and navigation. In FY 2010, TTB became the first recipient of the Treasury Section 508/IT Accessibility Award. Ensuring that information is available online to persons with disabilities is just one aspect of maintaining a quality Web site for all site visitors. TTB improved its accessibility compliance rate from 60 percent to 95 percent compliant within the first quarter of 2010. The Departmental goal was to have all Treasury bureau Web sites 90 percent compliant by July 2010.



### Message from the Chief Financial Officer

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At TTB, the responsibility to be conscientious stewards of the public purse is not exclusively held by the Chief Financial Officer—the need for responsible spending and sound fiscal planning is recognized and carried out at all levels of the organization. In FY 2010, the Bureau continued to cultivate this mindset of accountability through rigorous reviews of our programs and financial operations to identify areas for improved performance and efficiency. These efforts demonstrate our commitment to strong financial management and contributed to an unqualified audit opinion on the Bureau’s FY 2010 annual financial statements.

In the past, TTB’s financial information was reported as part of the Department of the Treasury’s consolidated annual financial statements. At the close of FY 2009, TTB underwent a limited scope audit, and received an unqualified audit opinion on the FY 2009 balance sheet, as well as reports on internal control over financial reporting in relation to the balance sheet and compliance with laws and regulations in relation to the balance sheet. TTB is now on an annual schedule for a full scope audit of its financial statements by an independent public accounting firm. Our request for and support of this annual audit affirms our commitment to a vigorous internal control environment and financial reporting excellence.

Further evidence of this commitment lies in our management practices, which include routine evaluations of our tax collection and revenue accounting operations at the National Revenue Center to validate that sound internal and administrative controls are in place for our key business processes that support the collection and tracking of nearly \$24 billion in annual Federal excise tax collections. These internal reviews focus on identifying any major risks for fraud, waste, and abuse associated with the Bureau’s tax collection activities, and serve to validate that TTB collects all revenue that is rightfully due on alcohol, tobacco, firearms, and ammunition products.

TTB also met the Department of the Treasury’s goals for the Office of Management and Budget’s acquisition improvement mandate. TTB delivered on our performance targets for procurement savings and in reducing high risk contracts in FY 2010, documenting \$1.2 million in savings and avoided costs and \$2.8 million in high risk reductions. We will continue our use of cost avoidance and lower risk contracting strategies in the coming fiscal years.

Management excellence also requires investments in technology to create efficiencies and realize savings. In this regard, TTB developed a new business application to improve our service to those operating in the industries we regulate. Permits Online will transform the way TTB interacts with industry, and will result in savings on both ends of the permit application process.

The Bureau also enhanced our performance dashboard to provide managers with more on-demand business analytics. The dashboard is an online portal that collects and calculates key workload and

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performance metrics related to TTB operations and enables trend analysis on major service areas. This analytics tool has improved the reliability and accuracy of the performance information gathered and reported by TTB.

TTB also made strategic investments in its workforce to sustain succession planning efforts and meet mission needs. For the third year, TTB selected a class for its Emerging Leaders Program (ELP). The ELP is a three-year certificate program to build the essential leadership skills of the next generation of leaders at TTB.

Meeting our human capital, acquisition, and financial management goals is critical to producing agency performance results that are relevant and valuable to American taxpayers. In the years ahead, strategic fiscal planning and targeted investments in technology and the TTB workforce will support the Bureau in improving the management and performance of this organization.



Cheri D. Mitchell

Assistant Administrator, Management/CFO

## Part III:

# Financial Results, Position, Condition and Auditors' Reports

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### Budget Highlights by Fund Account

The FY 2010 TTB budget of \$103,000,000 consists of direct appropriations. The budget authorizes the full time equivalent (FTE) staffing level of 535 direct FTE.

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

The Bureau obligated or expended 99.7 percent of the \$100,000,000 in FY 2010 direct funding from its one-year Salaries and Expenses appropriation.

Also, the Bureau awarded contracts in the amount of \$2,000,000 during fiscal years 2009 and 2010 to replace all data storage arrays that were approaching end of life, remote access network equipment, servers that were at or beyond end of life, and other internal network equipment in TTB data centers.

<b>FY 2010 Salaries and Expenses</b>	
<b>Appropriations (Public Law 111-117) Consolidated Appropriations Act of 2010</b>	<b>\$103,000,000</b>
Salaries & Expenses FY 2010	\$100,000,000
Salaries & Expenses FY 2010/2011 (Funds restricted for the hiring, training, and equipping of special agents).	\$3,000,000
Other Sources of Funds:	
<b>Salaries &amp; Expenses FY 2009/10 (IT Infrastructure)</b>	<b>\$2,000,000</b>
Amount Spent in FY 2009	\$797,174
Amount Spent in FY 2010	\$1,202,826
<b>Salaries &amp; Expense FY 2009/10 (50% Prior Year Recovery) 1/</b>	<b>\$256,000</b>
Amount Spent in FY 2010	\$256,000

1/ General Provisions of the appropriations bill provide that 50 percent of the unobligated balances remaining available at the end of fiscal year 2009 shall remain available through September 30, 2010.

## TTB 2010 ANNUAL REPORT

The \$3 million in direct funding that was restricted to expenses associated with the criminal enforcement activity remains available until September 30, 2011. In FY 2010, the Bureau entered into an interagency agreement with the IRS Criminal Investigation unit to begin criminal investigations into tax fraud in the TTB regulated industries.

<b>FY 2009/2010 Salaries and Expenses</b>	
Reprogramming	\$256,000

Also during FY 2010, an additional \$256,000 from the prior year account of unobligated available balances (often referred to as the 50 percent account) was authorized by Congress to cover a one-time data upload (non-recurring cost) of active industry member information from TTB's Integrated Revenue Information System (IRIS) to the Permits Online system. Permits Online is a Web-based E-Government system that TTB plans to initially deploy in FY 2011 with the goal to fully automate all permit applications and amendments in FY 2012. This system will convert the paper-driven process for original and amended permits and registrations to an electronic format to streamline both the submission and processing of applications.

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

The Bureau collected \$4.2 million in offsetting collections during FY 2010. The primary source of reimbursable funding involved collections from the cover over program and enforcement activity in Puerto Rico, which amounted to \$2.6 million (62 percent) of the offsetting collections.

#### **Puerto Rico Cover Over and Enforcement Activities**

All costs associated with the functioning and support of the Puerto Rico office are paid from the cover over program, which is offset from cover-over taxes collected in the United States on products originating in Puerto Rico (\$378 million) and the Virgin Islands (\$9 million).

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

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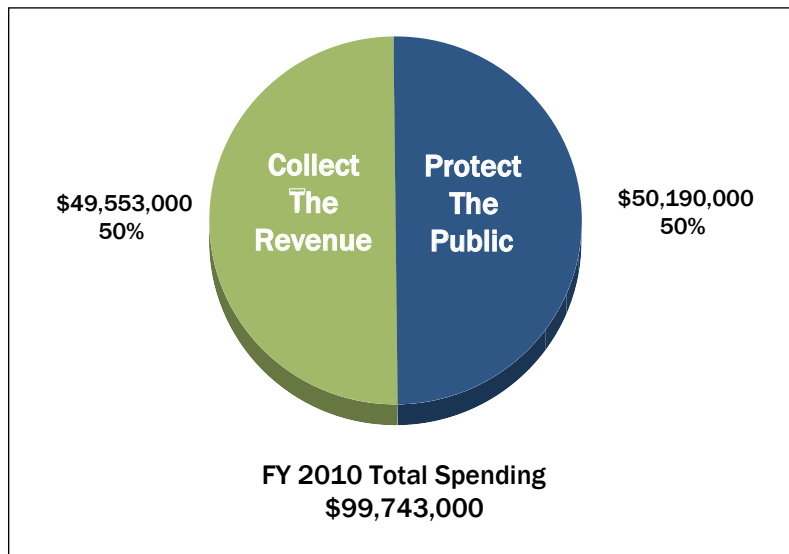
All distilled spirits producers and processors, wineries, wholesalers, importers, Manufacturer of Nonbeverage Products claimants, and specially denatured alcohol permit applicants are subject to a qualification inspection under the IRC.

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

## Linking Budget and Program Spending

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

In FY 2010, TTB used an account code structure which provides a direct link from the Bureau budget to specific programs and project activities. An analysis of the data stemming from the account code structure shows that, in FY 2010, TTB spent \$99,743,000 of its annual appropriation equally under these two budget activities.



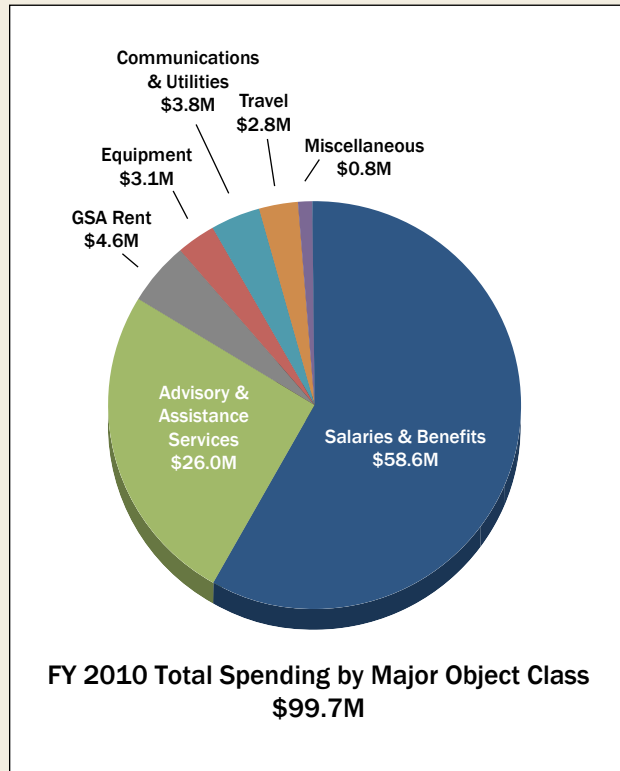
*The Total Spending amount includes obligations and expenditures from the FY 2010 TTB appropriation.*

In order to ascertain the full costs of each of these budget activities, the overhead costs were allocated and combined with the direct program costs. TTB arrived at the overhead allocation by applying the pro rata share of the number of direct program dollars to each overhead cost category.

The overhead is comprised of three major cost components: 1) general and administrative costs; 2) legal costs; and 3) information technology costs. The general and administrative category consists of costs related to operating the human resources, finance, procurement, training, facilities management, and other support-type functions.

## Spending by Major Object Class

In this report, TTB presents its spending by budget activity and program to explain the cost of delivering the services that support the mission. The Bureau also presents specific data regarding the purchase of goods and services by major object class that support its program activities. For TTB, the majority of spending falls into two principal major object classes. These two object class categories comprise 85 percent of the Bureau's spending from its annual appropriations and include Salaries and Benefits and Advisory and Assistance Services (Contracts). At a cost of \$58.6 million, or 59 percent of total spending by object class, Salaries and Benefits covers the cost of the Bureau's roughly 500 FTE positions in FY 2010. The Advisory and Assistance Services object class constitutes \$26 million, or 26 percent, of FY 2010 spending, and covers the cost of both commercial and intragovernmental services.



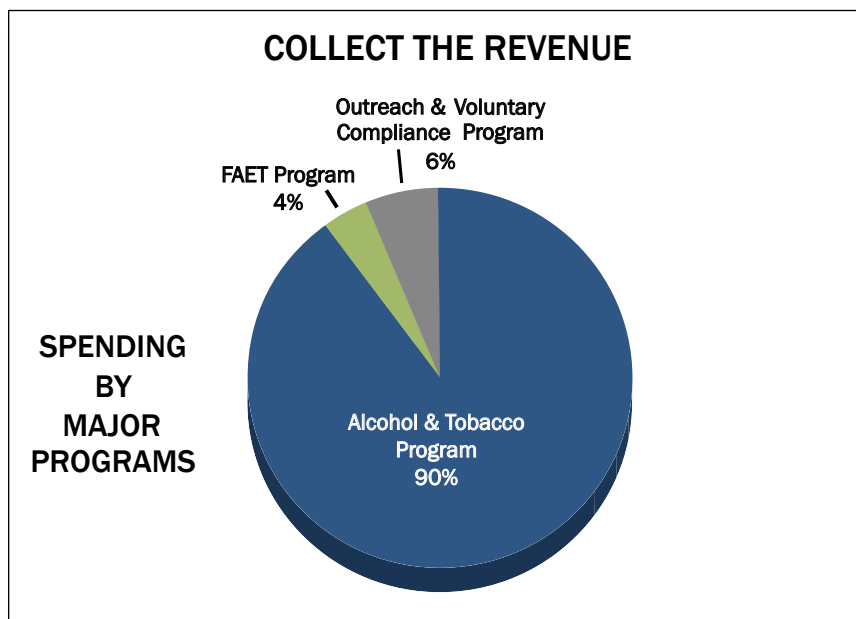
The commercial contracts category is predominantly IT contracts in support of engineering, infrastructure, and support services. Also, it includes other commercial contracts for services such as the scanning and imaging of label applications and tax forms, lab maintenance, and Web site development. Intragovernmental services include spending related to administrative support services provided by our shared service provider for human resources, accounting, travel, and procurement. Other intragovernmental contract services include the costs for background investigations, publications in the Federal Register, administrative support services, and Federal protective services. The Bureau's travel costs are primarily related to its audits and investigations. The remaining object classes that cover the FY 2010 spending activity include those cost categories for rent, communications, equipment, and other miscellaneous categories.

## Spending by Budget Activity to Achieve TTB Mission Goals

### Collect the Revenue..... \$49,553,000

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

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



In FY 2010, TTB expended 90 percent of its Collect the Revenue resources in collecting Federal excise taxes from the alcohol and tobacco industries and 4 percent in collecting FAET. The specific projects that comprise these costs include the processing of tax returns and operational reports at the National Revenue Center and the audits and investigations conducted on industry.

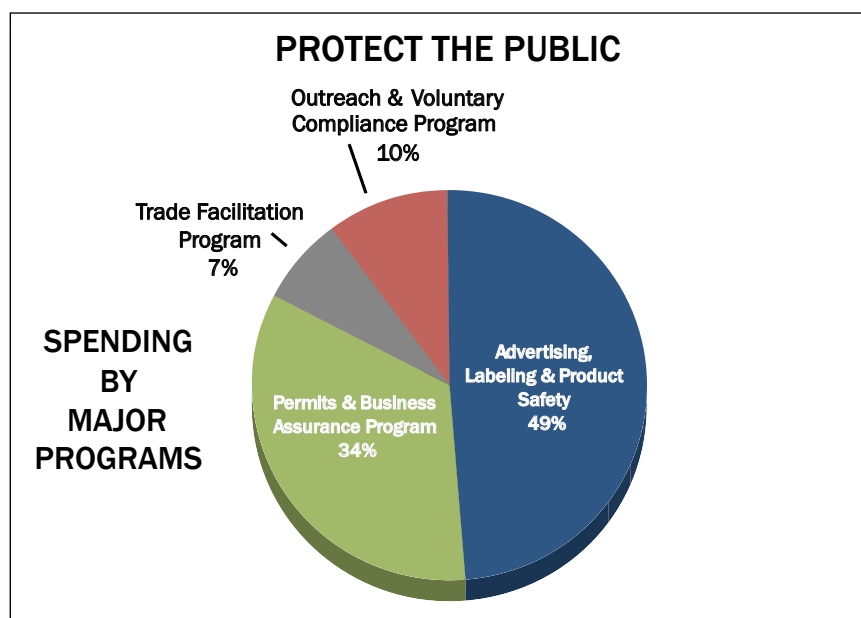
Costs for the Outreach Program reached 6 percent of our Collect the Revenue resources. These resources went toward efforts to educate and train industry members regarding their obligations in the areas of tax calculations and remittance.

### Protect the Public..... \$50,190,000

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

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

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



An analysis of the financial data from FY 2010 reveals that TTB spent the preponderance of its Protect the Public resources on two programs: Labeling, Advertising, and Product Safety at 49 percent, and Permits and Business Assurance at 34 percent.

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

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

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



## Systems and Controls

### Introduction

During FY 2010, TTB contracted with BPD ARC to handle its administrative, human resources, and financial functions.

### Accounting Systems and Controls

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

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

### Federal Managers' Financial Integrity Act of 1982 (FMFIA)

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

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

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

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

These policies address:

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

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

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

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

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

This increased emphasis on management controls has had a positive impact on programs and enabled the Bureau to achieve the intended results. The process also ensures that the utilization of resources is consistent with mission priorities and that program and resources are being used without waste, fraud, or mismanagement. Also, in addition to the A-123 review, TTB conducted a series of office reviews during FY 2010 that included an extensive review of administrative and internal controls.

The audit of the FY 2010 financial statements sheet disclosed no instances of noncompliance on FFMIA matters, and showed that the Bureau operates in substantial compliance with 1) Federal financial management systems requirements, 2) applicable Federal accounting standards, and 3) the United States Government Standard General Ledger at the transaction level. However, the audit identified a control deficiency related to expensing capital assets and prepaid expenses. Corrective actions have already been implemented to address the weaknesses.

### Financial Statement Highlights

The following overview of the TTB financial statements highlights certain aspects of the financial statements for the fiscal year ended September 30, 2010.

- The Statement of Custodial Activity shows the amount of revenue received during FY 2010 compared with FY 2009, along with tax refunds, drawback on Manufacturer of Nonbeverage Products claims, and cover-over payments. The amount displayed shows that the total Federal excise tax revenues collected from alcohol, tobacco, firearms, and ammunition amounted to \$23.8 billion. Within this total, the Bureau processed tax refunds, drawback claims, and cover-over payments in the amount of \$713 million.
  - **Drawback claims** of \$298 million were processed based on claims filed from MNBPs. Under current law, a drawback claim is allowed when distilled spirits on which the tax has been paid were unfit for beverage purposes and used in the production of medicines, medicinal preparations, food products, flavors, flavoring extracts, or perfumes.
  - **Tax refunds** and other adjustments (e.g., interest) were processed in the amount of \$28 million.
  - **Cover-over payments** were returned to Puerto Rico and the Virgin Islands in the amount of \$387 million. Such taxes collected on rum imported in the United States are “covered over,” or paid into, the treasuries of Puerto Rico and the Virgin Islands.
  - **The disposition of the custodial revenue**, after refunds, claims, and cover-over payments, nets to \$23.0 billion, and that amount was deposited to the U.S. Treasury to fund the Federal Government, with the exception of the Federal firearms and ammunition Federal excise taxes. Those revenues, in the amount of \$361 million, were remitted to the Fish and Wildlife Restoration Fund under provisions of the Pittman Robertson Act of 1937.
- The Statement of Net Cost shows the total net cost of operations at \$105.6 million for the Bureau to administer its two budget activities.
  - The total net cost reported as program costs under the Collect the Revenue program was \$50.7 million.
  - The total net cost reported as program costs under the Protect the Public program was \$54.9 million.

- The Balance Sheet shows the assets, liabilities, and net position as of a point in time, in this case, as of September 30, 2010.
  - The total assets were reported as \$78.5 million at the close of the fiscal year. Of this amount, \$36.7 million is classified as the fund balance with Treasury. That fund balance account is the undisbursed account balance with the Treasury, primarily resulting from undisbursed appropriations.
  - The total liabilities amount reported is \$46.4 million, of which total intragovernmental liabilities amounts to \$9.3 million. The other liabilities are classified by type, such as accrued tax refunds, payables, and other liabilities.
- The Statement of Change in Net Position shows a total net position balance of \$32.1 million, and that amount represents the unexpended appropriations from both prior periods and from the current operating cycle in addition to Net Position from Operations.
- The Statement of Budgetary Resources shows the budgetary resources received and the status of those resources. For TTB, the resources are primarily annual appropriations received from the Omnibus Appropriations Act in the amount of \$103 million, in addition to spending authority from collections. The offsetting collections amount was \$4.2 million. Of that amount, \$2.6 million is from the recovery of those costs associated with the administration of the cover over program, along with other miscellaneous reimbursable activities.

### Notes to the Basic Financial Statements

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

### Supplementary Information

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

## Financial Statements, Accompanying Notes, and Supplemental Information

### Limitations of Financial Statements

The principal statements have been prepared to report the financial position and results of operations of the entity, pursuant to the requirements of 31 U.S.C. 3515(b). While the statements have been prepared from the books and records of the entity in accordance with GAAP for federal entities and the formats prescribed by the Office of Management and Budget (OMB), the statements are in addition to the financial reports used to monitor and control budgetary resources, which are prepared from the same books and records. For fiscal 2010, all financial statements and notes have been audited. During 2009, only the Balance Sheet and related notes were audited.

### Management Responsibilities

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

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

### TTB in Relation to Treasury's Annual Financial Statements

The Department of the Treasury received an unqualified audit opinion on its FY 2010 financial statements. The financial activities of the Bureau are an integral part of the information reported by the Department of the Treasury.

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



KPMG LLP  
2001 M Street, N.W.  
Washington, DC 20036-3389

## Independent Auditors' Report

Inspector General  
United States Department of the Treasury

Administrator  
Alcohol and Tobacco Tax and Trade Bureau:

We have audited the accompanying balance sheets of the Alcohol and Tobacco Tax and Trade Bureau as of September 30, 2010 and 2009, and the statements of net cost, changes in net position, budgetary resources, and custodial activity (hereinafter referred to as "financial statements") for the year ended September 30, 2010. These financial statements are the responsibility of the Alcohol and Tobacco Tax and Trade Bureau's management. Our responsibility is to express an opinion on these financial statements based on our audits. We were not engaged to audit the statements of net cost, changes in net position, budgetary resources, and custodial activity (hereinafter referred to as "other 2009 financial statements") for the year ended September 30, 2009. Accordingly, we do not express an opinion on the other 2009 financial statements.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Alcohol and Tobacco Tax and Trade Bureau as of September 30, 2010 and 2009, and its net cost, change in net position, budgetary resources, and custodial activity for the year ended September 30, 2010 in conformity with U.S. generally accepted accounting principles.

The information in the *Part I: Management's Discussion and Analysis (MD&A)* and *Required Supplementary Information (RSI)* sections is not a required part of the financial statements, but is supplementary information required by U.S. generally accepted accounting principles. Certain information presented in the MD&A and RSI is based on the other 2009 financial statements that we were not engaged to audit. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this information. However, we did not audit this information and, accordingly, we express no opinion on it.



Our audits were conducted for the purpose of forming an opinion on the financial statements taken as a whole. The Other Accompanying Information included in (1) pages i through vi, (2) *Part II: Program Performance Results*, (3) pages 50 through 60 and pages 98 through 101 of *Part III: Financial Results, Position, and Condition*, and (4) *Part IV: Appendices* is presented for purposes of additional analysis and is not a required as part of the basic financial statements. This information has not been subjected to auditing procedures and, accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our reports dated December 14, 2010, on our consideration of the Alcohol and Tobacco Tax and Trade Bureau's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in assessing the results of our audits.

KPMG LLP

December 14, 2010



KPMG LLP  
2001 M Street, NW  
Washington, DC 20036-3389

## Independent Auditors' Report on Internal Control Over Financial Reporting

Inspector General  
United States Department of the Treasury

Administrator  
Alcohol and Tobacco Tax and Trade Bureau:

We have audited the balance sheets of the Alcohol and Tobacco Tax and Trade Bureau as of September 30, 2010 and 2009, and the statements of net cost, changes in net position, budgetary resources, and custodial activity (hereinafter referred to as "financial statements") for the year ended September 30, 2010 and have issued our report thereon dated December 14, 2010. We were not engaged to audit the statements of net cost, changes in net position, budgetary resources, and custodial activity (hereinafter referred to as "other 2009 financial statements") for the year ended September 30, 2009.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement.

The management of the Alcohol and Tobacco Tax and Trade Bureau is responsible for establishing and maintaining effective internal control. In planning and performing our fiscal year 2010 audit, we considered the Alcohol and Tobacco Tax and Trade Bureau's internal control over financial reporting as it relates to the financial statements by obtaining an understanding of the design effectiveness of the Alcohol and Tobacco Tax and Trade Bureau's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Alcohol and Tobacco Tax and Trade Bureau's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Alcohol and Tobacco Tax and Trade Bureau's internal control over financial reporting. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph of this report and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies, or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies or material weaknesses have been identified.





A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. In our fiscal year 2010 audit, we identified a significant deficiency in internal control over financial reporting described in Exhibit I that we consider to be a material weakness.

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

Exhibit II presents the status of prior year material weaknesses.

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

KPMG LLP

December 14, 2010

## MATERIAL WEAKNESS

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**IMPROVEMENTS ARE NEEDED IN THE REVIEW OF PURCHASE REQUISITIONS**

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Upon initiating purchase requisitions within the PRISM system, TTB requesters are entering incorrect budget object class (BOC) codes and accepting a default USSGL account number of “6100” for the requisitions. An element of the BOC code can indicate that the use of funds is for capital items and whether the goods or services ordered should be recorded as an expense or a capital asset within the ORACLE general ledger system. Funds control managers, the Director of the Acquisition and Facilities Management Division (AFMD), and the Chief Financial Officer review and approve, within the PRISM system, all of the requisitions. However, these reviews are not identifying inaccurately entered BOCs or the incorrect USSGL account number. An additional review performed by the Chief of the Accounting Branch of the general ledger transactions for these procurements, designed to detect and correct inaccurate recording of both the BOC codes and the use of USSGL account numbers did not occur during the first nine months of the fiscal year.

In performing tests of details over non-payroll operating expenses recorded during the period 10/1/2009 to 7/31/2010, we identified exceptions related to improper expensing of non-federal pre-paid services and of assets that should have been capitalized. These errors resulted in a total known overstatement of expenses by \$319,125. This total, identified through our statistically based testing of expenses, projects to a material error.

Statement on Federal Financial Accounting Standards (SFFAS) No. 1 states that “advances are cash outlays made by a federal entity to its employees, contractors, grantees, or others to cover a part or all of the recipients' anticipated expenses or as advance payments for the cost of goods and services the entity acquires.” Additionally, “advances and prepayments should be recorded as assets. Advances and prepayments are reduced when goods or services are received, contract terms are met, progress is made under a contract, or prepaid expenses expire.”

SFFAS No. 6 states that “property, plant, and equipment consists of tangible assets, including land, that meet the following criteria: they have estimated lives of 2 or more years; they are not intended for sale in the normal course of operations; and they have been acquired or constructed with the intention of being used, or being available for use by the entity.

As a result of this weakness the capital accounts in the TTB general ledger and reported in the financial statements were understated and the expenses were overstated. In recognition of the existence of misclassified expenses, TTB management performed a review of all expensed transactions in excess of their capitalization threshold of \$25,000 but recorded to non-capital asset BOCs. This review identified property, plant, and equipment purchases of \$1.516 million that had been misclassified and not detected during the review of the related purchase requisitions by TTB management.

**Recommendations:**

We recommend that management of the Alcohol and Tobacco Tax and Trade Bureau:

1. Prepare and distribute to TTB employees detailed guidance on the criteria that should be considered when determining whether an order should be recorded to a capital or non-capital asset BOC and on the use of USSGL account numbers within PRISM.

2. Perform periodic reviews of procurement transactions processed through PRISM that will detect and correct errors related to the non-capitalization of goods and services and ensure the accuracy of the general ledger during the fiscal year.

**Management's Response:**

TTB concurs with the recommendations. The CFO's office has already completed the corrective action on the first recommendation. A reference guide was developed and distributed to purchasers as an aid in determining what components of a fixed asset purchase may or may not need to be capitalized. The guide further aids the purchasers in coding the transactions in the procurement system, PRISM, based on their determinations. TTB is also committed to performing their secondary reviews of expenditures on a more routine basis, and correcting property transactions that have incorrectly posted to the accounting system on a more timely basis.

**EXHIBIT II****ALCOHOL AND TOBACCO TAX AND TRADE BUREAU**

Status of Prior Year Findings

September 30, 2010

<b>Fiscal Year 2009 Finding</b>	<b>Deficiency Type</b>	<b>Fiscal Year 2010 Status</b>
<b>1) Improvements Are Needed In Property Capitalization Controls</b>	Material Weakness	Closed
<b>2) Improvements Are Needed In Accounts Payable Accrual Controls, Testing And Review Of Journal Entry Support, And Review Of Allowances For Accounts Receivable</b>	Material Weakness	Closed



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## Independent Auditors' Report on Compliance and Other Matters

Inspector General  
United States Department of the Treasury

Administrator  
Alcohol and Tobacco Tax and Trade Bureau:

We have audited the balance sheets of the Alcohol and Tobacco Tax and Trade Bureau as of September 30, 2010 and 2009, and the statements of net cost, changes in net position, budgetary resources, and custodial activity (hereinafter referred to as "financial statements") for the year ended September 30, 2010 and have issued our report thereon dated December 14, 2010. We were not engaged to audit the statements of net cost, changes in net position, budgetary resources, and custodial activity (hereinafter referred to as "other 2009 financial statements") for the year ended September 30, 2009.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

The management of the Alcohol and Tobacco Tax and Trade Bureau is responsible for complying with laws, regulations, and contracts applicable to the Alcohol and Tobacco Tax and Trade Bureau. As part of obtaining reasonable assurance about whether the Alcohol and Tobacco Tax and Trade Bureau's financial statements are free of material misstatement, we performed tests of the Alcohol and Tobacco Tax and Trade Bureau's compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of the financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 07-04, including the provisions referred to in Section 803(a) of the *Federal Financial Management Improvement Act of 1996* (FFMIA). We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws, regulations, and contracts applicable to the Alcohol and Tobacco Tax and Trade Bureau. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our tests of compliance described in the preceding paragraph of this report, exclusive of those referred to in FFMIA, disclosed no instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards* and OMB Bulletin No. 07-04.

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



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

KPMG LLP

December 14, 2010

# TTB 2010 ANNUAL REPORT

## DEPARTMENT OF THE TREASURY ALCOHOL AND TOBACCO TAX AND TRADE BUREAU BALANCE SHEETS As of September 30, 2010 and 2009

	2010	2009
<i>(In Thousands)</i>		
<b>ASSETS</b>		
<b>Intragovernmental Assets:</b>		
Fund Balance with Treasury (Note 2)	\$ 36,748	\$ 31,225
Accounts Receivable (Note 3)	567	489
Due from the General Fund (Notes 5 and 8)	12,802	8,489
Advances (Note 7)	<u>852</u>	<u>1,933</u>
<b>Total Intragovernmental Assets</b>	<b>50,969</b>	<b>42,136</b>
Accounts Receivable (Note 3)	343	379
Tax and Trade Receivables, Net (Notes 4 and 8)	7,970	9,030
Property, Plant and Equipment, Net (Note 6)	<u>19,257</u>	<u>15,650</u>
<b>TOTAL ASSETS (Note 8)</b>	<b><u>\$ 78,539</u></b>	<b><u>\$ 67,195</u></b>
<b>LIABILITIES</b>		
<b>Intragovernmental Liabilities:</b>		
Accounts Payable	\$ 700	\$ 408
Payroll Benefits	581	527
FECA Liabilities	48	64
Due to the General Fund (Notes 4 and 5)	7,550	8,173
Other Liabilities (Note 9)	<u>420</u>	<u>854</u>
<b>Total Intragovernmental Liabilities</b>	<b>9,299</b>	<b>10,026</b>
Accounts Payable	6,041	3,820
Payroll Benefits	2,599	2,408
FECA Actuarial Liability	132	243
Refunds (Note 5)	12,802	8,491
Unfunded Leave	4,377	4,319
Cash Bond Liabilities (Note 2)	10,811	8,677
Other Liabilities (Note 9)	<u>358</u>	<u>446</u>
<b>TOTAL LIABILITIES</b>	<b><u>\$ 46,419</u></b>	<b><u>\$ 38,430</u></b>
<b>NET POSITION</b>		
Unexpended Appropriations	\$ 17,416	\$ 17,734
Cumulative Results of Operations	<u>14,704</u>	<u>11,031</u>
<b>TOTAL NET POSITION</b>	<b>32,120</b>	<b>28,765</b>
<b>TOTAL LIABILITIES AND NET POSITION</b>	<b><u>\$ 78,539</u></b>	<b><u>\$ 67,195</u></b>

*The accompanying notes are an integral part of these statements.*

**DEPARTMENT OF THE TREASURY  
ALCOHOL AND TOBACCO TAX AND TRADE BUREAU  
STATEMENTS OF NET COST  
For the Years Ended September 30, 2010 and 2009**

	<b>2010</b>	<b>2009</b> (Unaudited)
	<i>(In Thousands)</i>	
<b>PROTECT THE PUBLIC</b>		
<b>Program Costs</b>		
Intragovernmental Gross Costs	\$ 15,366	\$ 13,489
Less: Intragovernmental Earned Revenue	<u>-</u>	<u>(7)</u>
Intragovernmental Net Costs	15,366	13,482
Gross Costs with the Public	39,537	36,442
Less: Earned Revenues from the Public	<u>(8)</u>	<u>(27)</u>
Net Costs with the Public	39,529	36,415
Total Net Program Cost	<u>\$ 54,895</u>	<u>\$ 49,897</u>
<b>COLLECT THE REVENUE</b>		
<b>Program Costs</b>		
Intragovernmental Gross Costs	\$ 14,950	\$ 14,330
Less: Intragovernmental Earned Revenue	<u>(97)</u>	<u>(606)</u>
Intragovernmental Net Costs	14,853	13,724
Gross Costs with the Public	38,470	38,713
Less: Earned Revenues from the Public	<u>(2,606)</u>	<u>(2,472)</u>
Net Costs with the Public	35,864	36,241
Total Net Program Cost	<u>\$ 50,717</u>	<u>\$ 49,965</u>
<b>NET COST OF OPERATIONS (Note 13)</b>	<u>\$ 105,612</u>	<u>\$ 99,862</u>

*The accompanying notes are an integral part of these statements.*



# TTB 2010 ANNUAL REPORT

## DEPARTMENT OF THE TREASURY ALCOHOL AND TOBACCO TAX AND TRADE BUREAU STATEMENTS OF CHANGES IN NET POSITION For the Years Ended September 30, 2010 and 2009

	<b>2010</b>	<b>2009</b> (Unaudited)
	<i>(In Thousands)</i>	
<b>Cumulative Results of Operations</b>		
Beginning Balances	\$ 11,031	\$ 8,660
<b>Budgetary Financing Sources</b>		
Appropriations Used	102,659	97,704
<b>Other Financing Sources</b>		
Transfers-in without reimbursement	1,528	399
Imputed Financing from Costs Absorbed by Others (Note 12)	<u>5,098</u>	<u>4,130</u>
<b>Total Financing Sources</b>	109,285	102,233
<b>Net Cost of Operations</b> (Note 13)	<u>(105,612)</u>	<u>(99,862)</u>
<b>Net Change</b>	<u>3,673</u>	<u>2,371</u>
<b>Cumulative Results of Operations</b>	<u>\$ 14,704</u>	<u>\$ 11,031</u>
<b>UNEXPENDED APPROPRIATIONS</b>		
Beginning Balances	\$ 17,734	\$ 17,463
<b>Budgetary Financing Sources</b>		
Appropriations Received	103,000	99,065
Other Adjustments	(659)	(1,090)
Appropriations Used	<u>(102,659)</u>	<u>(97,704)</u>
<b>Total Budgetary Financing Sources</b>	<u>(318)</u>	<u>271</u>
<b>Net Position of Unexpended Appropriations</b>	<u>\$ 17,416</u>	<u>\$ 17,734</u>
<b>TOTAL NET POSITION</b>	<u>\$ 32,120</u>	<u>\$ 28,765</u>

*The accompanying notes are an integral part of these statements.*

# TTB 2010 ANNUAL REPORT

## DEPARTMENT OF THE TREASURY ALCOHOL AND TOBACCO TAX AND TRADE BUREAU STATEMENTS OF BUDGETARY RESOURCES For the Years Ended September 30, 2010 and 2009

	2010	2009 (Unaudited)
<i>(In Thousands)</i>		
<b>BUDGETARY RESOURCES</b> (Note 14)		
Unobligated Balance		
Beginning of Period	\$ 3,157	\$ 2,408
Recoveries of Prior Year Obligations	1,408	1,102
Budget Authority:		
Appropriations Received	103,000	99,065
Spending Authority from Offsetting Collections:		
Earned		
Collected	4,196	3,097
Change in Receivable from Federal Sources	44	408
Change in Unfilled Customer Orders Without Advance from Federal Sources	(200)	276
Subtotal	107,040	102,846
Permanently not Available	(659)	(1,090)
<b>TOTAL BUDGETARY RESOURCES</b>	<b>110,946</b>	<b>105,266</b>
<b>STATUS OF BUDGETARY RESOURCES</b>		
Obligations Incurred: (Note 15)		
Direct	\$ 102,117	\$ 98,235
Reimbursable	3,984	3,874
Subtotal	106,101	102,109
Unobligated Balance Apportioned	3,247	1,653
Unobligated Balance not Available	1,598	1,504
<b>TOTAL STATUS OF BUDGETARY RESOURCES</b>	<b>\$ 110,946</b>	<b>\$ 105,266</b>

*The accompanying notes are an integral part of these statements.*

# TTB 2010 ANNUAL REPORT

## DEPARTMENT OF THE TREASURY ALCOHOL AND TOBACCO TAX AND TRADE BUREAU STATEMENTS OF BUDGETARY RESOURCES For the Years Ended September 30, 2010 and 2009

	2010	2009 (Unaudited)
<i>(In Thousands)</i>		
<b>RELATIONSHIP OF OBLIGATIONS TO OUTLAYS:</b>		
Unpaid obligations brought forward, Oct 1	\$ 20,509	\$ 19,084
Uncollected customer payments from Federal sources brought forward Oct 1	<u>(1,563)</u>	<u>(880)</u>
Total unpaid obligated balance brought forward, net	18,946	18,204
Obligations incurred, net	106,101	102,109
Gross Outlays	103,060	99,582
Recoveries of prior year unpaid obligations, actual	(1,408)	(1,102)
Change in uncollected customer payments from Federal sources	156	(684)
Obligated balances, net end of period		
Unpaid obligations	22,141	20,509
Uncollected customer payments from Federal sources	<u>(1,407)</u>	<u>(1,563)</u>
Total unpaid obligated balance, net, end of period	20,734	18,946
Net Outlays		
Gross outlays	103,060	99,582
Offsetting collections	(4,196)	(3,097)
Distributed offsetting receipts	<u>(9)</u>	<u>(17)</u>
<b>NET OUTLAYS</b>	<b><u>\$ 98,855</u></b>	<b><u>\$ 96,468</u></b>

*The accompanying notes are an integral part of these statements.*

# TTB 2010 ANNUAL REPORT

## DEPARTMENT OF THE TREASURY ALCOHOL AND TOBACCO TAX AND TRADE BUREAU STATEMENTS OF CUSTODIAL ACTIVITY For the Years Ended September 30, 2010 and 2009

	2010	2009 (Unaudited)
<i>(In Thousands)</i>		
<b>SOURCES OF CUSTODIAL REVENUE</b>		
<b>Revenue Received</b>		
Excise Taxes (Note 16)	\$ 23,756,513	\$ 20,616,487
Interest, Fines and Penalties	3,597	2,602
Other Custodial Revenue	9	17
<b>Total Revenue Received</b> (Note 17)	23,760,119	20,619,106
Refunds and Drawbacks (Note 16)	(326,143)	(286,655)
<b>Net Revenue Received</b>	23,433,976	20,332,451
Accrual Adjustment	(5,370)	450
<b>Total Source of Custodial Revenue</b>	\$ 23,428,606	\$ 20,332,901
<b>DISPOSITION OF CUSTODIAL REVENUE</b>		
Amounts Provided to Non-Federal Entities (Note 16)	387,057	481,319
Amounts Provided to Fund the Federal Government (Note 17)	23,046,919	19,851,132
Accrual Adjustment	(5,370)	450
<b>Total Disposition of Custodial Revenue</b>	\$ 23,428,606	\$ 20,332,901
<b>NET CUSTODIAL REVENUE ACTIVITY</b>	\$ -	\$ -

*The accompanying notes are an integral part of these statements.*

## Notes to the Financial Statements

### Note 1. Summary of Significant Accounting Policies

#### **A. Reporting Entity**

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

#### **B. Basis of Presentation**

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

#### **C. Basis of Accounting**

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

## ***D. Revenue and Financing Sources***

### ***(1) Exchange Revenue***

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

### ***(2) Financing Sources***

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

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

### ***(3) Imputed Financing Sources***

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

## ***E. Custodial Revenue***

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

## ***F. Fund Balance with Treasury***

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

## ***G. Accounts Receivable***

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

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

## ***H. Property, Plant, and Equipment***

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

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

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

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

## ***I. Advances***

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

### ***J. Non-entity Assets***

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

### ***K. Liabilities***

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

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

### ***L. Litigation Contingencies and Settlements***

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

### ***M. Annual, Sick, and Other Leave***

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

### ***N. Interest on Late Payments***

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



### ***O. Retirement Plan***

Employees hired after December 31, 1983, are automatically covered by FERS and Social Security. For most employees hired after December 31, 1983, TTB also contributes the employers' matching share of Social Security. For the FERS basic benefit, employees contribute 0.8 percent of basic pay while TTB contributes 11.2 percent, for a total contribution rate of 12.0 percent in FY 2010, as well as FY 2009. The cost of providing a FERS basic benefit, as provided by the Office of Personnel Management (OPM), is equal to the amounts contributed by TTB and the employees.

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

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

### ***P. Federal Employees' Compensation Act***

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

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

### ***Q. Use of Estimates***

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

### ***R. Tax Exempt Status***

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

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### Note 2. Fund Balance with Treasury

Fund Balance with Treasury as of September 30, 2010 and 2009 consisted of the following (in thousands):

	<u>2010</u>	<u>2009</u>
Fund Balances:		
General Funds	\$25,579	\$22,103
Other Funds	<u>11,169</u>	<u>9,122</u>
Total	<u>\$36,748</u>	<u>\$31,225</u>
Status of Fund Balances:		
Unobligated Balance - Available	\$ 3,247	\$ 1,653
Unobligated Balance - Unavailable	1,598	1,504
Obligated Balance Not Yet Disbursed	<u>20,734</u>	<u>18,946</u>
Subtotal	25,579	22,103
Adjustment for Non-Budgetary Funds	<u>11,169</u>	<u>9,122</u>
Total Status of Fund Balances	<u>\$36,748</u>	<u>\$31,225</u>

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

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

**Note 3. Accounts Receivable**

Accounts Receivable as of September 30, 2010 and 2009 consisted of the following (in thousands):

	<u>2010</u>	<u>2009</u>
Intragovernmental Accounts Receivable:		
Due from Treasury Departmental Offices	\$ 81	\$ 204
Due from Treasury Executive Office of Asset Forfeiture	470	285
Due from Community Financial Development Institutions Fund	<u>16</u>	<u>-</u>
Total Intragovernmental Accounts Receivable	<u>\$ 567</u>	<u>\$ 489</u>
Due from the Government of Puerto Rico	\$ 331	\$ 365
Due from Commercial Vendors	5	5
Due from Employees	<u>7</u>	<u>9</u>
Total Accounts Receivable Due from the Public	<u>\$ 343</u>	<u>\$ 379</u>

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

**Note 4. Tax and Trade Receivables, Net**

Tax and Trade Receivables as of September 30, 2010 and 2009 consisted of the following (in thousands):

	<u>2010</u>	<u>2009</u>
Tax and Trade Receivables	\$ 97,158	\$ 107,925
Interest Receivable	13,240	18,767
Penalties, Fines and Administrative Fees Receivable	<u>10,125</u>	<u>12,007</u>
Total Tax and Trade Receivables	120,523	138,699
Allowance for Doubtful Accounts	<u>(112,553)</u>	<u>(129,669)</u>
Total Tax and Trade Receivables, Net	<u>\$ 7,970</u>	<u>\$ 9,030</u>

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

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

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

	<u>2010</u>	<u>2009</u>
Due from the General Fund	<u>\$ 12,802</u>	<u>\$ 8,489</u>

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

	<u>2010</u>	<u>2009</u>
Due to the General Fund	<u>\$ 7,550</u>	<u>\$ 8,173</u>

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

Property, Plant and Equipment as of September 30, 2010 and 2009 consisted of the following (in thousands):

<u>2010</u>	Estimated Useful Life (Years)	Acquisition Value	Accumulated Depreciation	Net Book Value
Internal Use Software	3 - 5	\$ 11,060	\$ 4,346	\$ 6,714
Equipment	4 - 6	8,357	4,697	3,660
Leasehold Improvements	2 - 5	691	462	229
Building	40	9,772	1,592	8,180
Construction in Process		474	-	474
Total PP&E		<u>\$ 30,354</u>	<u>\$ 11,097</u>	<u>\$ 19,257</u>
<u>2009</u>	Estimated Useful Life (Years)	Acquisition Value	Accumulated Depreciation	Net Book Value
Internal Use Software	3 - 5	\$ 8,760	\$ 3,926	\$ 4,834
Equipment	4 - 6	5,885	3,687	2,198
Leasehold Improvements	2 - 5	535	350	185
Building	40	9,772	1,339	8,433
Construction in Process		-	-	-
Total PP&E		<u>\$ 24,952</u>	<u>\$ 9,302</u>	<u>\$ 15,650</u>

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

The balance in the buildings account represents TTB's 13.2 percent equity interest in the National Laboratory Center facility in Beltsville, Maryland, which TTB co-owns with ATF. The ownership rights were established in a June 4, 2004, opinion from the Chief Counsel.

Note 7. Advances

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

Note 8. Non-entity Assets

Non-entity assets as of September 30, 2010 and 2009 consisted of the following (in thousands):

	<u>2010</u>	<u>2009</u>
Intragovernmental Non-entity Assets:		
Fund Balance with Treasury	\$ 11,169	\$ 9,122
Due from the General Fund	<u>12,802</u>	<u>8,489</u>
Total Intragovernmental Non-entity Assets	23,971	17,611
Tax and Trade Receivables, Net	<u>7,970</u>	<u>9,030</u>
Total Non-Entity Assets	31,941	26,641
Total Entity Assets	<u>46,598</u>	<u>40,554</u>
Total Assets	<u>\$ 78,539</u>	<u>\$ 67,195</u>

Note 9. Other Liabilities

Other Liabilities as of September 30, 2010 and 2009 consisted of the following (in thousands):

	<u>2010</u>	<u>2009</u>
Due to the Fish and Wildlife Fund	<u>\$ 420</u>	<u>\$ 854</u>
Other Intragovernmental Liabilities	420	854
Offers-in-Compromise not yet Accepted	<u>358</u>	<u>446</u>
Total Other Liabilities with the Public	358	446
Total Other Liabilities	<u>\$ 778</u>	<u>\$ 1,300</u>

All Other Liabilities are considered current liabilities.

**Note 10. Liabilities Not Covered by Budgetary Resources**

Liabilities not Covered by Budgetary Resources as of September 30, 2010 and 2009 consisted of the following (in thousands):

	<u>2010</u>	<u>2009</u>
Accrued FECA Liability	<u>\$ 48</u>	<u>\$ 64</u>
Total Intragovernmental Liabilities not Covered by Budgetary Resources	<u>48</u>	<u>64</u>
FECA Actuarial Liability	132	243
Accrued Leave	<u>4,377</u>	<u>4,319</u>
Total Liabilities with the Public not Covered by Budgetary Resources	<u>4,509</u>	<u>4,562</u>
Total Liabilities not Covered By Budgetary Resources	4,557	4,626
Total Liabilities Covered by Budgetary Resources	<u>41,862</u>	<u>33,804</u>
Total Liabilities	<u>\$ 46,419</u>	<u>\$ 38,430</u>

**Note 11. Future Funding Requirements**

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

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



Note 12. Imputed Financing

Imputed Financing as of September 30, 2010 and 2009 consisted of the following (in thousands):

	<u>2010</u>	<u>2009</u> (Unaudited)
Health Insurance	\$ 2,665	\$ 2,576
Life Insurance	8	8
Pension	<u>2,425</u>	<u>1,546</u>
Total Imputed Financing	<u>\$ 5,098</u>	<u>\$ 4,130</u>

Imputed financing recognizes actual cost of future benefits to be paid by other Federal entities. These benefits include Federal Employees Health and Benefits Program (FEHB), Federal Employees Group Life Insurance Program (FEGLI), and pensions. Imputed financing also recognizes costs paid by the Judgment Fund. The Fund was established and funded by Congress under 31 U.S.C. 1304 to pay in whole or in part court judgments and settlement agreements negotiated by Treasury on behalf of agencies, as well as certain types of administrative awards. The Judgment Fund did not pay out any awards on TTB's behalf during fiscal years 2010 or 2009.

TTB does not report CSRS assets, FERS assets, accumulated plan benefits, or unfunded liabilities, if any, applicable to retirement plans because the accounting for and reporting of such amounts is the responsibility of OPM. Based on cost factors provided by OPM, which vary by retirement plan, estimated future pension benefits for TTB employees, to be paid by OPM, totaled \$2.4 million and \$1.5 million for fiscal years 2010 and 2009 respectively. Similarly, OPM rather than TTB, reports liabilities for future payments to retired employees who participate in the FEHB and FEGLI programs. The FEHB cost factor applied to a weighted average number of employees enrolled in the FEHB program increased in FY 2010 to \$5,906, from \$5,756 in FY 2009, producing \$2.7 million and \$2.6 million of imputed cost for employees' health benefits in each respective year. The cost factor, as provided by OPM, for employees enrolled in the FEGLI program, remained unchanged from FY 2009 to FY 2010, at .02 percent of employees' basic pay. The FEGLI amounts totaling \$8,000 each are also included as an expense and imputed financing source in TTB financial statements for fiscal years 2010 and 2009, respectively.

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

Consolidated Gross Cost and Earned Revenue by Budget Function Classification as of September 30, 2010 and 2009 consisted of the following (in thousands):

Fiscal Year Ended September 30, 2010

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

Fiscal Year Ended September 30, 2009 (Unaudited)

<u>Activity</u>	<u>Budget Function Classification Name</u>	<u>Code</u>	<u>Gross Costs</u>	<u>Earned Revenue</u>	<u>Net Costs</u>
Intragovernmental	Central Fiscal Operations	803	\$ 27,819	\$ (613)	\$ 27,206
With the Public	Central Fiscal Operations	803	<u>75,155</u>	<u>(2,499)</u>	<u>72,656</u>
Consolidated	Central Fiscal Operations	803	<u>\$102,974</u>	<u>\$ (3,112)</u>	<u>\$ 99,862</u>

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

The following charts displays balances from the FY 2009 Statement of Budgetary Resources and actual fiscal year balances included in the FY 2011 Presidents Budget. There were no differences. The FY 2012 budget, which would include FY 2010 actuals, had not been published at the time of this report.

	<b>September 30, 2009 (In Millions / Unaudited)</b>	
	Statement of Budgetary Resources	President's Budget
<b>BUDGETARY RESOURCES AVAILABLE FOR OBLIGATION</b>	<u>\$ 103</u>	<u>\$ 103</u>
<b>STATUS OF BUDGETARY RESOURCES AVAILABLE OBLIGATION</b>		
Obligations Incurred	\$ 102	\$ 102
Unobligated balance carried forward, end of year	<u>1</u>	<u>1</u>
<b>TOTAL STATUS OF BUDGETARY RESOURCES AVAILABLE FOR OBLIGATION</b>	<u>\$ 103</u>	<u>\$ 103</u>
<b>NET OUTLAYS</b>	<u>\$ 96</u>	<u>\$ 96</u>

Additionally, the FY 2011 President’s Budget disclosed budget authority of \$473 million for FY 2009, funding cover-over payments to Puerto Rico, which is not reported in the Statement of Budgetary Resources.

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

**Note 15. Apportionment Categories of Obligations Incurred**

Obligations Incurred as of September 30, 2010 and 2009 consisted of the following (in thousands):

Fiscal Year	Apportionment Category	Direct Obligations	Reimbursable Obligations	Total Obligations Incurred
2010	Category B	<u>\$ 102,117</u>	<u>\$ 3,984</u>	<u>\$ 106,101</u>
2009 (Unaudited)	Category B	<u>\$ 98,235</u>	<u>\$ 3,874</u>	<u>\$ 102,109</u>

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

	<u>2010</u>	<u>2009</u> (Unaudited)
Undelivered Orders End of Period	<u>\$ 13,073</u>	<u>\$ 15,278</u>

**Note 16. Net Custodial Revenue Activity**

- **Excise Taxes**

As an agent of the Federal Government and as authorized by 26 U.S.C., TTB collects excise taxes from alcohol, tobacco, firearms, and ammunition industries. In addition, special occupational taxes are collected from certain alcohol and tobacco businesses. During FY 2010 and FY 2009, TTB collected \$23.8 billion and \$20.6 billion respectively in taxes, interest, and other custodial revenues.

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

- **Refunds and Other Payments**

During FY 2010 and FY 2009, TTB issued nearly \$713 million and \$768 million in refunds, cover-over payments, and drawback payments in the respective years.

### **Tax Refunds**

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

### **Cover-over Payments**

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

TTB maintains operations in Puerto Rico to enforce the provisions of chapter 51 in respect to items of Puerto Rican manufacture brought in to the United States. These operations include conducting annual revenue, application, and product integrity investigations of large alcohol and tobacco industry members. Except for application investigations, TTB investigates medium and small alcohol and tobacco producers in response to specific problems and risk indicators. Revenue inspections are used to verify that TTB is collecting all of the revenue that is rightfully due from the taxpayer. TTB staff in Puerto Rico also conducts qualification inspections of all distilled spirits producers/processors, wineries, wholesalers, importers, Manufacturer of Nonbeverage Products (MNBP) claimants, and Specially Denatured Alcohol permit applicants. All costs associated with the functioning and supporting of the Puerto Rico office, \$2.6 and \$2.5 million in FY 2010 and FY 2009 respectively, are offset against the cover-over payments made by the United States to Puerto Rico.

### **Drawbacks**

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

## TTB 2010 ANNUAL REPORT

Refunds, Drawbacks and Coverover Payments as of September 30, 2010 and 2009 consisted of the following (in thousands):

	<u>2010</u>	<u>2009</u> (Unaudited)
Alcohol and Tobacco Excise Tax Refunds	\$ 28,232	\$ 17,791
Drawbacks on MNBP Claims	297,596	268,612
Interest and Other Payments	315	252
Refunds and Drawbacks	326,143	286,655
Cover-over Payments - Puerto Rico	378,186	472,695
Cover-over Payments - Virgin Islands	8,871	8,624
Amounts Provided to Non-federal Entities	387,057	481,319
<b>Total Refunds, Drawbacks and Coverover Payments</b>	<b>\$ 713,200</b>	<b>\$ 767,974</b>

### Note 17. Custodial Revenue

Collection and Disposition of Custodial Revenue as of September 30, 2010 and 2009 consisted of the following (in thousands):

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

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Revenue Type	FY 2009 Collections and Refunds by Tax Year (Unaudited)				FY 2009
	2009	2008	2007	Pre-2007	Total
Excise Taxes	\$ 16,779,884	\$ 3,822,950	\$ 2,678	\$ 10,975	\$ 20,616,487
Fines, Penalties, Interest and Other	738	1,518	355	8	2,619
Total Revenue Received	16,780,622	3,824,468	3,033	10,983	20,619,106
Less: Amounts Collected for Non-federal Entities	(481,319)	-	-	-	(481,319)
Total	\$ 16,299,303	\$ 3,824,468	\$ 3,033	\$ 10,983	\$ 20,137,787
Refund Type					
Excise Taxes	\$ 135,765	\$ 146,681	\$ 2,317	\$ 1,699	\$ 286,462
Fines, Penalties, Interest and Other	193	-	-	-	193
Total Refunds & Drawbacks	\$ 135,958	\$ 146,681	\$ 2,317	\$ 1,699	\$ 286,655
Amounts Provided to Fund the Federal Government	\$ 16,163,345	\$ 3,677,787	\$ 716	\$ 9,284	\$ 19,851,132

### Note 18. Reconciliation of Net Cost of Operations to Budget

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

Reconciliation of Net Cost of Operations to Budget, as of September 30, 2010 and 2009 consisted of the following (in thousands)

	2010	2009 (Unaudited)
	<i>(In Thousands)</i>	
<b>Resources Used to Finance Activities</b>		
<b>Budgetary Resources Obligated</b>		
Obligations Incurred	\$ 106,101	\$ 102,109
Less: Spending Authority from Offsetting Collections and Recoveries	<u>(5,448)</u>	<u>(4,883)</u>
Obligations Net of Offsetting Collections and Recoveries	100,653	97,226
Less: Offsetting Receipts	<u>(9)</u>	<u>(17)</u>
Net Obligations	100,644	97,209
<b>Other Resources</b>		
Transfers-in without Reimbursement	1,528	399
Imputed Financing from Costs Absorbed by Others	<u>5,098</u>	<u>4,130</u>
Net Other Resources Used to Finance Activities	<u>6,626</u>	<u>4,529</u>
<b>Total Resources Used to Finance Activities</b>	<b>\$ 107,270</b>	<b>\$ 101,738</b>

**Resources Used to Finance Items not Part of the Net Cost Of Operations**

Change in Budgetary Resources Obligated for Goods, Services and Benefits Ordered but not Yet Provided (+/-)	\$ (2,006)	\$ (473)
Resources that Fund Expenses Recognized in Prior Periods	124	31
Other Budgetary Offsetting Collections and Receipts that do not Affect Net Cost of Operations	1,519	382
Resources that Finance the Acquisition of Assets	5,402	5,137
Other Resources or Adjustments to Net Obligated Resources that do not Affect Net Cost of Operations (+/-)	<u>(1,528)</u>	<u>(399)</u>
<b>Total Resources Used to Finance Items not Part of the Net Cost of Operations</b>	<b>\$ 3,511</b>	<b>\$ 4,678</b>
<b>Total Resources Used to Finance the Net Cost of Operations</b>	<b>\$ 103,759</b>	<b>\$ 97,060</b>

**Components of the Net Cost of Operations Requiring or Generating Resources in Future Periods**

<b>Components Requiring or Generating Resources in Future Periods:</b>		
Increase in Annual Leave Liability	\$ 58	\$ 39
<b>Total Components of Net Cost of Operations that will Require or Generate Resources in Future Periods</b>	<b>\$ 58</b>	<b>\$ 39</b>

**Components of the Net Cost of Operations not Requiring or Generating Resources**

Depreciation and Amortization	\$ 1,795	\$ 2,763
<b>Total Components of Net Cost of Operations that will not Require or Generate Resources</b>	<b>\$ 1,795</b>	<b>\$ 2,763</b>

<b>Total Components of Net Cost of Operations that will not Require or Generate Resources in the Current Period</b>	<b>\$ 1,853</b>	<b>\$ 2,802</b>
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<b>NET COST OF OPERATIONS</b>	<b><u>\$ 105,612</u></b>	<b><u>\$ 99,862</u></b>
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**Note 19. Contingent Liabilities**

As of September 30, 2010, TTB is party to six legal actions, regarding personnel matters, where legal counsel believes an unfavorable outcome is probable or reasonably possible. The maximum amount plaintiffs can recover for these six cases is \$1,800,000. It is estimated that TTB's potential liability on four of the six cases will approximate \$194,000. The potential liability on the other two cases cannot be estimated.



## Required Supplementary Information (Unaudited)

### Budgetary Information

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

### Excise Tax and Other Collections

Required Supplementary Information Excise Tax and Other Collections by Fiscal Year Unaudited							
Dollars in Thousands							
Fiscal Year	Alcohol	Tobacco	FAET	SOT	FST	Other	Total
2001	\$ 6,674,425	\$ 7,119,726	\$ 175,959	\$ 103,610	\$ 528	\$ 168	\$ 14,074,416
2002	6,889,401	7,763,652	205,027	101,893	115,609	159	15,075,741
2003	6,910,631	7,380,807	193,414	103,781	1,628	-	14,590,261
2004	6,995,366	7,433,852	216,006	100,562	-	359	14,746,145
2005	7,074,076	7,409,608	225,818	10,190	9	141	14,719,842
2006	7,182,940	7,350,058	249,578	2,895	638	146	14,786,255
2007	7,232,138	7,194,081	287,835	2,808	-	32	14,716,894
2008	7,420,576	6,851,705	312,622	448	-	634	14,585,985
2009	7,424,292	11,548,504	452,693	272	1,192,375	970	20,619,106
2010	7,476,789	15,913,479	360,813	300	8,558	180	23,760,119
Average	\$ 7,128,063	\$ 8,596,547	\$ 267,977	\$ 42,676	\$ 131,935	\$ 279	\$ 16,167,476

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

TTB collects Firearms and Ammunition Excise Tax (FAET) on behalf of the Department of Interior, U.S. Fish and Wildlife Service, and deposits the collections directly into the Fish and Wildlife Restoration Fund. During fiscal years 2010 and 2009, TTB incurred \$2.3 million and \$2.9 million respectively of direct and indirect costs associated with collecting the FAET taxes. The law currently does not provide for TTB to recover these costs. The cost of the program was communicated to the U.S. Fish and Wildlife Service so the agency could properly record an imputed cost in its financial records.

## TTB 2010 ANNUAL REPORT

### Refunds, Cover-over Payments, and Drawback Payments

<b>Required Supplementary Information</b>							
<b>Refunds, Cover-over Payments, and Drawback Payments by Fiscal Year</b>							
<b>Unaudited</b>							
<b>Dollars in Thousands</b>							
<b>Fiscal Year</b>	<b>Cover Over Puerto Rico</b>	<b>Cover Over Virgin Islands</b>	<b>A&amp;T Excise Tax</b>	<b>Drawbacks MNBP Claims</b>	<b>Interest and Other</b>	<b>Total</b>	
2001	\$ 332,903	\$ 3,532	\$ 13,260	\$ 289,985	\$ 1,765	\$ 641,445	
2002	340,362	5,145	10,523	361,854	1,855	719,739	
2003	356,144	6,405	15,168	296,168	2,011	675,896	
2004	335,293	6,244	15,409	355,605	1,216	713,767	
2005	419,602	6,010	18,504	317,132	2,100	763,348	
2006	358,664	6,491	17,524	337,632	699	721,010	
2007	459,278	8,054	13,208	335,706	972	817,218	
2008	373,418	7,615	14,125	283,462	2,938	681,558	
2009	472,695	8,624	17,791	268,612	252	767,974	
2010	378,186	8,871	28,232	297,596	315	713,200	
Average	\$ 382,655	\$ 6,699	\$ 16,374	\$ 314,375	\$ 1,412	\$ 721,516	

A&T - Alcohol and Tobacco

MNBP - Manufacturer of Nonbeverage Products

Note - During October 2008, the Puerto Rico cover-over rate was increased from \$10.50 per proof gallon to \$13.25 per proof gallon, with retroactive provisions, resulting in a substantial increase in the Puerto Rico cover-over payments during FY 2009. The increased rate expired December 31, 2009.

**Other Accompanying Information (Unaudited)**

Intragovernmental Assets

<b>Other Accompanying Information Intragovernmental Assets As of September 30, 2010 Unaudited</b>				
<b>Dollars in Thousands</b>				
Trading Partner	Agency Code	Fund Balance W/Treasury	Accounts Receivable	Advances and Other Assets
Department of the Treasury	20	\$ 36,748	\$ 567	\$ 852
General Fund	99	-	12,802	-
Total		<u>\$ 36,748</u>	<u>\$ 13,369</u>	<u>\$ 852</u>

<b>Other Accompanying Information Intragovernmental Assets As of September 30, 2009 Unaudited</b>				
<b>Dollars in Thousands</b>				
Trading Partner	Agency Code	Fund Balance W/Treasury	Accounts Receivable	Advances and Other Assets
Department of the Treasury	20	\$ 31,225	\$ 489	\$ 1,933
General Fund	99	-	8,489	-
Total		<u>\$ 31,225</u>	<u>\$ 8,978</u>	<u>\$ 1,933</u>

## TTB 2010 ANNUAL REPORT

### Intragovernmental Liabilities

<b>Other Accompanying Information Intragovernmental Liabilities As of September 30, 2010 Unaudited</b>				
<b>Dollars in Thousands</b>				
Trading Partner	Agency Code	Accounts Payable	Accrued FECA	Custodial and Other Liabilities
Government Printing Office	04	\$ 19	\$ -	\$ -
Department of the Interior	14	-	-	420
Department of Justice	15	273	-	-
Department of Labor	16	-	48	-
Department of the Treasury	20	2	-	-
Office of Personnel Management	24	-	-	422
General Services Administration	47	404	-	-
Treasury General Fund	99	2	-	7,709
Total		<u>\$ 700</u>	<u>\$ 48</u>	<u>\$ 8,551</u>

<b>Other Accompanying Information Intragovernmental Liabilities As of September 30, 2009 Unaudited</b>				
<b>Dollars in Thousands</b>				
Trading Partner	Agency Code	Accounts Payable	Accrued FECA	Custodial and Other Liabilities
Government Printing Office	04	\$ 241	\$ -	\$ -
Department of the Interior	14	-	-	854
Department of Justice	15	104	-	-
Department of Labor	16	-	64	-
Office of Personnel Management	24	-	-	384
General Services Administration	47	55	-	-
Department of Health and Human Services	75	2	-	-
Department of Defense	97	6	-	-
Treasury General Fund	99	-	-	8,316
Total		<u>\$ 408</u>	<u>\$ 64</u>	<u>\$ 9,554</u>

## TTB 2010 ANNUAL REPORT

### Intragovernmental Earned Revenue

<b>Other Accompanying Information</b>			
<b>Intragovernmental Earned Revenue</b>			
<b>For the Fiscal Years Ended September 30, 2010 and 2009</b>			
<b>Unaudited</b>			
<b>Dollars in Thousands</b>		<b>FY 2010</b>	<b>FY 2009</b>
Trading Partner	Agency Code		
Department of Treasury	20	<u>97</u>	<u>613</u>
Total		<u>\$ 97</u>	<u>\$ 613</u>
<u>Budget Function Classification</u>	<u>Code</u>	<u>FY 2010</u>	<u>FY 2009</u>
Central Fiscal Operations	803	<u>\$ 97</u>	<u>\$ 613</u>
Total		<u>\$ 97</u>	<u>\$ 613</u>

Intragovernmental Gross Cost

Other Accompanying Information Intragovernmental Gross Cost For the Fiscal Years Ended September 30, 2010 and 2009 Unaudited			
Dollars in Thousands		FY 2010	FY 2009
Trading Partner	Agency Code		
Library of Congress	03	\$ 53	\$ 55
Government Printing Office	04	176	402
Department of Interior	14	60	2
Department of Justice	15	694	650
Department of Labor	16	11	28
Department of State	19	18	2
Department of the Treasury	20	6,453	5,983
Office of Personnel Management	24	13,171	11,852
General Services Administration	47	6,375	5,607
Environmental Protection Agency	68	20	7
Department of Homeland Security	70	290	319
Department of Health and Human Services	75	29	30
National Archives Records Administration	88	36	35
Department of Defense	97	38	41
General Fund	99	2,892	2,806
	<b>Total</b>	<b>\$ 30,316</b>	<b>\$ 27,819</b>

During fiscal years 2010 and 2009, TTB incurred costs with other Federal agencies totaling approximately \$30 million and \$28 million in each of the respective years. The majority of those costs were associated with the five entities detailed below.

- **Department of Justice:** TTB paid ATF \$694,000 and \$650,000 in fiscal years 2010 and 2009 respectively for shared lab space and shared building services.
- **Department of the Treasury:** The Bureau received services from Treasury’s Working Capital Fund, as well as administrative services from the Bureau of Public Debt’s Administrative Resource Center, in fiscal years 2010 and 2009 in the amounts of \$6.5 million and \$6.0 million respectively.
- **Office of Personnel Management:** TTB incurred \$13.2 million and \$11.9 million in costs for employee benefits for fiscal years 2010 and 2009 respectively.
- **General Services Administration:** TTB paid \$6.4 million and \$5.6 million to GSA for rent and information technology services in fiscal years 2010 and 2009 respectively.
- **General Fund:** The Bureau paid \$2.9 million and \$2.8 million respectively for employee benefits and lockbox fees in fiscal years 2010 and 2009.

## Part IV

### Appendices

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#### Principal Officers of TTB

Administrator . . . . .	John Manfreda
Deputy Administrator . . . . .	Mary Ryan
Equal Employment Opportunity and Diversity Advancement . . . . .	Altivia Jackson
Assistant Administrator, Field Operations . . . . .	Tom Crone (acting)
Assistant Administrator, Headquarters Operations . . . . .	William Foster
Assistant Administrator, Management/CFO . . . . .	Cheri Mitchell
Assistant Administrator, Information Resources/CIO . . . . .	Robert Hughes
Director, Office of Inspection . . . . .	Theresa Glasscock
Executive Liaison for Industry and State Matters . . . . .	Susan Stewart Evans
Chief Counsel . . . . .	Robert Tobiassen

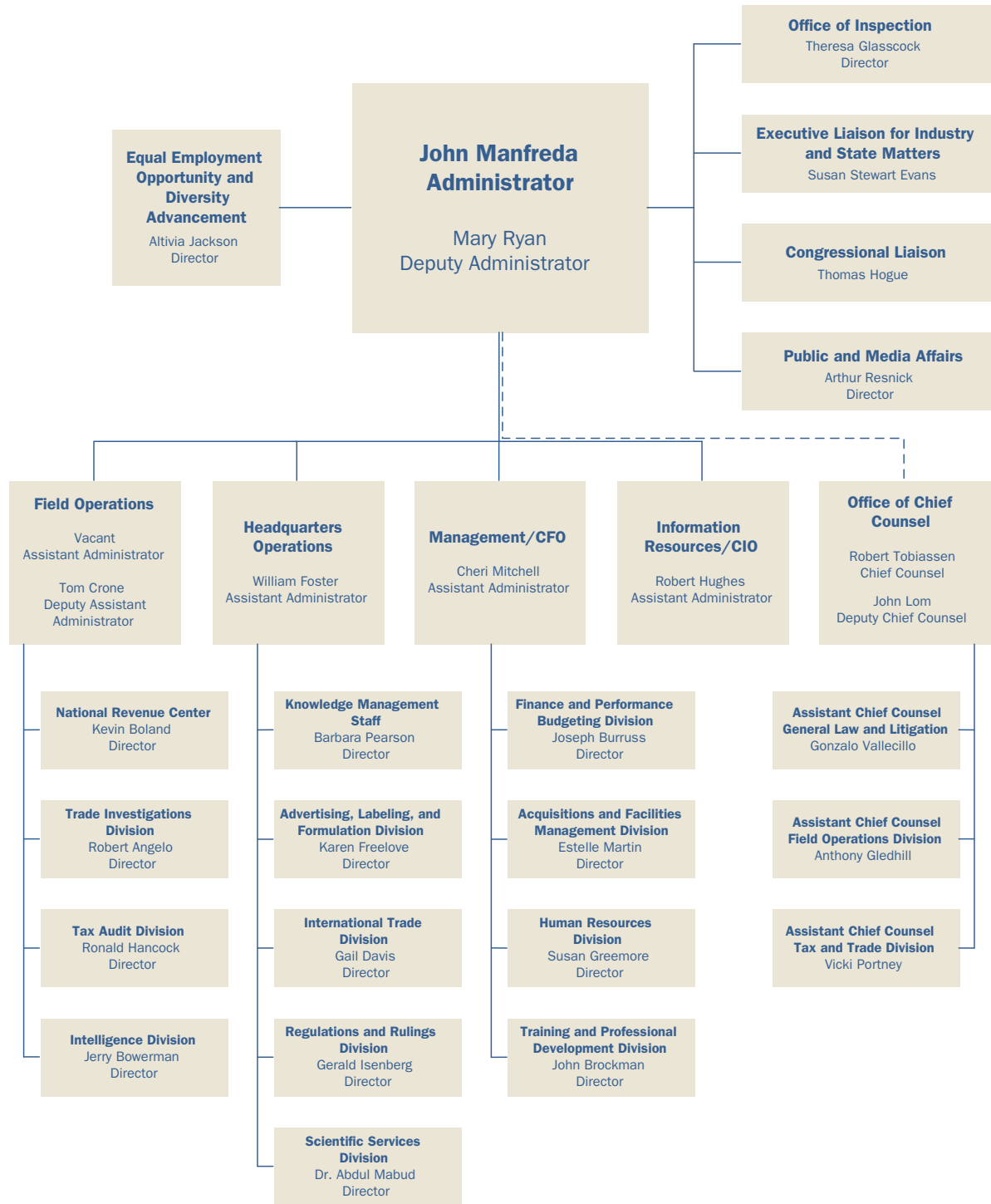
For additional information, contact:

Alcohol and Tobacco Tax and Trade Bureau  
1310 G Street, NW, Suite 300 East  
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TTB Organization Chart





## Connecting the Treasury and TTB Strategic Plans

Economy: U.S. and World Economies Perform at Full Economic Potential		
TREASURY STRATEGIC GOALS AND OBJECTIVES	TTB STRATEGIC GOALS	TTB OBJECTIVES
<p><b>TREASURY ECONOMIC STRATEGIC OBJECTIVE:</b> Improved economic opportunity, mobility and security with robust, real, sustainable economic growth at home and abroad</p> <p><b>Outcome:</b> Strong U.S. economic competitiveness</p>	<p><b>PROTECT THE PUBLIC (PTP):</b> Alcohol and tobacco industry operators meet permit qualifications, and alcohol beverage products comply with Federal production, labeling, and marketing requirements</p>	<p><b>TTB PTP OBJECTIVES</b></p> <p><b>PTP 1. BUSINESS INTEGRITY:</b> Assure that only qualified persons and business entities operate within the industries TTB regulates</p> <p><b>PTP 2. PRODUCT INTEGRITY:</b> Assure that alcohol beverage products comply with Federal production, labeling, and advertising requirements</p> <p><b>PTP 3. MARKET INTEGRITY:</b> Assure fair trade practices throughout the alcohol beverage marketplace</p>
Finance: Effectively Managed U.S. Government Finances		
TREASURY STRATEGIC GOALS AND OBJECTIVES	TTB STRATEGIC GOALS	TTB OBJECTIVES
<p><b>TREASURY FINANCIAL STRATEGIC OBJECTIVE:</b> Available cash resources to operate the government</p> <p><b>Outcome:</b> Revenue collected when due through a fair and uniform application of the law at the lowest possible cost</p>	<p><b>COLLECT THE REVENUE (CTR):</b> Enforce the tax code to ensure proper Federal tax payment on alcohol, tobacco, firearms, and ammunition products</p>	<p><b>TTB CTR OBJECTIVES</b></p> <p><b>CTR 1. TAX VERIFICATION AND VALIDATION:</b> Assure voluntary compliance in the timely and accurate remittance of tax payments</p> <p><b>CTR 2. CIVIL AND CRIMINAL ENFORCEMENT:</b> Detect and address noncompliance, excise tax evasion, and other criminal violations of the Internal Revenue Code in the industries TTB regulates</p>

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## Security: Strengthened International Financial System Security and Enhanced U.S. National Security

TREASURY STRATEGIC GOALS AND OBJECTIVES	TTB STRATEGIC GOALS	TTB OBJECTIVES
<p><b>TREASURY SECURITY STRATEGIC OBJECTIVE:</b> Prevented terrorism and promoted the Nation's security through strengthened international financial systems</p> <p><b>Outcome:</b> Removed or reduced threats to national security from terrorism, proliferation of weapons of mass destruction, narcotics trafficking and other criminal activity on the part of rogue regimes, individuals, and their support networks</p>	<p><b>PROTECT THE PUBLIC:</b> Alcohol and tobacco industry operators meet permit qualifications, and alcohol beverage products comply with Federal production, labeling, and marketing requirements</p>	<p><b>TTB PTP OBJECTIVES (Security):</b></p> <p><b>PTP 1. BUSINESS INTEGRITY:</b> Assure that only qualified persons and business entities operate within the industries TTB regulates</p>

## Management: Management and Organizational Excellence

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

**Note:** TTB revised its goals and objectives in FY 2010, and will reflect these changes in its next five-year strategic plan. The current TTB strategic plan covers the period of FY 2007 – 2012.





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