



Annual Plan Fiscal Year 2008

OIG-CA-08-007

Office of Inspector General

DEPARTMENT OF THE TREASURY

FOREWORD

This annual plan outlines the major initiatives, priorities, and challenges of the Department of the Treasury's Office of Inspector General for fiscal year 2008.

The projects described in this plan represent, in our collective judgment, areas of known or emerging risks and vulnerabilities in the Department. We strongly encourage Department of the Treasury and bureau management to use the plan to identify areas for self-assessment and to take corrective measures when vulnerabilities and control weaknesses are identified, particularly for issues we have identified as significant but, because of limited resources, we do not expect to address this year.

It should also be noted that with the year-long continuing resolution during fiscal year 2007, our office froze practically all hiring during the fiscal year and we were unable to fill critical vacancies that occurred through attrition. Additionally, we curtailed mission-related travel, training, and routine upgrades to our information technology (IT) infrastructure. As we begin our fiscal year 2008 work plan, we are doing so with more than 10 percent less staff from a year ago. We also started fiscal year 2008 under a continuing resolution which will impact our ability to undertake the work identified in this plan.

December 2007

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OVERVIEW

Introduction

This planning document outlines the Treasury Office of Inspector General's (OIG) major initiatives, priorities, and challenges for fiscal year 2008. Its purpose is to give Treasury officials, the administration, members of Congress, and other stakeholders a greater understanding of who we are, what we do, and what our intended work is for fiscal year 2008. Each of the four OIG components (Audit, Investigations, Counsel, and Management) contributed to developing this plan.

Background

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

- Conducting and supervising audits and investigations
- Providing leadership and coordination of policies that (1) promote economy, efficiency, and effectiveness in Treasury programs and operations and (2) prevent and detect fraud and abuse in Treasury programs and operations
- Providing a means for keeping the Secretary and Congress fully and currently informed about problems and deficiencies in Treasury programs and operations
- Submitting semiannual reports to Congress, through the Secretary, that (1) summarize OIG activities during the preceding period that disclose problems, abuses, or deficiencies in the administration of Treasury programs and operations and (2) contain and discuss OIG recommendations for corrective action

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

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

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OIG has jurisdiction over the following Treasury bureaus:

- **Alcohol and Tobacco Tax and Trade Bureau (TTB)**, which enforces and administers laws covering the production, use, and distribution of alcohol and tobacco products and collects excise taxes for firearms and ammunition
- **Bureau of Engraving and Printing (BEP)**, which produces U.S. currency and other government securities and redeems damaged or mutilated currency for the public
- **Bureau of the Public Debt (BPD)**, which borrows the money needed to operate the federal government, accounts for the resulting debt, and provides reimbursable support services to federal agencies
- **Financial Crimes Enforcement Network (FinCEN)**, which administers the Bank Secrecy Act (BSA); supports law enforcement, intelligence, and regulatory agencies in the sharing and analysis of financial intelligence; and builds global cooperation with financial intelligence units of other countries
- **Financial Management Service (FMS)**, which provides central payment services to federal agencies; operates the federal government's collections and deposit systems; provides government-wide accounting and reporting services, including preparation of the Financial Report of the United States Government; and manages the collection of delinquent debt owed the government
- **U.S. Mint**, which produces circulating coinage for use by the general population; produces and sells commemorative, numismatic, and investment products; and protects the federal government's precious metals and other monetary assets held in its custody
- **Office of the Comptroller of the Currency (OCC)**, which charters, regulates, and supervises national banks to ensure a safe, sound, and competitive banking system
- **Office of Thrift Supervision (OTS)**, which charters, regulates, and examines federal thrift institutions to ensure their safety and soundness

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In addition to these bureaus, other offices and programs under OIG jurisdiction include the following:

- **Departmental Offices**, which formulates policy and manages Treasury operations
- **Office of Terrorism and Financial Intelligence (TFI)**, which develops, organizes, and implements federal government strategies to combat terrorist financing and financial crime, both internationally and domestically, and is responsible for integrating FinCEN, the Office of Foreign Assets Control (OFAC), and the Treasury Executive Office for Asset Forfeiture (TEOAF)
- **Office of International Affairs (IA)**, which advises and assists in formulating and executing U.S. international economic and financial policy
- **Exchange Stabilization Fund**, which helps the Secretary carry out Treasury responsibilities regarding formulation and implementation of U.S. international monetary and financial policy, including exchange market intervention policy
- **Community Development Financial Institutions (CDFI) Fund**, which provides equity investments, grants, loans, and technical assistance to new and existing community development financial institutions; provides grants to insured depository institutions to facilitate investment in CDFI and increase community lending activities; and administers the New Markets Tax Credit program
- **Treasury Working Capital Fund**, which is a revolving fund financed by user entities that provides centralized administrative services across Treasury
- **Federal Financing Bank**, which was established to centralize and reduce the cost of federal and federally assisted borrowing and to ensure that such borrowing was coordinated in a manner to be least disruptive to private financial markets and institutions
- **Treasury Franchise Fund**, which is operated as an entrepreneurial government enterprise and provides common administrative support services (in the areas of human resources, procurement, accounting, and travel) on a competitive and fully cost-reimbursable basis
- **Office of D.C. Pensions**, which makes federal benefit payments associated with the District of Columbia retirement programs for police officers, firefighters, teachers, and judges

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Organizational Structure and Fiscal Resources

As previously stated, OIG is headed by the IG. Serving with the IG is the Deputy Inspector General, who shares responsibility with the IG for leading the OIG workforce and managing OIG resources.

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

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

The fiscal year 2008 President's Budget request for direct appropriations for OIG is \$18.45 million.

OIG Performance Measures

OIG established performance measures for fiscal year 2008 for Office of Audit and Office of Investigations, as discussed below.

Office of Audit Performance Measures

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

Audit Performance Measure 1: During fiscal year 2008, it is our goal to complete 56 audits and evaluations

The purposes of audits and evaluations are to (1) promote economy, efficiency, and effectiveness of Treasury programs and operations; (2) prevent and detect fraud, waste, and abuse in those programs and operations; and (3) keep the Secretary of the Treasury and Congress fully informed. Audits and evaluations are also a key element in fulfilling the federal government's duty to be accountable to the public.

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Audit Performance Measure 2: During fiscal year 2008, it is our goal to complete 100 percent of audits required by statute by the required date

Underlying legislation mandating certain audit work generally prescribes, or authorizes the Office of Management and Budget (OMB) to prescribe, the required completion date for recurring audits, such as those for annual audited financial statements. For other types of mandated audit work, such as a material loss review of a failed financial institution, the legislation generally prescribes a timeframe to issue a report (6 months for a material loss review, for example) from the date of an event that triggers the audit.

Audit Workload Measure: Monetary Benefits Identified

OIG audits and evaluations may identify questioned costs or make recommendations that funds be put to better use or that action be taken to generate revenue enhancements.

A questioned cost is a cost that is questioned because of (1) an alleged violation of a provision of a law, regulation, contract, grant, cooperative agreement, or other agreement or document governing the expenditure of funds; (2) a finding that, at the time of the audit, such cost is not supported by adequate documentation; or (3) a finding that the expenditure of funds for the intended purpose is unnecessary or unreasonable. A recommendation that funds be put to better use is a recommendation that, if implemented by management, could lead to more efficient use of government funds. The term *revenue enhancements* means an action recommended by our office that would, if implemented, increase the General Fund receipts of the federal government. Our audit and evaluation reports include, where appropriate, a schedule of monetary benefits identified, which provides the basis for reporting the workload measure.

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Office of Investigations Performance Measure

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

Investigative Performance Measure: During fiscal year 2008, our goal is to refer investigations for criminal prosecution, civil litigation, or corrective administrative action in a timely manner

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

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

OIG COMPONENT ORGANIZATIONS AND FISCAL YEAR 2008 INITIATIVES

This section describes the functions, organizational structures, priorities, and fiscal year 2008 initiatives for the four components of OIG.

Office of Audit

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

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

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

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

Performance Audit

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

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

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Director, Fiscal Service Audit, provides leadership for performance audits of FMS, BPD, and CDFI Fund.

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

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

Financial Management and Information Technology Audit

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

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

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

OIG COMPONENT ORGANIZATIONS AND FISCAL YEAR 2008 INITIATIVES

Fiscal Year 2008 Planning Approach This plan reflects our effort to provide appropriate audit and evaluation coverage to Treasury and its bureaus given our available resources. In formulating the plan, we also considered (a) observations and suggestions by our managers, auditors, evaluators, and investigators; (b) the Administration's fiscal year 2008 budget priorities for Treasury; and (c) recent Congressional activity, testimony by Treasury officials, and remarks by Treasury, OMB, and Congressional officials and staff indicating significant areas of interest.

Key features of this plan include the following:

- Department-wide Perspective The plan emphasizes the issues of greatest significance to the Department rather than to individual bureaus.
- Customer and Stakeholder Participation We provided a draft plan to Treasury officials for comment. The Directors and their staffs met with Department and bureau officials and staff throughout the year to solicit audit suggestions. We also solicited input from other interested staff with OMB, various Congressional committees, and GAO.
- Responsiveness to Changing Priorities and Needs The plan will be subject to revision throughout the year to accommodate new legislative requirements, changing bureau missions, and unforeseeable events or high-priority requests for our audit services.
- Continuity The plan is a dynamic document that will be updated and continued beyond fiscal year 2008.

Audit Priorities for Fiscal Year 2008

Priority 1 - Audit products mandated by law

Our office must allocate significant resources to meet legislative requirements related to (1) audited financial statements and financial-related review work; (2) information security; (3) in certain instances, failed financial institutions; and (4) as a biennial requirement, a review of Treasury's privacy and data protection procedures. During fiscal year 2008, we also have a new requirement to determine why Treasury did not prepare certain quadrennial reports.

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Priority 2 – Work requested by Congress or Otherwise Externally Driven

We typically receive 2 to 3 Congressional requests a year for specific work. Oftentimes requested work is already in our plan and is a matter of reprioritizing the timing or scope of the planned work. As a recent example, the Senate Intelligence Committee requested a review of a Treasury classified program which is included as an ongoing project in this Annual Plan. Other times, the requested work is in a new area and we assess whether the work should be undertaken. As an example, during fiscal year 2007 we completed a requested review of Treasury's trade promotion activities. With respect to externally driven work, the President's Council on Integrity and Efficiency, and more recently, the Office of the Director of National Intelligence (ODNI) identified important work affecting multiple agencies that has broad impact. As examples, in response to a council initiative, during fiscal year 2007 we assessed Treasury's progress in implementing OMB Memorandum M-06-016, *Protection of Agency Sensitive Information*. We also are participating in an ONDI OIG-coordinated joint Intelligence Community OIG review of the process to "nominate" individuals for inclusion on the Government's consolidated terrorist watch list.

Priority 3 – Self-Directed Work in Treasury's Highest-Risk Areas

We will undertake audits during fiscal year 2008 to assess the Department's progress in addressing serious deficiencies and emerging risks. Principal areas we will focus on with our limited resources are IT security, Terrorist Financing/Money Laundering, and capital investments.

Relationship of Audit Plan to Treasury Strategic Plan Treasury's mission, as stated in its strategic plan for fiscal years 2007-2012, is to serve the American people and strengthen national security by managing the U.S. Government's finances effectively, promoting economic growth and stability, and ensuring the safety, soundness, and security of U.S. and international financial systems. To accomplish this mission, the Department identified four strategic goals. As part of our audit planning process, we identified seven core "issue areas" that address one or several of Treasury's strategic goals.

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The following table shows the link between specific Treasury strategic goals and OIG issue areas:

Treasury Strategic Goal	OIG Issue Area
Effectively Managed U.S. Government Finances	<ul style="list-style-type: none"> • Government-wide Financial Services and Debt Management • Revenue Collection and Industry Regulation
U.S. and World Economies Perform at Full Economic Potential	<ul style="list-style-type: none"> • Safety, Soundness, and Accessibility of Financial Services • Domestic and International Assistance Programs • Bill and Coin Manufacturing, Marketing, and Distribution Operations
Prevented Terrorism and Promoted the Nation's Security Through Strengthened International Financial Systems	<ul style="list-style-type: none"> • Terrorist Financing, Money Laundering, and Foreign Assets Control
Management and Organizational Excellence	<ul style="list-style-type: none"> • Treasury General Management and Infrastructure Support (Financial Management, Information Systems Security, and General Management)

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

Audit Initiatives for Fiscal Year 2008 Through our planning process, we identified 25 projects that we will initiate during fiscal year 2008. We also plan to complete work on 46 projects started during fiscal year 2007. Additionally, we identified 111 high-priority projects that must be deferred to a future year because our resources do not permit them to be undertaken in fiscal year 2008. Our in-process and planned work and projects for future consideration are described in more detail in the *OIG Issue Areas and Planned Projects* section of this document.

Office of Investigations

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

Organizational Structure The Assistant Inspector General for Investigations is supported by a Deputy Assistant Inspector General for Investigations who manages two divisions—the

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Investigations Division and the Operations Division. At present, the Office responds to all allegations of fraud and other crimes from our office in Washington, D.C.

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

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

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

OIG has *concurrent* responsibility with the Federal Bureau of Investigation to combat *fraud and other crimes* that occur within or are directed against the Department's programs and operations. Therefore, a significant amount of our work has the potential to be investigated jointly with the Bureau and other federal law enforcement partners—often as part of a task force working in close cooperation with the U.S. Department of Justice (DOJ).

Cyber Investigative Branch OIG's Cyber Investigative Branch has been involved in over 50 cases in fiscal year 2007. Every case that our office has been involved in over the past year has had a technology connection, and this will be the case in the coming year. Therefore, recruiting, acquiring, training and retaining the highest qualified cyber personnel will be necessary as we continue to fulfill both the President's Management Agenda and the Department's strategic and annual planning goals. It should also be noted that Office of Audit IT audit staff coordinates with the Cyber Investigative Branch on areas of mutual interest.

Investigative Priorities for Fiscal Year 2008

We are committed to a vigorous, comprehensive, and capable investigative program. With this in mind, we established the following four overarching investigative priorities for 2008

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which are intended to detect and prevent fraud and other crimes against the Department's programs and operations.

Priority 1 – Criminal and serious employee misconduct

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

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

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

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

Priority 3 – Financial Programs and Operations Crime

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

Priority 4 – Critical Infrastructure and Fiscal Protection

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

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Relationship of Investigative Priorities to Treasury Strategic Plan

OIG's four overarching investigative priorities are intended to detect and prevent fraud and other crimes against the Department's programs and operations. The following chart identifies the Strategic Goals of the Department and provides a crosswalk to our investigative priorities to demonstrate the relationship between the investigative and policy priorities.

Treasury Strategic Goal	OIG Investigative Priorities			
	Criminal and Serious Employee Misconduct	Fraud Involving Contracts, Grants, Guarantees, and Funds	Financial Programs and Operations Crimes	Critical Infrastructure and Fiscal Protection
Effectively Managed U.S. Government Finances				√
U.S. and World Economies Perform at Full Economic Potential		√	√	
Prevented Terrorism and Promoted the Nation's Security Through Strengthened International Financial Systems		√	√	√
Management and Organizational Excellence	√	√		

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Investigative Products

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

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

Communication

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

Office of Counsel

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

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

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before the Merit Systems Protection Board and the Equal Employment Opportunity Commission.

The Office manages the OIG ethics program, which includes financial disclosure, training, and advice on the governing law and regulations. In the area of disclosure law, Office of Counsel manages OIG's Freedom of Information Act (FOIA) and Privacy Act programs. Office of Counsel also coordinates document requests from Congress and from litigation, as well as responding to Giglio² requests from DOJ for information on Treasury personnel.

Counsel Initiatives for Fiscal Year 2008 Office of Counsel will support OIG investigative, oversight, and audit activities by responding to requests for legal advice, and through reviewing and processing requests for the issuance of Inspector General subpoenas. In the area of disclosure, Office of Counsel will focus resources to provide timely responses to FOIA and Privacy Act requests, and to carry out its litigation responsibilities in Merit Systems Protection Board and Equal Employment Opportunity Commission cases. Based upon past experience, Office of Counsel expects to process 50 initial FOIA/Privacy Act requests and eight appeals from those initial responses. In the area of electronic FOIA, Office of Counsel expects to review approximately 50 audit, evaluation, and oversight reports for posting on OIG's web site. Office of Counsel will review the Privacy Act systems of records notices for both OIG's investigative and administrative records systems, with a view to possible revision, and will provide procedural review and training services as the OIG Senior Agency Official for Privacy. The Office will coordinate with the Department in updating the Treasury Order and Directives that establish and define OIG's authority, responsibility, and organization. Finally, Office of Counsel will respond to Giglio requests, coordinate responses to document requests from Congress, and respond to discovery requests arising from litigation involving the Department and its bureaus. Office of Counsel will provide training on the Inspector General Act and other subjects in connection with new employee orientation and in-service training. The Office will obtain necessary training in order to provide advice in emerging areas of OIG responsibility. As statutorily mandated, the Office will review legislative and regulatory proposals and, where appropriate, will coordinate comments.

Office of Management

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

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

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services, budget and finance, human resources, IT, general policies and procedures, and liaison to President's Council on Integrity and Efficiency and other organizations.

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

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

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

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

Management Initiatives for Fiscal Year 2008 Office of Management will continue to identify operational efficiencies to improve management support, while identifying opportunities to reduce costs. It will continue to enable OIG to maintain its independence from Treasury programs and policies, while continuing to provide OIG offices with required administrative support.

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

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

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

For the IT function, OIG has streamlined operations. Efforts continue to support the implementation of new management information systems; improve the implementation and quality of mobile communications; and ensure that automated systems are fully maintained, up-to-date, operational, and in compliance with all information security requirements.

OIG ISSUE AREAS AND PLANNED PROJECTS

Introduction; Management and Performance Challenges

Introduction

This section provides general background information on our overall assessment of significant management and performance challenges facing the Department. Following this background are brief descriptions of each OIG issue area, including (1) a description of significant risks to Treasury programs and operations, (2) in-progress audit and investigative projects and new projects to be started during fiscal year 2008, and (3) projects that have been identified through our planning process but will not be undertaken this fiscal year. Our discussion of risks is based principally on (1) prior audit and investigative work, (2) the initiation of new programs or operations, and/or (3) increased funding initiatives in mature programs or operations.

Management and Performance Challenges

In accordance with the Reports Consolidation Act of 2000, the IG annually provides the Secretary of the Treasury with his perspective on the most serious management and performance challenges facing the Department. The Secretary includes these challenges in the Department's annual performance and accountability report. In October 2007, Acting Inspector General Schindel continued to report the same five challenges as our office reported last year: (1) Corporate Management, (2) Management of Capital Investments, (3) Information Security, (4) Linking Resources to Results, and (5) Anti-Money Laundering and Terrorist Financing/Bank Secrecy Act Enforcement. As Mr. Schindel advised in his memorandum to Secretary Paulson, it is important to note that management and performance challenges do not necessarily represent a deficiency in management or performance. Instead, most of them represent inherent risks associated with Treasury's mission, organizational structure, or the environment in which it operates. As a result, the Department can take steps to mitigate these challenges but not entirely eliminate them; as such, they require constant management attention. In addition to these five management and performance challenges, our memorandum discussed two additional areas that are of increasing concern to our office. These areas are: the potential impact of worsening real estate and credit markets on Treasury's regulators, and the affect of stagnant or reduced budgets on the Department's control environment.

The five management and performance challenges are summarized below:

- Corporate Management. Starting in 2004, we identified corporate management as an overarching management challenge. In short, Treasury needs to provide effective corporate leadership in order to improve performance as a whole. Inherent in this is the need for clear lines of accountability between corporate, bureau, and program office management; enterprise solutions for core business activities; consistent application of

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accounting principles; and effective oversight of capital investments and information security. With nine bureaus and a number of program offices, Treasury is a highly decentralized organization. We believe the Department has made progress in building up a sustainable corporate control structure. The challenge now is to maintain emphasis on corporate governance and institutionalize these efforts to ensure that capital investments are properly managed, information about government operations and citizens is adequately secured, and financial resources used by Treasury can be linked to operational results.

- Management of Capital Investments. Managing large capital investments, particularly IT investments, is a difficult challenge facing any organization whether in the public or private sector. In prior years we have reported on a number of capital investment projects that either failed or had serious problems. In light of this, with hundreds of millions of procurement dollars at risk, Treasury needs to be vigilant in this area as it proceeds with its telecommunications transition to Treasury Network, implementation of Homeland Security Presidential Directive – 12, *Policy for a Common Identification Standard for Federal Employees and Contractor*, the anticipated renovation of the Treasury Annex, and other large capital investments.

It should be noted that during the last year, the Secretary and Deputy Secretary continued to emphasize that effective management of major IT investments is the responsibility of all Treasury executives. Additionally, the Department significantly increased the number of IT investments that are monitored through the Office of Management and Budget (OMB) quarterly high-risk reporting process. The Department also plans to reinstitute a governance board consisting of senior management officials to provide executive decision-making on, and oversight of, IT investment planning and management and to ensure compliance with the related statutory and regulatory requirements.

- Information Security. Despite notable accomplishments, the Department needs to improve its information security program and practices to achieve compliance with the Federal Information Security Management Act of 2002 (FISMA) and OMB requirements. Our 2007 FISMA evaluation, completed in October 2007, found that the Department made progress in addressing previously reported deficiencies in the areas of certification and accreditation, information security training, plans of actions and milestones, system inventory, and incident response. However, our evaluation disclosed a significant deficiency in configuration management. Specifically, we noted that Treasury did not have adequate configuration management to provide the security necessary to protect against common and dangerous threats.

During 2006, OMB issued Memorandum 06-16, *Protection of Sensitive Agency Information* (M-06-16), requiring agencies to perform specific actions to protect certain

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personally identifiable information. Last year, we reported that our evaluation of Treasury's compliance with M-06-16 disclosed that Treasury still faced significant challenges to meet these requirements. We will be performing follow-up work to determine if Treasury has progressed in resolving these issues. However, as a significant action, the Department recently established the Personally Identifiable Information Risk Management Group consisting of senior management officials. The purpose of this group is to help manage and contain breaches of personally identifiable information. Our office, along with Treasury Inspector General for Tax Administration (TIGTA), participates in the group in an advisory role.

- Linking Resources to Results. Because the Department has not fully developed and incorporated managerial cost accounting (MCA) into its business activities, the Department cannot adequately link financial resources to operating results. This inhibits comprehensive program performance reporting and meaningful cost benefit analyses of the Department's programs and operations. We have noted progress in this area, but more needs to be accomplished to implement an effective MCA program Treasury-wide. In 2006, we reported that the Department developed a high-level MCA implementation plan, but specific action items were not completed and certain target dates were missed. This year, Treasury established a workgroup to address MCA requirements and the workgroup has completed a number of actions. The Department expects to have a viable MCA program in place in fiscal year 2008.
- Anti-Money Laundering and Terrorist Financing/Bank Secrecy Act. Treasury faces unique challenges in carrying out its responsibilities under BSA and the USA PATRIOT Act to prevent and detect money laundering and terrorist financing. While FinCEN is the Treasury bureau responsible for administering BSA, a large number of federal and state entities participate in efforts to ensure compliance with BSA. These entities include the five federal banking regulators, IRS, the Securities and Exchange Commission, the Department of Justice, and state regulators. Many of these entities also participate in efforts to ensure compliance with U.S. foreign sanction programs administered by OFAC. The dynamics and challenges for Treasury of coordinating the efforts of multiple entities, many external to Treasury, are difficult. In this regard, FinCEN and OFAC have entered into memoranda of understanding (MOU) with many federal and state regulators in an attempt to build a consistent and effective process. Long-term data, however, is not yet available to make an overall determination of the effectiveness of the MOUs.

Recently, federal regulators and the Department of Justice have participated with FinCEN in assessing fines, often in the tens of millions of dollars, against financial institutions which have not been maintaining effective BSA compliance programs. While this is a sign that regulators are more willing to aggressively enforce BSA requirements, it is also a sign that not all financial institutions, despite years of

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warnings, have implemented effective or adequate programs. At the same time, the financial services industry has often complained about regulatory burden. To this end, Treasury has taken steps to clarify program and reporting requirements, and must continually monitor and balance the needs of law enforcement with these concerns.

In fiscal year 2006, the number of BSA reports filed increased to 17.6 million, from 15.6 million in fiscal year 2005. Although these reports are critical to law enforcement, past audits have shown that many contain incomplete or erroneous data. Also, the USA PATRIOT Act increased the types of financial institutions required to file these reports. The regulation of certain industries, such as casinos, insurance companies, jewelers, and money service businesses, is the responsibility of IRS as a default regulator. IRS has often struggled to conduct examinations of many of these entities and recently postponed examinations of jewelers, which were supposed to start in January 2006, until at least fiscal year 2008.

In addition to the five management and performance challenges, we also reported two areas that are of increasing concern to our office. While we have not specifically declared these areas as management and performance challenges, we continue to monitor their impact on the Department's programs and operations.

- Recently, conditions in the real estate market have worsened. At the same time, credit markets are being impacted by problems associated with subprime loans. Together, these events are putting pressure on financial institutions, including those supervised by OCC and OTS. For example, in September the OTS-supervised NetBank failed, representing the largest financial institution failure since 2001. Accordingly, Treasury needs to ensure it has the capability to monitor and take prompt action to address potential problems at other institutions should economic conditions worsen.
- Many federal agencies, including Treasury, are facing an increasingly difficult budget environment. In these situations agencies tend to rely on attrition and hiring freezes to address budget shortfalls. While in the short term this strategy may work, longer term it often leads to a less than optimal mix of positions and skills, ultimately impacting an agency's ability to meet its mission for many years. Additionally, agencies tend to cut certain operations that are viewed as non-mission related, particularly those involved in review and monitoring functions, including contractor oversight – fundamental elements of a strong control environment. Over time, such actions could lead to the deterioration of the control environment and compromise both the effectiveness and integrity of programs and operations.

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Treasury General Management and Infrastructure Support—Financial Management

Office of Audit Contact: Michael P. Fitzgerald, Director of Audit (202) 927-5789

Office of Investigations Contact: Gerald R. Garren, Special Agent in Charge, Investigations (202) 927-5829

Issue Area Discussion

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

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

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

Program Responsibilities The Department has responsibility for certain recently implemented government programs. These programs may generate complex accounting and auditing issues that must be closely monitored and ultimately resolved as part of the audit of Treasury's consolidated financial statements. Programs that will be reviewed as part of the audit of the fiscal year 2008 Department-wide financial statements include the following:

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

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from acts of terrorism above insurers' deductibles. The program has a \$100 billion cap.

In addition, the Department maintains the Working Capital Fund, which was established in 1970 to provide centrally common administrative services across the Department, achieve economies of scale, and eliminate duplication of effort and redundancies. Central services in the fund include: telecommunications, printing, duplicating, graphics, computer support/usage, personnel/payroll, automated financial management systems, training, short-term management assistance, procurement, IT services, equal employment opportunity services, and environmental health and safety services. These services are provided on a reimbursable basis to Treasury components at rates that recover the fund's operating expenses, including accrual of annual leave and depreciation of equipment. For fiscal year 2008, new obligations of the fund are estimated at \$253 million.

Known Weaknesses The Department received an unqualified audit opinion on its fiscal year 2007 consolidated financial statements. The IPA's audit report disclosed the following material weakness, other significant deficiencies, and instances of noncompliance with laws and regulations exclusive of FFMIA:

Material Weakness

- Financial management practices at the IRS (repeat condition)

Other Significant Deficiencies

- Information system controls (repeat condition)
- Financial management practices at the Department level

Instances of Noncompliance With Laws and Regulations Exclusive of FFMIA

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

The IPA also reported that the Department's financial management systems did not substantially comply with the requirements of FFMIA. In addition, the IPA reported an instance of a potential Anti-deficiency Act violation related to transactions and activities of the Treasury Franchises Fund.

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Treasury General Management and Infrastructure Support—Financial Management

In Progress and Planned Fiscal Year 2008 Projects

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

Audit Objective To determine whether the financial statements and schedules are fairly presented in all material respects. The audits will also report on internal control, compliance with laws and regulations, and compliance with FFMIA. During fiscal year 2008, we will complete audit work for the fiscal year 2007 financial statements and schedules. We will also begin audit work for the fiscal year 2008 financial statements and schedules. We anticipate that these projects will require 8,500 hours by OIG staff during the fiscal year.

Treasury's Working Capital Fund (In Progress)

Audit Objective To determine if the costs that the Department's Working Capital Fund charges to the bureaus are consistent with the costs the fund incurs for projects it performs on their behalf. Specifically, we plan to review in phases: (1) the existence, timeliness, and consistency of reconciliations between the actual costs incurred by the fund and costs billed to bureaus; (2) whether costs charged by the fund are appropriate; (3) whether costs charged by the fund to specific bureaus are supported by appropriate documentation; and (4) the reasonableness of assumptions, data, processes, or models used by the fund to estimate its annual costs. This project is a joint effort with TIGTA and we anticipate that it will require 600 hours during fiscal year 2008.

Single Audit Act Activities (On-going)

Audit Objective To ensure action is taken on findings related to Treasury programs identified by Single Audits of state and local governments. We anticipate this activity will require 100 hours.

Treasury's Implementation of the Improper Payments Information Act

Background An improper payment is any payment that should not have been made or that was made in an incorrect amount under statutory, contractual, administrative, or other legally applicable requirements. Incorrect amounts can be either overpayments or underpayments (including inappropriate denials of payment or service). An improper payment includes any payment that was made to an ineligible recipient or for an ineligible service, duplicate payments, payments for services not received, and payments that are for the incorrect amount. In addition, when an agency's review is unable to discern

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whether a payment was proper as a result of insufficient or lack of documentation, this payment is also considered erroneous. The purpose of the Improper Payments Information Act of 2002 (Public Law 107-300) is to eliminate improper payments and enhance the accuracy and integrity of Federal payments. In August 2006, OMB consolidated its implementation requirements for the act in appendix C to Circular A-123, *Management's Responsibility for Internal Control*.

Audit Objective To determine if the Department has implemented an effective process to assess the risk of improper payments by its offices and bureaus pursuant to the Improper Payments Information Act of 2002 and OMB requirements. We anticipate that this project will require 800 hours.

Projects Under Consideration for Future OIG Annual Plans

Treasury's Implementation of Managerial Cost Accounting

Background MCA involves the accumulation and analysis of financial and non-financial data, resulting in the allocation of costs to organizational pursuits such as performance goals, programs, activities, and outputs, and should be a fundamental part of a financial/performance management system. Both our office and GAO have reported the need for Treasury to implement MCA in a more effective manner. In 2006, we reported that the Department developed a high-level MCA implementation plan, but specific action items were not completed and certain target dates were missed. During 2007, Treasury established a Chief Financial Officer's Council Workgroup to address MCA requirements within Treasury. This workgroup is comprised of representatives from all of the Treasury offices and bureaus and is led by the Deputy Chief Financial Officer. We are also participating with the workgroup in an advisory capacity.

Audit Objective To assess the Department's progress in implementing MCA in a comprehensive and effective manner. We anticipate that this project will require 1,200 hours.

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Treasury General Management and Infrastructure Support—Information Systems Security

Office of Audit Contact: Louis C. King, Director of Audit (202) 927-5774

Office of Investigations Contact: Tim W. Clark, Special Agent, Cyber Division, (202) 927-5684

Issue Area Discussion

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

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

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

Legislative Mandate FISMA requires Treasury to have an annual independent evaluation of its information security program and practices to determine the effectiveness of such program and practices. As required by law, TIGTA conducts the annual independent evaluation as it pertains to IRS. A contractor under our oversight conducts the annual independent evaluation as it pertains to the remainder of Treasury's non-national security systems. In addition, our contractor incorporates the results of TIGTA's evaluation of IRS in Treasury's overall results. We conduct the evaluations pertaining to national security systems, including those under the purview of the Assistant Secretary for Intelligence and

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Analysis. The Director of National Intelligence prescribes the annual deadline for the intelligence program evaluations. OMB sets the deadlines for all other FISMA evaluations.

Known Weaknesses Based on the results of the 2007 FISMA evaluation of Treasury, including TIGTA's evaluation of IRS's systems, we reported that despite notable progress, Treasury had the following two significant deficiencies that constitute noncompliance with FISMA:

- Only four non-IRS bureaus or offices had compliant configuration guides or baselines. The remaining non-IRS bureaus or offices reviewed have implemented configuration baselines; however, these baselines are not in compliance with applicable National Institute of Science and Technology (NIST) guidance. Treasury issued its configuration management policy on January 30, 2007. This policy requires the implementation of applicable NIST guidance; however, it allows one year, or until February 1, 2008, to achieve compliance.
- Although TIGTA's 2007 FISMA report noted steady progress in complying with FISMA requirements, it also noted that the IRS still needs to do more to adequately secure its systems and data. TIGTA also reported that the most significant areas of concern were annual testing of security controls and contingency plans, implementation of configuration management standards, and privacy requirements for protecting personally identifiable information. For purposes of its Federal Managers' Financial Integrity Act responsibilities, IRS self-reported a material weakness in the area of information security and developed an action plan to address the weaknesses.

We also identified areas where Treasury improved its information security program and practices. Most notably, Treasury was consistently certifying and accrediting virtually all systems, as well as testing security controls and contingency plans on an annual basis. In addition, TIGTA reported that IRS's inventory is substantially complete, that IRS's plan of action and milestones process is adequate to ensure remediation of security weaknesses, and that policies and procedures are followed for reporting IRS's computer security incidents. We also noted significant improvement in the information security program and practices of non-IRS national security systems.

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Treasury General Management and Infrastructure Support—Information Systems Security

In Progress and Planned Fiscal Year 2008 Projects

FISMA Independent Evaluation – Unclassified Systems

Evaluation Objective A contractor under our oversight will determine if Treasury's information security program and practices, as they relate to Treasury's unclassified systems, are adequate. In addition, the contractor will determine the progress made in resolving previously reported FISMA weaknesses. We anticipate that 600 hours by OIG staff will be needed to provide guidance and oversight to the contractor during fiscal year 2008.

FISMA Independent Evaluation – National Security Systems

Evaluation Objective To determine if Treasury's information security program and practices, as they relate to Treasury's national security systems, are adequate. In addition, we will determine the progress made in resolving previously reported FISMA weaknesses. We anticipate that this evaluation will require 500 hours.

Penetration Testing and Vulnerabilities Assessment (On-going)

Audit Objective To determine if (1) computer hackers can use common or specialized tools to gain unauthorized and illegal access to Treasury's networks, (2) malicious internal users can use these same tools or other techniques to gain unauthorized access to systems, and (3) unauthorized outsiders or personnel can gain access to sensitive computer equipment. For fiscal year 2008, we plan to conclude evaluations at OCC and FinCEN and perform an evaluation at TTB. We anticipate that these three evaluations will require a total of 3,000 hours.

Security of Personally Identifiable Information/Section 522

Background Stolen social security numbers, names, addresses, birthdates, etc., are used to perpetrate identity theft and to invade privacy. Recent issues in the private sector and the federal government have demonstrated that unauthorized parties can successfully remove or steal this kind of information and place millions of citizens at risk. In an effort to address these issues at the federal level, OMB issued M-07-16, *Safeguarding Against and Responding to the Breach of Personally Identifiable Information*. M-07-16 reminds agencies of the requirements set forth by FISMA of 2002 and by the Privacy Act of 1974. In particular, it reminds agencies of the need to reduce the volume of personally identifiable information and the use of social security numbers. In addition, it requires agencies to establish a breach notification policy within 120 days of the issuance of the

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memorandum, and sets forth a framework for agencies to use to develop this policy. M-07-16 also establishes new incident handling and reporting requirements, and requires the establishment of policy pertaining to individuals who can access personally identifiable information.

Additionally, the Transportation, Treasury, Independent Agency, and General Government Appropriation Act, 2005 (P.L. 108-447, Division H) requires that within 12 months of the law's enactment (by December 2005), covered agencies, including Treasury, were to establish and implement comprehensive privacy and data protection procedures governing the collection, use, sharing, disclosure, transfer, storage, and security of information in an identifiable form relating to the agency employees and the public. The Act also requires that at least every 2 years, an independent evaluation be made of (1) the agency's use of information in identifiable form and (2) the privacy and data protection procedures of the agency. The next independent evaluation under this Act is due December 2008.³

Audit Objective To determine if the Treasury has (1) met the requirements of the Privacy Act of 1974 and OMB M-07-16, and (2) properly secured or mitigated risks pertaining to personally identifiable information. We plan to use the results of this audit to meet our next reporting requirement under Section 522. We anticipate that this project will require 1,200 hours.

Projects Under Consideration for Future OIG Annual Plans

Disaster Recovery Exercises (On-going)

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

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

Background Wide variations in the quality and security of forms of identification used to gain access to secure Federal and other facilities where there is potential for terrorist attacks need to be eliminated. Therefore, in August 2004, the President issued Homeland Security Presidential Directive 12 (HSPD-12), *Policy for a Common Identification Standard for Federal Employees and Contractors*. HSPD-12 set forth the policy of the United States to enhance security, increase government efficiency, reduce identity fraud, and protect

³ At the time this plan was prepared, legislation was pending that will allow our office greater flexibility in performing these reviews.

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personal privacy by establishing a mandatory, government-wide standard for “secure and reliable forms of identification” issued by the federal government to its employees and contractors. “Secure and reliable forms of identification” for purposes of HSPD-12 means identification that (a) is issued based on sound criteria for verifying an individual employee’s identity; (b) is strongly resistant to identify fraud, tampering, counterfeiting, and terrorist exploitation; (c) can be rapidly authenticated electronically; and (d) is issued only by providers whose reliability has been established by an official accreditation process.

Audit Objective To determine what steps Treasury has taken to implement the requirements set forth in HSPD-12. We anticipate that this project will require 500 hours.

TNet Implementation

Background The Department, its bureaus, other non-Treasury financial, enforcement and economic organizations and on-site contractors encompass approximately 184,000 users that need telecommunication services. A net customer growth factor of three or four percent is anticipated per year. Many of these services are currently provided through the Treasury Communications System and Digital Telecommunications System. In late fiscal year 2007 Treasury awarded a task order for the Treasury Network through General Services Administration’s Networx Universal Contract to replace these systems. The transition is expected to start during November 2007. Treasury is allowing 9 months for the transition to be completed. Treasury Network is expected to provide a basic service tailored to a site’s network availability, bandwidth, class of service, and help desk support requirements. In addition, some enhanced services will be offered.

Audit Objective To determine if Treasury is managing the transition to Treasury Network in a manner that (1) ensures that users will have the services they require without disruption; (2) provides adequate security for sensitive Treasury information; (3) results in volume discounts; and (4) improves the integration of Treasury systems. We anticipate that this project will require 1,200 hours.

Treasury Implementation of IPv6

Background Internet Protocol version 6 is the next generation protocol designed by the Internet Engineering Task Force to replace the current protocol, version 4. Most of today’s internet uses version 4, which is now nearly 20 years old. Version 6 fixes a number of problems in version 4, such as the limited number of available version 4 addresses. Version 6 is expected to gradually replace version 4, with the two coexisting for a number of years during a transition period. OMB set a June 2008 deadline for civilian agencies to add the new technology to their networks.

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Audit Objective To determine what steps Treasury has taken to prepare for implementation of Internet Protocol version 6 throughout the Department. We anticipate that this project will require 1,500 hours.

System Certification and Accreditation Processes

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

Treasury's System Reviews

Background Through our FISMA efforts, we identified that the total number of systems continues to repeatedly change at Treasury. The change appears to be due largely on how systems are defined. As a result, bureaus used their own definitions to determine what constitutes a system is and how many they have. Although Treasury issued a definition of "system" in 2006, the changes in system inventories continue. During fiscal year 2007, the Treasury FISMA system inventory significantly changed yet again. The changing number of systems may impact the adequacy of the system reviews and alter FISMA scores. OMB's FISMA implementation guidance specifies requirements for the annual evaluation of agency programs, systems and contractor operations/facilities by program officials, Chief Information Officers, and the Inspector General. These requirements include the number of systems by bureau and an indication of the number of systems reviewed during the reporting period. Also required is a description of the methods used by agency officials to ensure that services provided by contractors, or other agencies, meet the requirements of FISMA, OMB policy, and NIST guidelines.

Audit Objective To determine if Treasury's (1) processes for conducting reviews of systems installed at Treasury and contractor facilities are adequate and compliant with OMB's FISMA implementation guidance, including Federal Information Standards Publication 199 and NIST Special Publication 800-53 requirements, and (2) system inventory methods can be relied on to accurately, consistently, and completely identify all its systems. We anticipate that this project will require 1,000 hours.

Cyber-Based Systems – Critical Infrastructure Protection Program

Audit Objective To determine (1) what progress Treasury has made in identifying and prioritizing its critical infrastructure, (2) if Treasury is adequately protecting this

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infrastructure from terrorist attacks, and (3) if Treasury is in compliance with other requirements of Homeland Security Presidential Directive 7. We anticipate that this project will require 800 hours.

Web Servers – Controls and Security

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

Treasury's Enterprise Environment

Audit Objective To determine if the Treasury Chief Information Officer and bureau Chief Information Officers have implemented an enterprise environment framework that eliminates redundancy, reduces cost, improves quality and timeliness of information, enhances system integration, and properly secures information. We anticipate that this project will require 1,600 hours.

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

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

Data Centers – Security Reviews

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

Wireless Network Security

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

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disclosure), (2) there are any unauthorized wireless networks on Treasury premises, and (3) Treasury has established adequate policy and oversight regarding wireless networking. We anticipate that this project will require 800 hours.

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Treasury General Management and Infrastructure Support—General Management

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Office of Investigations Contact: Gerald R. Garren, Special Agent in Charge, Investigations (202) 927-5829

Issue Area Discussion

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

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

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

Under the Clinger-Cohen Act of 1996, agencies are required to submit business plans for IT investments to OMB. If the agency's investment plan contains one or more planning weaknesses, it's placed on OMB's Management Watch List and targeted for follow-up action to correct potential planning deficiencies prior to execution. In August 2005, OMB established a High Risk List for IT projects to complement its Management Watch List which focuses on planning aspects for major investments and performance data to ensure agencies and programs are meeting their intended goals and achieving results. Projects on the High Risk List are those requiring special attention from the highest level of agency

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management, but aren't projects necessarily "at risk" of failure. Both lists are publicly available on OMB's website.

As of September 30, 2007, the Management Watch List included 16 Treasury IT investments, of which 10 investments were non-IRS. The High Risk List included 84 Treasury IT investments, of which 51 investments were non-IRS.

Human Capital The Department implemented an automated, integrated Human Resources system called HR Connect, which has been considered in the past as a high-risk project. This Department-wide system is intended to bring about significant changes in Human Resources practices through the year 2007. Appropriated funding to support this initiative is maintained at the Department and managed by the Human Resources System Program Office. In its fiscal year 2007 Capital Asset Plan and Business Case, the HR Connect Program Office reported that over the 15-year life of the program, it expected to incur total project investment and operational costs of about \$493.6 million and receive total benefits of about \$933.8 million. In February 2005, TIGTA reported that, among other things, the underlying analysis provided by the Office did not support past savings claimed. This program, however, has not been recently audited.

Improper Payments Erroneous payments in Federal programs can result from payments to ineligible program beneficiaries, over- or underpayments to beneficiaries, or duplicative payments. The Improper Payments Information Act of 2002 requires agencies to review annually all programs vulnerable to significant erroneous payments. Agencies must also estimate the extent of erroneous payments. Agencies estimating more than \$10 million in erroneous payments are required to send a report to Congress and to develop a plan for reducing those payments. The Administration has made the reduction of improper and erroneous payments a focus of the President's Management Agenda. OMB reported that for fiscal year 2006, the total federal improper payment rate was 2.9 percent and total improper payments equaled \$40.5 billion. These numbers represented a reduction in the total rate and amount of improper payments reported since fiscal year 2004 (from 3.9 percent and \$45.1 billion, respectively). Treasury reported that for fiscal year 2006, no non-IRS programs or activities were a high-risk for significant erroneous payments.

Procurement Total contract obligations by the Department and its bureaus totals approximately \$3.8 billion annually. Contract obligations involving IT procurements by the Department and its bureaus total approximately \$1.7 billion annually. Use of government credit cards for micro-purchases (generally for goods and services under \$3,000) is also extensive, and a strong control environment over this activity is essential to prevent abuse. Approximately 70 percent of Treasury's purchases above the micro-purchases level are through fixed price contracts.

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OIG is the Department's focal point for obtaining pre-award, costs incurred, and other contract audits requested by Departmental Offices and the bureaus. These audits are typically performed by the Defense Contract Audit Agency as coordinated through our office. During fiscal year 2007, approximately \$306 million of pre-award and \$0.1 million of contract close-out costs were audited for the Treasury bureaus. It should be noted that the number of requests by bureau contracting officers for contract audits has declined significantly over the last 2 years.

Non-Appropriated Activities Four Treasury bureaus (BEP, the Mint, OCC, and OTS) do not receive appropriated funds; instead, they operate with revolving funds⁴. BEP and the Mint assess charges for manufactured goods, while OCC and OTS assess fees for regulatory activities. These four bureaus generally have greater latitude than Treasury's appropriated bureaus in how they conduct their operations.

Treasury Franchise Fund First piloted pursuant to GMRA, the Treasury Franchise Fund was permanently established by the Transportation, Treasury, Independent Agencies, and General Government Appropriations Act, 2005 (P.L. 108-447). The Fund is a revolving fund that is used to supply financial and administrative services on a fee-for-service basis. Activities include procurement; consolidated/integrated administrative management; financial management administrative support; and financial systems, consulting, and training services. The Fund consists of four entities: FedSource; Administrative Resource Center, a component of BPD; Federal Consulting Group; and Treasury Agency Services. The Administrative Resource Center was recognized as a Center of Excellence in the Financial Management Line of Business in 2005, making it eligible to enter into competitions to provide cross-agency financial management services on a government-wide basis. For fiscal year 2008, service activities are expected to have new budget authority of \$797 million and employ 909 people. It should also be noted that effective April 2007, responsibility for program direction and oversight of FedSource was transferred from the Treasury Deputy Chief Financial Officer to BPD. BPD is in the process of transitioning out of the FedSource business by September 30, 2008. According to BPD, FedSource was instructed to suspend the issuance of new task orders effective October 1, 2007.

Potential Integrity Risks Departmental Offices has overall policy, oversight and management responsibilities for the Treasury Department. Potential integrity risks are posed by both external personnel – contractors/consultants, terrorists and hackers; as well as internal personnel – employees, who can be disgruntled, unethical, or untrained. Such personnel can pose potential integrity risks by: (1) disrupting Treasury functions, (2) violating laws, (3) awarding contracts for less than best value, (4) receiving bribes or

⁴ A revolving fund is a fund or account whose income remains available to finance its continuing operations without any fiscal year limitation.

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kick-backs, (5) stealing or revealing sensitive data, and (6) receiving Federal Workers' Compensation Program benefits under false pretenses in violation of the Federal Employees' Compensation Act, and (7) otherwise conduct activities in a manner that wastes taxpayer's money.

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

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

In Progress and Planned Fiscal Year 2008 Projects

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

Background During fiscal year 2006, the Department of Defense (DoD) procured property and services through the Treasury Franchise Fund totaling approximately \$166 million. In coordination with DoD OIG, we are auditing Treasury's procurements on behalf of DoD. This coordinated audit is required by Section 811 of the National Defense Authorization Act for Fiscal Year 2006.⁵ During fiscal year 2006, pursuant to the Act, DoD OIG and our office determined that the Treasury Franchise Fund was not compliant with DoD procurement requirements, but had a program in place to improve compliance. Our respective determination was based on tests of fiscal year 2005 procurement activity. With this determination, the Act requires DoD OIG and our office to perform a second review of the Treasury Franchise Fund to assess compliance with DoD procurement requirements during fiscal year 2006. In this regard, we and DoD OIG informed the Senate and House Committees on Armed Services by the required date of June 15, 2007, that FedSource made notable progress to address weaknesses found in prior audits; however,

⁵ P.L. 109-163.

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we found some continuing weaknesses, as well as other problems that need attention. Additionally, we informed the Committees that Treasury plans to transition out of the FedSource business by the end of fiscal year 2008.

Audit Objective To determine whether Treasury's procurement policies, procedures, and internal controls applicable to the procurement of products and services on behalf of DoD, and the manner in which they are administered, are adequate to ensure Treasury's compliance with laws and regulations that apply to procurements of property and services made directly by DoD. We anticipate that this project will require 100 hours to complete in fiscal year 2008.

Corrective Action Verification (On-going)

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

Audit Objective To determine whether management has taken corrective action that is responsive to the intent of selected recommendations from prior OIG audit reports. In selecting recommendations for verification, we will also consider open recommendations that are over 1-year to assess the progress made towards implementing planned actions. We plan to complete 4 corrective action verifications during fiscal year 2008. We anticipate that each verification will require 100 hours.

Contract Audit Oversight Activities (On-Going)

Audit Objective To oversee and coordinate Defense Contract Audit Agency contract audit services requested by procurement officers. We anticipate that 200 hours will be required for this activity during fiscal year 2008.

Projects Under Consideration for Future OIG Annual Plans

BPD Administrative Resource Center User Fees Collection and Reimbursable Agreements

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

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ARC, and (5) ARC is accounting for the full cost incurred for providing its services. We anticipate that this project will require 2,400 hours.

Resolution of Accountable Officer Irregularities

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

Audit Objective To determine whether irregularities in the accounts of Treasury accountable officers are resolved in accordance with Treasury Directive 32-04. We anticipate that this project will require 800 hours.

Employee Bonus Policies at Non-Appropriated Bureaus

Audit Objective To determine whether (1) policies for employee bonuses at non-appropriated bureaus are in accordance with the law and (2) bonuses paid conform to established policies. Separate audits are planned at each non-appropriated bureau, beginning with a pilot audit at the Mint. We anticipate that each project will require 2,000 hours.

HR Connect Processing Controls

Audit Objective To determine if appropriate controls were implemented over the processing of personnel actions and access to employee information. We anticipate that this project will require 2,000 hours.

Purchase Card Review Initiative

Background This joint Office of Investigations and Office of Audit proactive review will assess the Department's internal control procedures for the purchase card program and identify potentially inappropriate, abusive, unauthorized, and fraudulent transactions for further review.

Investigative/Audit Objective To (1) identify weaknesses in internal controls over purchase cards that could lead to fraud, waste, and abuse; (2) detect transactions that were

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prohibited or inadequately controlled; and (3) identify questionable and abusive transactions.

Government Performance and Results Act Performance Measures

Background The Government Performance and Results Act of 1993 requires federal agencies to annually report their success in achieving their performance goals. The Act mandates that the agency compare their actual results with the goals that were established and report why the goals were not met and the plans necessary to meet the goals. Key performance measures must be included in the agency's Management Discussion and Analysis section of their financial statements in accordance with generally accepted accounting principles and OMB financial reporting requirements.

Audit Objective To determine if the performance measures in the Department's and non-IRS bureaus' Performance and Accountability Reports are meaningful and the reported performance data is reliable and complete. We anticipate that this project will require 2,000 hours.

Treasury's Responsiveness to Freedom of Information Act Requests

Audit Objective To determine if the Department and non-IRS bureaus (1) have adequate systems to record, track, and complete FOIA requests in a timely manner; (2) provide points of contact and monitoring systems to ensure that inquiries regarding existing FOIA requests have been properly addressed with the requesters; and (3) are compliant with the 1996 electronic FOIA amendments to the FOIA. As part of this project, we plan to follow up on issues with Treasury identified in a March 2007 GAO report *Freedom of Information Act: Processing Trends Show Importance of Improvement Plans* (GAO-07-441). We anticipate that this project will require 1,600 hours.

Analysis of Procurement Methods Used Within the Department

Audit Objective To determine whether Treasury offices and bureaus could benefit from employing a strategic approach to procurement. As part of this project, we plan to use "spend analysis" to identify opportunities for taking an enterprise-wide approach to buying goods and services. We anticipate that this project will require 2,000 hours.

Bureau Controls Over Government-Issued Travel Cards

Audit Objective To determine whether bureau controls over the use of travel cards are adequate. Separate audits are planned for selected bureaus. We anticipate that each project will require 1,200 hours at each bureau.

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Treasury Audit Follow-up System

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

Treasury Information Technology Project Planning and Execution

Audit Objective To assess the Department’s implementation of the IT project planning and execution requirements prescribed in OMB Memorandum M-05-23, *Improving Information Technology Project Planning and Execution*. More specifically, we plan to assess the use of the Earned Value Management System and operational analyses where appropriate and the process used by the Department to identify and, as appropriate, monitor high-risk projects. We anticipate that this project will require 2,400 hours.

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Terrorist Financing, Money Laundering, and Foreign Assets Control

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Office of Investigations Contact: Gerald R. Garren, Special Agent in Charge, Investigations (202) 927-5829

Issue Area Discussion

TFI marshals the Department's intelligence and enforcement functions with the twin aims of safeguarding the financial system against illicit use and combating rogue nations, terrorist facilitators, weapons of mass destruction proliferators, money launderers, drug kingpins, and other national security threats. TFI provides policy, strategic, and operational direction to the Department on issues which threaten the integrity of the financial system and the nation. TFI, headed by the Under Secretary for Terrorism and Financial Intelligence, is comprised of the following organizations:

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

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

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

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- Bank Secrecy Act The BSA, enacted to help deter, detect, and investigate money laundering, requires financial institutions to file Currency Transaction Reports for transactions exceeding \$10,000 and Suspicious Activity Reports (SAR) for transactions that are of a suspicious nature. These reports are provided to FinCEN but the report data are managed by the IRS's Enterprise Computing Center – Detroit.
- Annunzio-Wylie Anti-Money Laundering Act (1992) This Act increased penalties for depository institutions that violate federal anti-money laundering laws.
- Money Laundering Suppression Act (1994) This Act mandated certain exemptions to filing Currency Transaction Reports in an effort to reduce the number being reported, directed the Treasury Secretary to designate a single agency to receive SAR filings, required the registration of money service businesses (MSB), and clarified the applicability of the BSA to state-chartered and tribal gaming establishments.
- Money Laundering and Financial Crimes Strategy Act (1998) This Act directed the Treasury Secretary to develop a national strategy for combating money laundering.
- Title III of the USA PATRIOT Act (2001) The USA PATRIOT Act clarified that terrorist financing would be prosecutable under existing money laundering laws. The Act (1) requires that each financial institution establish an anti-money laundering program, (2) extends the SARs filing requirement to broker-dealers, (3) requires financial institutions to establish procedures to verify the identities and addresses of customers seeking to open accounts, and (4) requires FinCEN to maintain a highly secure network that allows financial institutions to file BSA reports electronically. (This network was established and is now known as BSA Direct E-Filing.)

For fiscal year 2006, Treasury reported that it spent \$420 million with a workforce of 2,099 employees to fight the financial war on terror. These figures do not include the costs incurred by the OCC, OTS, and IRS to ensure compliance with BSA and related laws, or by financial regulators, law enforcement, or other organizations outside of Treasury, who participate in this effort.

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

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Commission and the Commodities Futures Trading Commission to enhance BSA compliance oversight in the non-bank financial sectors.

In June 2005, FinCEN and the Federal Financial Institutions Examination Council, composed of the five federal banking agencies, issued the *Bank Secrecy Act/Anti-Money Laundering Manual* for uniformly conducting BSA examinations. The publication of this guidance was designed to further ensure consistency and identify additional clarity for conducting these examinations. In addition, the Manual includes examination procedures for OFAC programs. The Manual was updated in 2006 and 2007.

In July 2007, the financial institution regulators issued further clarifying guidance by spelling out in an interagency announcement, which compliance deficiencies would automatically trigger cease-and-desist orders. First, a cease-and-desist is likely to be issued to a financial institution which did not fix previously identified problems in its BSA program. Second, a cease-and-desist order will also be issued when an institution does not establish, implement, and maintain a reasonably designed BSA compliance program. This guidance from the regulators appears to be designed to eliminate uncertainty about their expectations and the consequences should those expectations not be met. Smaller, technical violations need to be corrected, but are not a cause for a cease-and-desist order.

OFAC's authority to impose controls on transactions and to freeze foreign assets is derived from the President's constitutional and statutory wartime, and national emergency powers. In performing its mission, OFAC relies principally on delegations of authority made pursuant to the President's broad powers under the Trading with the Enemy Act, International Emergency Economic Powers Act, and the United Nations Participation Act to prohibit or regulate commercial or financial transactions involving specific foreign countries, entities, or individuals. In administering and enforcing economic sanctions programs, OFAC maintains a close working relationship with other federal agencies to ensure that these programs are implemented properly and enforced effectively. OFAC works directly with the Department of State; the Department of Commerce; the Department of Justice, the Federal Bureau of Investigation, the Department of Homeland Security's U.S. Customs and Border Protection and U.S. Immigration and Customs Enforcement; bank regulatory agencies; and other law enforcement agencies. OFAC currently administers 32 economic sanctions programs against foreign governments, entities, and individuals. Although 8 of these programs were terminated, they still require residual administrative and enforcement activities.

Similar to FinCEN, OFAC relies on other regulators to examine and enforce compliance by covered financial institutions with OFAC requirements. In April 2006, OFAC executed a MOU with the five federal banking agencies to share information and improve coordination. The *Bank Secrecy Act/Anti-Money Laundering Manual* contains examination procedures for OFAC requirements.

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

One aspect of the task force’s work is assessing a country’s compliance with the international anti-money laundering and combating terrorist financing standards as contained in the “40 + 9 Recommendations.” In June 2006, the task force issued a report that evaluates the anti-money laundering and combating terrorist financing regime of the U.S. The report discusses U.S. money laundering and terrorist financing vulnerabilities, strategies, and preventive measures. The report also describes the U.S. financial, law enforcement, legal, and regulatory sectors, and includes recommendations to strengthen U.S. anti-money laundering and combating terrorist financing efforts. With respect to the “40 + 9 Recommendations,” the assessment found that the U.S. was Compliant for 15 Recommendations, Largely Compliant for 28 Recommendations; Partially Compliant for 2 Recommendations, and Non-Compliant for 4 Recommendations.

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

A Treasury program that was the subject of Congressional interest and media attention during fiscal year 2006 is the Terrorist Finance Tracking Program. The program was

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

Potential Weaknesses OIG audits in prior years have found problems in either the detection of BSA violations or timely enforcement of BSA. This has continued through the most recent year. FinCEN is dependent on many federal and other regulators to examine institutions for compliance with program requirements. The Department has continued to take steps to strengthen BSA administration and compliance as well as compliance with OFAC requirements. However, the nature of this Treasury mission area is inherently one of the high-risk areas of the Department.

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

Cross-Border Wire Transfers Section 6302 of the Intelligence Reform and Terrorism Prevention Act of 2004 (P.L. 108-458) directs the Secretary of the Treasury to determine whether reporting requirements should be imposed on financial institutions of certain cross-border wire transfers. In January 2007, Treasury reported that the system is feasible, but a number of issues need to be worked out first before implementing a requirement. One significant matter is the need for FinCEN to develop and implement a financial institution cross-border wire transfer reporting system. Funds were not available in fiscal year 2007, though Treasury's fiscal year 2008 budget request includes \$2.5 million for this effort. Based on FinCEN's recent track record with BSA Direct Retrieval and Sharing Component, a flawed system development effort terminated in 2006, there is some measure of concern about FinCEN's ability to develop a system.

MSBs MSBs encountered increased difficulty in establishing and maintaining banking services. Many banks are reluctant to deal with the perceived risk of having MSBs as customers and have been terminating accounts or refusing new accounts. This action has reduced banking services for many, particularly those without access to formal banks. Restricting MSB access to banks can drive these transactions underground and

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reduce transparency, thereby harming U.S. efforts to prevent money laundering and combat terrorist financing.

Our planned work for fiscal year 2008 does not include any specific audit projects related to cross-border wire transfers and MSB access to banking services, though we do have those audits under consideration for future year plans. We will continue to monitor both these areas in our planning of future work.

Potential Integrity Risks The success of Treasury efforts to support law enforcement in the fight against terrorist financing, money laundering, and other financial crime is dependent on honest and complete reporting of currency transactions and suspicious financial activity. In addition to the potential weaknesses we have listed above, we believe there are several potential integrity risks associated with BSA. Specifically, the integrity risks associated with this area include (1) the failure by financial institutions to file required BSA reports; (2) filing a false or fraudulent BSA report; (3) internal and external misuse or disclosure of sensitive BSA information contrary to law; (4) inappropriate handling or use of sensitive but unclassified, law enforcement sensitive, or classified information; and (5) criminal violations of foreign sanctions program.

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

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

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The Treasury Forfeiture Fund equitable sharing program allows for any federal, state, or local law enforcement agency that directly participates in an investigation or prosecution that results in a federal forfeiture to request an equitable share of the net proceeds of the forfeiture. There are restrictions on how recipient agencies may use these funds. Recipient agencies must also provide an annual accounting of equitable sharing receipts and expenditures to TEOAF. Prior OIG audits have found instances of misuse of these funds by certain recipient agencies. It should be noted, however, that we have not performed any audits in this area since fiscal year 1996.

In Progress and Planned Fiscal Year 2008 Projects

Treasury Foreign Intelligence Network Redesign and Modernization Project (In Progress)

Background The modernization of the Treasury Foreign Intelligence Network, a system critical to the support of Treasury's national security mission, is Treasury's highest systems development priority. The data from the system is utilized by the Secretary of the Treasury, the Deputy Secretary of the Treasury, the Under Secretary for Treasury Foreign Intelligence, the Under Secretary for International Affairs, the Office of Intelligence and Analysis, OFAC, FinCEN and other components. Treasury received appropriated funds of approximately \$36 million for the project through fiscal year 2007. The development phase of the project was scheduled to be completed by the end of fiscal year 2007.

Audit Objective The objectives of this audit are to determine whether (1) the project business case for the Treasury Foreign Intelligence Network redesign and modernization is based on appropriate and supportable assumptions and cost/benefit estimates, (2) procurement requirements were followed in the acquisition of contract support, and (3) sound project management principles are being followed in carrying out the project. We anticipate that this project will require 500 hours to complete in fiscal year 2008.

Treasury's Administration of BSA (In Progress)

Audit Objective To identify and describe Treasury's authority and responsibility for the administration of BSA and enhanced provisions of the USA PATRIOT Act and answer the following questions: (1) Which major domestic organizations are involved in the enforcement and compliance of BSA and what authority does Treasury have over the BSA-related efforts of these organizations? (2) How does Treasury direct and coordinate BSA enforcement and compliance? (3) Are government-wide BSA costs and performance data available to link resources to results? We anticipate that this project will require 200 hours to complete in fiscal year 2008.

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OTS BSA Compliance Examinations (In Progress)

Audit Objective To assess the adequacy of OTS's examination program for thrift compliance with the BSA and USA PATRIOT Act. We anticipated that this project will require 400 hours to complete in fiscal year 2008.

FinCEN BSA Direct System (In Progress)

Audit Objective To assess FinCEN's efforts in planning, awarding, monitoring, resolving disparities, and reporting performance, for the retrieval and sharing component of the BSA Direct contract. We anticipate that this project will require 500 hours to complete in fiscal year 2008.

FinCEN Monitoring of Suspicious Activity Report Data Quality (In Progress)

Background Our office performed three prior audits in which we raised concerns over longstanding SAR data quality and that these data problems could adversely affect FinCEN's ability to meet its core mission relative to BSA and attendant terrorist financing and money laundering programs. Our last audit of this area, completed in March 2005, found that FinCEN had not established data quality standards from which SARs could be routinely monitored for data quality purposes. We also found that most previously reported control weaknesses and conditions remained outstanding. During this audit, we sampled over 400 SARs filed by depository institutions and MSBs, finding that 62 percent of them contained one or more data quality problems (i.e., missing, incomplete, inappropriate, and/or inconsistent information) in a data field critical to law enforcement agencies). Data quality problems were found with 68 percent of the sampled SARs filed by MSBs. (*FinCEN: Heightened Management Attention Needed Over Longstanding SAR Data Quality Problems*; OIG-05-033). FinCEN has reported that our recommendations in this report are implemented.

Audit Objective To assess the effectiveness of FinCEN's corrective actions to the recommendations in our March 2005 report and evaluate the current processes for accumulating and distributing SAR data to ensure data integrity. We anticipate that this project will require 2,000 hours to complete in fiscal year 2008.

Classified Project (In Progress)

Audit Objective We are participating in a joint review with other Intelligence Community OIGs of a classified program pursuant a request by the Senate Committee on Intelligence. We anticipate that this project will require 600 hours to complete during fiscal year 2008.

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Multi-agency Review of the Consolidated Terrorist Watch List Nomination Process (In Progress)

Audit Objective We are participating with other Intelligence Community OIGs in a multi-agency review to ascertain, both within agencies and across the Intelligence Community, whether: (1) processes and standards for nominating individuals to the consolidated watch list are consistent, articulated in policy or other guidance, and understood by nominators; (2) quality control processes are in place; (3) responsibility for nominations is clear, effective, and understood; (4) nominators receive adequate training, guidance, or information on the nominations process; (5) agencies maintain records of their nominations; and (6) organizations with terrorism, counterterrorism, and domestic counterterrorism information appropriately participate in the nomination process. We anticipate that our review of Treasury as it relates to this project will require 100 hours to complete in fiscal year 2008.

OFAC Policies and Procedures

Audit Objective To determine if OFAC has adequately documented their current policies, procedures, and practices. We anticipate this project will require 800 hours.

FinCEN Suspicious Activity Report Data Quality for Money Services Businesses

Audit Objective To determine the types of MSB SAR quality problems, the causes for the problems, and FinCEN's efforts to address these problems. We anticipate that this project will require 1,600 hours.

FinCEN Memoranda of Understanding with Financial Institution Regulators

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

OCC Wells Fargo Bank Enforcement (Follow-Up)

Background In August 2006, our office completed an audit of the enforcement action taken by OCC to address longstanding and recurring BSA compliance problems with Wells Fargo Bank, the nation's fifth largest bank. OCC addressed these program failures by issuing Wells a non-public, informal action which required Wells to develop and implement

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a correction plan. We took issue with the use of an informal action but, with the correction plan already being developed by the bank, recommended that OCC closely monitor it. Wells was supposed to complete corrections by December 2006. We also reported that OCC did not follow its usual practice of allowing its Washington Supervision Review Committee to review the proposed enforcement action to identify possible policy and other concerns. Further, OCC also did not adequately communicate with FinCEN about Well's BSA violations. We included several recommendations to OCC to address these matters.

Audit Objective To assess OCC's implementation of corrective actions to the recommendations in our August 2006 report. We anticipate that the project will require a total of 800 hours.

Security Clearances of Individuals Handling Sensitive Bank Secrecy Act Reports

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

OFAC Follow-up on Cases Referred for Further Inquiry

Background OFAC coordinates with financial institution regulators to ensure financial institutions have adequate controls in place to comply with OFAC sanctions programs. OFAC also uses other, independent methods to measure compliance.

Audit Objective To determine is OFAC is performing adequate follow-up when independent review data raises questions about the adequacy of financial institution compliance with OFAC sanctions programs. We anticipate that this project will require 1,200 hours.

Mutilated Currency Redemption Initiative

Background This proactive Office of Investigations and Office of Audit initiative will review BEP policies and procedures and related authorities that provided for the redemption of mutilated currency through official Treasury warrants. The assessment will focus on potential vulnerabilities which may be exploited by criminal and terrorist organizations to further their illicit activities through these programs.

Investigative/Audit Objective To identify and assess potential vulnerabilities posed by the currency redemption programs of BEP. We anticipate that this project will require 1,600 hours.

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Projects Under Consideration for Future OIG Annual Plans

FinCEN Civil Penalties for BSA Program Violations

Audit Objective To determine (1) whether FinCEN is assessing civil penalties for BSA violations when appropriate, (2) how the penalties are coordinated with the regulatory agencies, and (3) how the amounts of the penalties are established. We anticipate that this project will require 2,000 hours.

Electronic Banking and BSA Compliance

Background Online banking has been around for years. It is offered as a service by a large number of financial institutions. Most of this online activity involves traditional financial institutions that have typical walk-in banking, but also offer customers the ability to conduct business online. These traditional banks require customers to open accounts in person and prove their identity using a government-issued identification card, such as a driver's license. However, the banking industry has been evolving to the point that certain financial institutions conduct all of their business online. This includes allowing account holders to open accounts without ever setting foot in a "storefront" location.

Audit Objective To determine how FinCEN, OCC, and OTS ensure adequate customer identification and customer due diligence controls are in place for financial institutions that extensively or exclusively conduct business online. We anticipate that this project will require 2,400 hours.

Securities Industry Reporting of Suspicious Transactions

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

OCC BSA Examination of Private Banking (Follow-Up)

Background In November 2001, our office issued an audit report on OCC examination of private banking for BSA compliance. The audit found that OCC did not cover BSA compliance for 17 percent of bank trust departments and in 60 percent of those banks offering private banking services. We recommended that OCC take a number of actions to improve its trust and private banking BSA examination coverage. Private banking continues to be an area of concern. For example, a 2005 Senate Permanent

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Subcommittee of Investigation report on the former Riggs Bank identified extensive problems in Riggs' oversight of its private banking customers.

Audit Objective To determine whether OCC's BSA compliance examination coverage of national bank trust and private banking services is adequate. As part of this audit, we plan to follow up on the corrective actions taken in response to our report *Bank Secrecy Act: OCC Examination Coverage of Trust and Private Banking Services* (OIG-02-016). We anticipate that this project will require 2,000 hours.

Treasury Secure Data Network

Audit Objective To determine whether (1) the project business case for the upgrade and enhancement of the Treasury Secure Data Network is based on appropriate assumptions and cost/benefit estimates, and (2) sound project management principles are followed in carrying out the project. We anticipate that this project will require 1,200 hours.

OFAC and FinCEN Enterprise Content Management System

Background Treasury has requested fiscal year 2008 funding of \$6 million to enable a pilot enterprise-wide Enterprise Content Management solution for the Department, initially meeting the business requirements of OFAC and FinCEN. The enterprise-wide approach, to be performed under the oversight of the Treasury Chief Information Officer, is expected to ensure that all Department-wide Enterprise Content Management efforts map to consistent standards, are aligned with related government-wide initiatives, such as the Case Management Line of Business, and leverage commonalities in requirements among Treasury components, thereby achieving economies of scale and efficiencies in information sharing.

Audit Objective To determine whether (1) the pilot Enterprise Content Management project business case is based on appropriate and supportable assumptions and cost/benefit estimates, (2) sound project management principles are followed in carrying out the project, and (3) efforts are coordinated with the Department's planning for document management systems Treasury-wide. We anticipate that this project will require 1,600 hours.

FinCEN Cross-Border Wire Transfer System

Background The Intelligence Reform Act of 2004 required FinCEN to complete a study assessing the feasibility and impact of implementing financial institution cross-border wire transfer reporting requirements. Treasury delivered this study in January 2007, which found the reporting requirement feasible and potentially valuable. The requirement has not

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yet been implemented, in part because it would require FinCEN to develop a system. FinCEN was recently unsuccessful in developing another BSA-related system, BSA Direct Retrieval and Sharing, and questions have been raised about FinCEN's ability to develop a cross-border wire transfer system.

Audit Objective To determine the data and methodology FinCEN used to make its assessment, and the status of the system's development. We anticipate that this project will require 2,000 hours.

Insurance Companies Reporting of Suspicious Transactions

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

OCC BSA and USA PATRIOT Act Compliance Examinations and Enforcement Actions

Audit Objective To determine the effectiveness of OCC's programs to conduct supervisory activities and, when necessary, take enforcement actions to ensure that national banks have controls in place and provide the requisite notices to law enforcement to deter and detect money laundering, terrorist financing, and other related criminal acts. The last time we comprehensively reviewed OCC's BSA compliance examination program was in fiscal year 2000. We anticipate that this project will require 3,000 hours.

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

Audit Objective To determine if FinCEN has implemented an effective system to provide for the sharing of information between law enforcement authorities and financial institutions, and among financial institutions themselves, in accordance with Section 314 of the USA PATRIOT Act. We anticipate that this project will require 1,600 hours.

Anti-Money Laundering Regulations for the Real Estate Industry

Background Section 352 of the USA PATRIOT Act includes entities involved in real estate closings and settlements in the definition of financial institutions, and requires these entities to comply with anti-money laundering requirements unless Treasury specifically exempts them. In 2003, FinCEN issued an advance notice of proposed rulemaking and asked the real estate industry for help in assessing risks and defining who is involved in transactions. FinCEN has yet to issue regulations.

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Audit Objective To determine and assess the progress of FinCEN effort's to issue anti-money laundering regulations for the real estate industry. We anticipate that this project will require 1,600 hours.

Efforts to Provide Banking Services to Money Service Businesses

Background In April 2005 testimony before a Senate committee, OCC expressed concerns about the money laundering risks associated with MSBs. FinCEN also testified and clarified the minimum steps banking organizations should take when providing banking services to MSBs. One of the end results from that testimony was that banks dropped MSBs as customers. FinCEN, Treasury, and financial regulators have since taken steps to convince banks that MSBs should not be automatically dropped as customers, and should be provided banking services.

Audit Objective To assess the efforts by Treasury to ensure that MSBs have appropriate access to banking services. We anticipate that this project will require 2,000 hours.

OTS BSA Enforcement

Background Our office performed an audit in 2003 that identified weaknesses in the OTS BSA enforcement program. OTS issued formal sanctions against only 11 of 180 thrifts (taken from a sample of 351 thrifts) who were found to have substantive BSA compliance problems. OTS consistently relied on moral suasion and thrift management assurances that BSA violations would be addressed. OTS concurred with our recommendations to improve the enforcement program.

Audit Objective To determine whether OTS is taking timely and sufficient enforcement action against thrifts with substantive BSA violations. As part of this audit, we plan to follow up on the corrective actions taken in response to our report *OTS: Enforcement Actions Taken for Bank Secrecy Act Violations* (OIG-03-095). We anticipate that this project will require 2,000 hours.

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

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

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

Compliance by Money Services Business Industry with Sanction Programs

Background According to OFAC, authority to examine MSBs for compliance with OFAC requirements has been delegated to the IRS. OFAC and IRS are also developing a MOU related to this activity.

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

Intelligence Support Provided by the Office of Intelligence and Analysis

Background The Intelligence Authorization Act for Fiscal Year 2004 codified the Office of Intelligence and Analysis and assigned to that office responsibility for the receipt, analysis, collation, and dissemination of foreign intelligence and foreign counterintelligence information related to the operations and responsibilities of Treasury.

Audit Objective To assess progress by the Office of Intelligence and Analysis progress in meeting its responsibilities under the Intelligence Authorization Act. We anticipate that this project will require 2,400 hours.

FinCEN Access and Monitoring Controls Over BSA Data

Background FinCEN shares BSA data, which is sensitive financial information, with a variety of law enforcement customers. One means of accessing the data is through the Gateway program, which allows users to access the IRS Currency and Banking Retrieval System, using a secure web application known as Secure Outreach. Over 4,600 users accessed the database in 2006 and FinCEN expects this number to climb to 10,000 by 2009. FinCEN needs to ensure the data is protected and not inappropriately accessed through browsing or other means.

Audit Objective To determine if FinCEN is properly controlling and monitoring external access to BSA data. We anticipate that this project will require 1,200 hours.

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FinCEN Compliance Inspections for Users of BSA Data

Background FinCEN's policy is to inspect users of BSA data every 3 years to ensure that security controls are adequate and the data is protected. Our office performed an audit in 2006 of FinCEN data analysis and identified that FinCEN had not performed all of its required inspections. Several agencies had not been inspected in years.

Audit Objective To determine if FinCEN is monitoring users of BSA data, through inspections or other means, to ensure the data is appropriately accessed and protected. As part of this audit, we will follow up on the corrective actions taken in response to our report *Terrorist Financing/Money Laundering: FinCEN Has Taken Steps to Better Analyze Bank Secrecy Act Data But Challenges Remain* (OIG-06-030). We anticipate that this project will require 1,200 hours.

Controls Over Intelligence Sharing

Background During fiscal year 2004, we completed an evaluation, requested by the Treasury General Counsel, which found certain issues in the process by which certain Treasury bureaus and offices obtained sensitive and classified intelligence information.⁶

Audit Objective To assess, since the creation of Office of Intelligence and Analysis, intelligence sharing within Treasury. We anticipate that this project will require 1,200 hours.

OFAC Memoranda of Understanding With Financial Institution Regulators

Audit Objective To determine whether (1) OFAC is receiving timely, complete, and reliable information under the April 2006 MOU with the federal banking regulators; and (2) the purpose of the MOU—to help OFAC in fulfilling its role as administrator and enforcer of economic sanctions and to assist the regulators in fulfilling their roles as banking organization supervisors—is being achieved. To address these objectives, we plan to conduct audit work at OFAC, OCC, and OTS. We anticipate that the projects will require a total of 2,400 hours.

Timely Filing of BSA Reports

Audit Objective To determine if effective controls are in place to (1) monitor the timeliness of the filing of BSA reports by covered institutions, and (2) ensure enforcement action is taken when warranted. We anticipate that this project will require 1,600 hours.

⁶ Our evaluation report on these matters, OIG-CA-04-003, is classified.

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

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

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

Financial Industry Use of Interdiction Software to Comply With OFAC Sanctions

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

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

Intelligence Oversight Board Reporting

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

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Executive Order or any other Presidential Directive. The Board, in turn, reports any such activities to the President.

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

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

TEOAF Use of Treasury Forfeiture Fund Receipts to Support Law Enforcement

Audit Objective To determine whether TEOAF has appropriate controls to: (1) distribute funds to eligible law enforcement agencies in accordance with applicable laws, regulations, and policies; and (2) ensure the distributed receipts are used for intended purposes. As part of this work, we plan to determine whether selected state and local government agencies use equitable sharing funds in accordance with Treasury guidelines. We anticipate that each agency review will require 1,200 hours. It should be noted that the last time we audited the use of equitable sharing funds by local government agencies was in fiscal year 1996. That year, we conducted a series of audits that found significant instances of misuse or poor accountability over these funds.

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Government-wide Financial Services and Debt Management

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Issue Area Discussion

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

Disbursement and Collections FMS's goal is to provide reliable and accurate processing of federal payments which is an essential part of supporting the U.S. economy. These payments total approximately \$1.5 trillion annually. Accurate, on-time payments are of considerable financial importance to American citizens, whether recipients of Social Security or Veterans' benefits, income tax refunds, or other federal payments. During fiscal year 2007, FMS issued more than 979 million payments via paper check and electronically transferred funds to more than 100 million individuals.

In fiscal year, 2007, FMS also collected approximately \$3.11 trillion annually in payments to the government through 9,000 financial institutions. Nearly \$2.46 trillion of this amount is collected electronically.

Since enactment of the Debt Collection Improvement Act of 1996, FMS has collected about \$31.5 billion in delinquent debt. Prompt referral of eligible delinquent debts to Treasury by federal program agencies is critical to the success of collection efforts. At the close of fiscal year 2007, FMS reported that 100 percent (\$37.6 billion) of the eligible federal non-tax debts had been referred for collection by payment offset. For the same time period, FMS reported that 100 percent (\$9.3 billion) of the eligible debts had been referred to the Cross-Servicing Program for collection. Total collections were about \$3.76 billion for fiscal year 2007.

Public Debt The goal of Treasury debt management is to achieve the lowest borrowing costs over time, and Treasury debt managers commit to regular and predictable debt issuance in pursuing this goal. Treasury debt management decisions are made through deliberate and distinct processes, taking into account new information as it may become available.

The federal debt has two major components: Debt Held by the Public and Intragovernmental Holdings. Debt Held by the Public is the federal debt held by individuals, corporations, state or local governments, foreign governments, and other entities outside of the U.S. government. Types of securities held by the public include Treasury Bills, Treasury Notes, Treasury Bonds, Treasury Inflation-Protected Securities, U.S. Savings Bonds, State and Local Government Series, Foreign Series, and Domestic Series. Intragovernmental Holdings are primarily Government Account Series securities held by

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federal government trust funds, revolving funds, and special funds. As of September 30, 2007, the total federal debt outstanding was \$8.97 trillion, of which \$5.05 trillion was Debt Held by the Public, and \$3.92 trillion was Intragovernmental Holdings. The interest expense on the federal debt during fiscal years 2007 and 2006 was \$432 billion and \$403 billion, respectively.

Like FMS, BPD's operations demand modernized electronic and information system technology. BPD implemented the TreasuryDirect system in 2002. Currently, TreasuryDirect holds more than 600,000 accounts.

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

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

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

In an effort to proactively minimize potential integrity risks, OIG is exploring the use of data mining methods⁷ to analyze FMS payments to reveal hidden patterns relating to trends, relationships, and correlations between the data. Based upon the collection of this sensitive data, trends and patterns can potentially identify ongoing fraud and abuse directed against or occurring within the operations of the FMS.

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

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During 2006, the Office of Investigations initiated, with OIGs of five other agencies, a project to proactively identify potentially fraudulent benefit payments warranting further investigation. The other agencies we are working with on this initiative are the Department of Veterans Affairs, the Social Security Administration, the Railroad Retirement Board, the Office of Personnel Management, and the Defense Criminal Investigative Service. This Treasury OIG initiative directly supports the President's Management Agenda to reduce improper payments government-wide. Chief among our roles is to help federal agencies detect, investigate, and prevent criminal activity related to improper benefit payments, thus helping to ensure that taxpayer dollars are spent wisely and efficiently. Since its inception, this joint effort has resulted in the identification of 88 potential violators who may have unlawfully obtained approximately \$5.9 million in federal benefits. The effort has also resulted in the arrest of 20 individuals, the conviction of 14, restitutions of \$530,950, and the recovery of \$85,404.

In Progress and Planned Fiscal Year 2008 Projects

Survey of FMS Programs to Collect Delinquent Non-Tax Debt (In Progress)

Background The Debt Collection Improvement Act of 1996 and other statutes provide the tools for administering the collection of delinquent non-tax and tax debts. FMS is charged with implementing the government's delinquent debt collection program. The Debt Collection Improvement Act also requires agencies to take prompt action to recover debts, aggressively monitor all accounts, properly screen potential borrowers in the case of credit programs, resolve the outstanding debt through a variety of options, including referring the debt to the Department of Justice for litigation, and unless exempt by law, transfer all non-tax debts delinquent more than 180 days to Treasury for administrative offset and cross-servicing. The last time we audited FMS's debt collection activities was in fiscal year 2000.

Audit Objective To perform a survey of FMS programs and activities to carry out its responsibilities under the Debt Collection Improvement Act for the purpose of identifying those programs and activities that, based on our assessment of risk, should be audited in more depth. The Treasury Offset Program and cross-servicing collection efforts will be included in the programs that we will survey. We anticipate that the survey will require 400 hours and each separate audit will require 2,000 hours.

FMS Controls Over Disbursement Activities

Background The Improper Payments Information Act of 2002 provides Federal agencies with the definition of "improper payments" made by the Federal government. The

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improper payment definition includes (1) payments that should not have been made; (2) payments made for the incorrect amount; (3) payments to ineligible recipients; (4) payments for ineligible services; (5) duplicate payments; and (6) payments for services not received. A number of these definitions can only be addressed through the evaluation of program eligibility requirements at the cognizant agencies. However, the presence of comprehensive centralized disbursement data at FMS offers the opportunity to identify prospective improper payments from a global standpoint and also assess control measures in place at FMS to limit improper payments.

Audit Objective(s) Given the complexity of FMS as well as the volume of disbursement activity, the following objectives may be addressed in multiple audits. To (1) determine if controls were in place at FMS to detect fraudulent replacement payment requests for both Treasury Check and Electronic Funds Transfer payments and if procedures have been implemented to timely identify proper replacement payments made in a timely manner; (2) utilize FMS data to identify potential duplicate payments made by the same agency to the same vendor, employee, or beneficiary for the same service, entitlement, or payments made by multiple agencies to the same recipient for the same service; (3) analyze FMS payment data for patterns indicating possible abuses by recipients that may have resulted in improper payments made from multiple programs within agencies, as well as across multiple Federal agencies; (4) identify the volume of possible improper benefits paid on behalf of deceased individuals and to assess controls in place at FMS to detect such improper payments; and (5) evaluate if adequate procedures were implemented to reconcile disbursement data between the agencies, FMS Regional Finance Centers, and the main FMS system applications to ensure that only authorized transactions are disbursed and all variances are identified and evaluated. We anticipate that these projects will require 2,000 hours each.

Projects Under Consideration for Future OIG Annual Plans

Survey of Treasury Securities Programs

Background The last time our office conducted performance audit work of BPD's auction process for Treasury securities was during fiscal year 2000.

Audit Objective To perform a survey of the auction process for Treasury securities and related controls for the purpose of identifying areas that, based on our assessment of risk, should be audited in more depth. We anticipate that the survey will require 800 hours.

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Survey of FMS U.S. Debit Card Program

Background U.S. Debit Card is an FMS program jointly managed by JPMorgan Chase to give federal agencies the ability to deliver funds through debit cards, providing an electronic alternative to checks, drafts, and imprest funds. A subset of the program, Direct Express Card, provides a mechanism for the delivery of federal benefits, such as Social Security payments. According to FMS, implementation of the Direct Express program is planned in the spring of 2008. The program will provide an EFT alternative for unbanked social security and supplemental security income recipients and will significantly increase the number of payments issued via debit cards.

Audit Objective To perform a survey of the U.S. Debit Card program and related controls for the purpose of identifying areas that, based on our assessment of risk, should be audited in more depth. We anticipate that the survey will require 800 hours.

FMS Acquisition of Banking Services

Background The Consolidated Appropriations Act, 2004, authorized a permanent, indefinite appropriation for FMS to use to acquire banking services. In the past, these services were paid for through compensating balances maintained with certain financial institutions. A fiscal year 2003 OIG audit, *Government-wide Financial Management Services: Additional Control and Oversight Needed to Reduce Costs and Improve the Plastic Card Network* (OIG-03-088), found that the use of compensating balances was expensive and FMS did not have adequate controls to ensure that the costs of banking services acquired through compensating balances were appropriate.

Audit Objective To determine whether FMS is acquiring banking services in an appropriate and cost effective manner. We anticipate that this project will require 2,000 hours.

FMS Oversight of Lockbox Operations

Background FMS has the authority to designate depositories to provide lockbox services for collections and other transactions with the government. Collections through lockboxes are substantial; in fiscal year 2006, FMS reported total lockbox collections of about \$415 billion, of which \$361 billion was for federal tax payments and \$54 billion was for nontax payments. Several incidences of loss or mishandling of essential documents and thefts at lockbox contractors have been reported. For example, in 2006, TIGTA identified 54 checks totaling \$2.8 million as stolen from a lockbox in Dallas. Another recent case involved missing passport applications from a lockbox in Delaware.

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Audit Objective: To determine whether FMS's oversight of lockbox contractors is effective. We anticipate that this project will require 2,000 hours.

Improper Benefit Payments Initiative

Investigative Objective In support of the President's Management Agenda, our objective is to reduce improper payments government-wide. As resources permit, and on a case by case basis, we will continue this initiative to analyze Treasury payment data to detect, investigate, and prevent criminal activity related to improper benefit payments.

FMS Treasury Check Information System

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

Audit Objective To determine if the Treasury Check Information System is meeting its intended purpose. We anticipate that this audit will require 2,000 hours.

FMS Use of the Internet Payment Platform

Background The Internet Payment Platform is an Internet-based payment information portal for use by Federal agencies and their vendors. According to FMS, as currently planned, the portal will not be used as a vehicle to certify or disburse payments. Information created throughout the procurement-to-pay cycle will be accumulated and made assessable by the portal. The portal is also intended to provide a digital alternative to paper-based purchasing and invoicing processes by making purchase orders and invoices accessible via the internet. By automating current paper-based or fax-based transactions, it is anticipated that the portal will expedite the processing of vendor payments by agencies. It is also anticipated that the portal will allow for more efficient exchange of invoice/payment processing information between Federal agencies and their vendors by providing access to information on purchase orders, invoices, and Treasury-disbursed payments. FMS piloted the portal from January 2003 to June 2004, and the first phase of the system was implemented in November 2007.

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

OIG ISSUE AREAS AND PLANNED PROJECTS

Government-wide Financial Services and Debt Management

FMS Debt Check Program

Background FMS developed Debt Check to allow agencies and outside lenders to determine whether applicants for federal loans, loan insurance, or loan guarantees owe delinquent non-tax debt or delinquent child support to the federal government. Federal agencies are required to deny loans, loan insurance, or loan guarantees to entities that owe delinquent, non-tax debt to the federal government. By Executive Order, this prohibition has been extended to delinquent child-support debtors whose debts have been referred to the Treasury Offset Program for administrative offset.

Audit Objective To determine if FMS implemented the Debt Check program in an effective manner. We anticipate that this project will require 1,600 hours.

FMS's Collection Strategy

Background FMS is in the process of developing and implementing a long-term collection strategy. This strategy would involve the design of a collection mix for each agency that would achieve cost efficiency by using the most cost-effective collection methods for each agency. The approach is aimed at lowering transaction costs for each agency, thereby lowering overall costs to the federal government. FMS planned to conduct a pilot test of the approach with a group of federal agencies in a phased-in manner during calendar year 2007.

Audit Objective To determine whether FMS has taken action to implement the new collection strategy and evaluate its effectiveness. We anticipate that this audit will require 2,000 hours.

OIG ISSUE AREAS AND PLANNED PROJECTS

Safety, Soundness, and Accessibility of Financial Services

Office of Audit Contact: Susan L. Barron, Director of Audit (202) 927-5776

Office of Investigations Contact: Gerald R. Garren, Special Agent in Charge, Investigations (202) 927-5829

Issue Area Discussion

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

OCC is responsible for licensing, regulating, and supervising approximately 1,850 nationally chartered banks, more than 80 uninsured trust companies, and 50 federal branches or agencies of foreign banks. OCC supervised national banks hold over \$6.6 trillion in commercial banking assets. OCC has nearly 3,000 employees located throughout the U.S., and funds its operations (\$579 million in fiscal year 2006) largely through assessments levied on national banks and from various licensing fees.

OTS charters, regulates and supervise the vast majority of the nation's savings associations, commonly referred to as "thrifts." OTS supervises approximately 840 of the nation's thrifts accounting for \$1.5 trillion of total thrift assets. OTS also supervises approximately 470 U.S.-domiciled holding company enterprises with \$8.5 trillion in consolidated assets. OTS has approximately 960 employees located in Washington, D.C., and across four regional offices. OTS's fiscal year 2007 operating budget totals approximately \$232.5 million, which like OCC, is largely funded through assessments.

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

From 2003 to 2006, the banking and thrift industries sustained strong growth marked by record earnings, profits, and capitalization. National bank earnings have remained at historically high levels for a decade. During this period, national banks exceeded earnings milestones and set new records for both return on equity and return on assets.

In 2007, the banking industries' operating environment became less favorable. While the banking industry ended the second quarter of 2007 with record earnings of \$36.7 billion, the fourth-highest quarterly amount ever, that amount was nevertheless 3.4 percent less than the earnings posted in the second quarter of 2006. For the second consecutive quarter, fewer than half of all insured institutions reported higher quarterly earnings than a year earlier. Reflecting an erosion in asset quality, provisions for loan losses increased

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Safety, Soundness, and Accessibility of Financial Services

75 percent from a year earlier. Non-interest expenses were up, as several large banks reported higher payroll expenses. These higher costs were partially offset by increases in net interest income, non-interest income, and gains on sales of securities and other assets.

OCC indicated that while earnings at national banks were at healthy levels, the ratio of provisions for loan losses moved up in the first half of 2007, reversing the previous trend, as the mortgage market faltered. OCC expected the credit markets' liquidity squeeze experienced in the summer of 2007 to add to the challenges of sustaining earnings growth. OTS reported for the second quarter of 2007 solid earnings and profitability, solid loan growth, and strong capital. Although problem asset levels have risen, reflecting the slowing housing sector and other economic conditions, they remain at relatively low levels.

Besides financial performance, traditional measures and indicators of safety and soundness have also reflected the industry's slight decline in performance. Problem banks and thrifts -- those with composite examination CAMELS ratings⁸ of 4 or 5 -- totaled 29 as of May 2007, up from 16 as of June 30, 2006. Additionally, three bank failures occurred in 2007. The February failure of the \$15.8 million-asset, FDIC-regulated Metropolitan Savings Bank of Pittsburgh was the first insolvency in 3 years. The September failure of the \$2.5 billion-asset, OTS-regulated NetBank is the largest failure since Superior Bank in 2001. As the estimated loss for NetBank will exceed \$25 million, our office is mandated by law to perform a material loss review into the failure.⁹ In October, the FDIC-regulated Miami Valley Bank in Ohio failed with \$86.7 million in assets.

Safety and soundness risks facing the banking industry include rising interest rates, the increase in defaults on subprime mortgages due to the adjustable interest rate resetting, and the slowdown in the real estate market. Rising interest rates can adversely affect institutions' financial net interest margins, where interest earned on loans made by the institutions do not keep pace with the rising interest payments made on their deposits and require changes in risk management by financial institutions. Non traditional mortgage

⁸ Financial institution regulators use the Uniform Financial Institutions Rating System to evaluate an institution's performance. CAMELS is an acronym for the performance rating components: Capital adequacy, Asset quality, Management administration, Earnings, Liquidity, and Sensitivity to market risk. Numerical values range from 1 to 5, with 1 being the highest rating and 5 representing the worst rated banks.

⁹ 12 U.S.C. §1831o(k) requires our office to review a failed financial institution supervised by OCC or OTS if the loss to a deposit insurance fund exceeds the greater of \$25 million or 2 percent of the institution's total assets.

OIG ISSUE AREAS AND PLANNED PROJECTS

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products¹⁰ expose banks to losses from home foreclosures and liquidations if homeowners are unable to make payments on their mortgages due to rising interest rates. Subprime adjustable-rate mortgages were the driving force behind the rise in foreclosures in the first quarter of 2007. Foreclosure filings in the first quarter rose 35 percent from a year earlier with 37 out of 50 states reporting year-over-year increases. In addition, the slowdown in the real estate market has led to overall declines in mortgage lending.

Another emerging event in the banking industry is the adoption of Basel II. Basel II is an effort by international banking supervisors to update the original international bank capital accord (Basel I), which has been in effect since 1988. Basel II aims to improve the consistency of capital regulations internationally, make regulatory capital more risk sensitive, and promote enhanced risk-management practices. The Federal Reserve Board, OTS, OCC, and FDIC announced on July 20, 2007, agreement on the implementation of Basel II. Compliance with Basel II would be mandatory for the nation's largest, most internationally active banking organizations—those with \$250 billion of assets or exposure to foreign markets above \$10 billion. This would include about a dozen of the largest banks and thrifts in the U.S. The regulators agreed to allow smaller banks to adopt the Basel II approach. We will be following OCC's and OTS's efforts to implement the Basel II rules and monitor its impact on safety and soundness.

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

Significant pricing variability in the subprime market has increased concerns about the fairness of creditor decisions. For the first time in 2004, Home Mortgage Disclosure Act data included information concerning the annual percentage rate charged borrowers on higher-cost home loans. The higher priced segment of the home loan market, a segment virtually nonexistent a decade ago, is now a substantial part of the market. The growth of this market segment, while affording some consumers greater access to credit, has been accompanied by concerns about abusive lending practices. The same data details several aspects of the loan transaction and the identity of the borrower, including race, ethnicity, sex, and income. Recent data disclosed by banks shows that minority borrowers have

¹⁰ Non-traditional mortgage products include option Adjustable Rate Mortgages, Interest-Only mortgages, and subprime mortgages. Subprime mortgages are mortgages that have higher interest rates due to deficiencies in either the credit history or the financial health of the borrower.

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been far more likely to receive such loans raising concerns over possible discriminatory and predatory lending.

Another area of growing concern has been the reoccurring incidences of customer financial privacy and identity theft. A press release issued by the Identity Theft Resource Center states nearly 20 million people were affected by security breaches in 2006. Banking, credit, and financial services entities accounted for 8 percent of those breaches. As of July 31, 2007, however, that number has decreased to 6.7 percent. The President's Identity Theft Task Force, which included the federal banking regulators, issued a strategic plan for combating identity theft in April 2007. The plan calls for national standards to be established to require private sector entities to safeguard the personal data they compile, and that federal agencies should implement an awareness campaign to educate consumers, the private sector, and the public sector on deterring, detecting, and defending against identity theft.

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

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

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

In Progress and Planned Fiscal Year 2008 Projects

OCC Use of Home Mortgage Disclosure Act Data (In Progress)

Audit Objective To determine if OCC (1) was making effective use of Home Mortgage Disclosure Act data; and (2) taking appropriate action to address possible discriminatory

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lending practices based on the data. We anticipate that this project will require 400 hours to complete in fiscal year 2008.

NetBank Material Loss Review

Audit Objective To: (1) determine the cause(s) of NetBank's failure; (2) assess the supervision exercised over the institution; and (3) as applicable, make recommendations to prevent similar losses in the future. We anticipate that this review will require 5,000 hours.

Projects Under Consideration for Future OIG Annual Plans

Protecting the Financial Services Sector Critical Infrastructure

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

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

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

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

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

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OCC/OTS Assessment of Interest Rate Risk

Background Interest rate risk is the exposure of a bank's financial condition to adverse movements in interest rates. Excessive interest rate risk can pose a significant threat to a bank's earnings and capital base. Accordingly, an effective risk management process that maintains interest rate risk within prudent levels is essential to the safety and soundness of banks.

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

OTS Strategic Management of Human Capital

Background About 65 percent of OTS's approximately 1,000 employees will be eligible to retire during the next 5 years. If this occurs, there would be a significant loss of institutional knowledge that could possibly affect OTS's effectiveness.

Audit Objective To determine what actions OTS is taking to address several human capital concerns including the impact of a potentially large number of employees retiring in the near future. We anticipate that this project will require 1,600 hours.

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

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

OCC/OTS Examinations Coverage of Identity Theft Risk

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

OCC/OTS Examiner Safeguards Over Bank Sensitive Information

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

OIG ISSUE AREAS AND PLANNED PROJECTS

Safety, Soundness, and Accessibility of Financial Services

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

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

OCC/OTS Risk-Based Supervision

Audit Objective To determine if (1) full scope examinations are being conducted over the required 12 month or 18 month cycles, as applicable; (2) exceptions are adequately supported; and (3) examination procedures adequately address those areas determined to be low risk. We anticipate that this project will require 1,600 hours at each regulator.

OTS Examinations of Holding Companies

Audit Objective To assess the effectiveness of OTS holding company examination policies, procedures, and practices and determine how OTS examines thrift holding companies. We anticipate that this project will require 2,000 hours.

OCC/OTS Risk Management of Derivatives at Financial Institutions

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

OCC Examinations of Large Banks

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

OCC/OTS Examinations of Financial Institution Non-Banking Related Activities

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

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

OCC/OTS Monitoring Bank Underwriting Standards for Mortgage Loans

Background Underwriting standards refer to loan terms and covenants used by financial institutions when originating loans. Recent surveys of credit underwriting practices have found some easing of underwriting standards in the industry.

Audit Objective To determine how regulators evaluate the appropriateness of the standards used and what actions are taken when the standards appear too lax. We anticipate that this project will require 2,000 hours at each regulator.

OIG ISSUE AREAS AND PLANNED PROJECTS

Revenue Collection and Industry Regulation

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Office of Investigations Contact: Gerald R. Garren, Special Agent in Charge, Investigations (202) 927-5829

Issue Area Discussion

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

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

Collecting the Revenue During fiscal year 2006, TTB collected \$14.8 billion in excise taxes and other revenue, refunded \$356 million to taxpayers, and provided \$367 million in "cover over" (taxes collected on rum products) to the governments of Puerto Rico and the U.S. Virgin Islands. In fiscal year 2006, TTB reported that it collected \$323 in alcohol and tobacco excise taxes for every dollar spent. TTB also reported that its regulatory audits resulted in \$4.4 million in collections and \$8.1 million in taxes, penalties, and interest potentially due. To ensure compliance, TTB has been using an approach that audits large taxpayers (about 400 taxpayers account for 98 percent of the tax collections) and audits the remaining taxpayers based on risk and random sampling.

OIG ISSUE AREAS AND PLANNED PROJECTS

Revenue Collection and Industry Regulation

Protecting the Public TTB regulates the alcohol and tobacco industries to protect consumers from fraud and deception. As part of the regulatory process, TTB processes applications to enter into the alcohol and tobacco industries. TTB is also responsible for ensuring alcoholic beverages are produced, labeled, advertised, and marketed in accordance with Federal law. TTB reviews labels and formulas for domestic and imported beverage alcohol products and maintains public access to approved Certificates of Label Approval, which are required for every alcoholic beverage. In fiscal year 2006, TTB received 111,000 Certificate of Label Approval applications and approved 80,000. Thirty-eight percent of the applications were received electronically, exceeding TTB's goal of 27 percent. However, TTB fell short of its goal of processing 55 percent of applications in 9 calendar days, achieving an actual total of 44 percent. TTB also samples products for laboratory reviews. TTB uses the beverage sampling program to determine whether alcoholic beverages for sale at retailers meet fill, alcohol content, and other requirements. TTB also reviews alcohol formulas and conducts laboratory analysis of certain products. For example, TTB samples imported products for pre-import review and laboratory analysis.

Prior Audit Work Due to other priority audit work, we completed only two audits of TTB in the last 5 years.

- A fiscal year 2006 audit found that the Tax Audit Division, after developing a risk assessment model to use in selecting taxpayers for audit, abandoned its use. TTB decided to use only revenue as a risk factor and to audit the top 400 taxpayers. The audit found that the model TTB developed contained inaccurate and incomplete data, which affected the overall rankings. The audit also found taxpayer account balances maintained at the National Revenue Center were not always accurate because electronic payments had been posted to the wrong taxpayer accounts.
- An audit completed in 2004 was followed-up on prior OIG audits that found significant vulnerabilities in the controls over excise tax waivers associated with exported alcohol and tobacco products. The prior audits, conducted in fiscal years 1999 and 2000, found missing documentary support at the National Revenue Center for these waivers that raised questions about whether the products were actually exported and the waivers appropriate. The waivers provided tax exemptions in the hundreds of millions of dollars. Despite improvements in controls, the 2004 follow-up audit found continuing problems with documentation not being available to support the exportation of these products. In response, TTB has revised the process. Now, rather than having all supporting documentation submitted to the National Revenue Center for administrative review, TTB requires the manufacturers and importers to maintain documentary support at their premises for review by the Tax Audit Division during on-site audits.

OIG ISSUE AREAS AND PLANNED PROJECTS

Revenue Collection and Industry Regulation

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

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

Potential Integrity Risks We believe the major integrity risk regarding revenue collection and industry regulation is the failure by industry members to pay all taxes due, either intentionally or otherwise, coupled with the concurrent failure of TTB to detect this underpayment. Intentional failure to pay all taxes due would likely require deceit or fraud on the part of taxpayers as well as attempts to corrupt TTB employees through bribery or other means. Similarly, fraudulent manufacturers or distributors could create a risk for consumers by placing unsafe or deceptively advertised products into the marketplace, particularly if TTB's protective programs are not functioning well enough to detect these products. In addition, TTB has to be vigilant concerning the possibility of contaminated products reaching the marketplace inadvertently, including those from foreign countries. With respect to formulating tax policy, regulations, and rulings, there is also a risk of undue influence by impacted parties who could potentially benefit from Treasury positions on tax matters.

In Progress and Planned Fiscal Year 2008 Projects

Based on current resource levels, mandated work, and risk relative to other OIG Issue Areas, no audits of TTB programs and operations are planned for fiscal year 2008.

OIG ISSUE AREAS AND PLANNED PROJECTS

Revenue Collection and Industry Regulation

Review of the Tax Guidance Process, Including IRS Notice 2007-17 (In Progress)

Audit Objective To evaluate the (1) process and related controls for developing published tax guidance; and (2) the model of the pilot program described in IRS Notice 2007-17. This is a joint OIG/TIGTA audit undertaken pursuant to a request by the Senate Finance Committee. OIG is focusing on the Office of Tax Policy and TIGTA is focusing on the IRS. We anticipate this project will require 400 hours to complete during fiscal year 2008.

Projects Under Consideration for Future OIG Annual Plans

TTB Alcohol and Tobacco Permit Program

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

TTB Review of Foreign Beverages

Background TTB is responsible for ensuring alcoholic beverages are safe, including those entering the market from foreign countries. Since TTB does not have access to foreign production plants, TTB monitors foreign beverage products by conducting a pre-import review, which could include laboratory analysis TTB monitors post-market alcohol beverage products by collecting random or targeted samples from retail outlets, and sending samples to TTB laboratories for analysis.

Audit Objective To evaluate TTB's efforts to ensure safe imported beverage products through its pre-import activities, post-market sampling, and laboratory analysis efforts. We estimate this project will require 2,000 hours.

TTB Alcohol and Tobacco Laboratories

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

OIG ISSUE AREAS AND PLANNED PROJECTS

Revenue Collection and Industry Regulation

TTB Designation of American Viticultural Areas

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

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

TTB Collection Procedures

Audit Objective To determine whether TTB has effective collection procedures for delinquent accounts, and is using these procedures to encourage prompt payment. We estimate this project will require 1,600 hours.

Manufacturer Non-Beverage Drawback Program

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

TTB Use of Collateral to Protect Revenue

Background TTB protects excise tax revenue by mandating that taxpayers pledge collateral – such as a bond, note, or securities – in the event they do not fulfill their tax payment obligations. The instruments are used to offset tax liability when payments are not received.

Audit Objective To determine whether TTB is ensuring that taxpayers maintain an adequate amount of collateral to protect tax revenue. We anticipate that this project will require 1,200 hours.

TTB Background Investigations

Audit Objective To determine if TTB staff with access to sensitive tax return data have up-to-date background investigations. We anticipate that this project will require 1,600 hours.

OIG ISSUE AREAS AND PLANNED PROJECTS

Revenue Collection and Industry Regulation

TTB On-Line Certificate of Label Approval

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

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

Audit Objective To determine if effective controls are in place to ensure that claims presented to TTB for excise tax refunds for alcohol and tobacco products lost or destroyed in natural disasters are legitimate and accurate. We estimate this project will require 800 hours.

TTB Approval to Share Winemaking Facilities and Obtain Wine Tax Credits

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

Audit Objective To determine whether TTB has adequate controls to ensure that applicants for these arrangements are legitimate, qualified, and eligible for wine credits. We anticipate that this project will require 1,600 hours.

TTB Safeguards Over Taxpayer Information

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

OIG ISSUE AREAS AND PLANNED PROJECTS

Bill and Coin Manufacturing, Marketing, and Distribution Operations

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Office of Investigations Contact: Gerald R. Garren, Special Agent in Charge, Investigations (202) 927-5829

Issue Area Discussion

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

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

In 2006, BEP delivered 8.26 billion Federal Reserve Notes to the Federal Reserve System. This resulted in revenue of \$477 million and an excess of expenses over revenue of \$8.2 million. According to BEP, the excess of expenses over revenues was planned and funded out of working capital.

The Mint's principal mission is to produce the nation's circulation coinage for trade and commerce. Along with the Mint's headquarters in Washington, D.C., there are four production facilities (Philadelphia, West Point, Denver, and San Francisco) and the bullion depository at Fort Knox. During fiscal year 2006, the Mint manufactured 16.2 billion coins for the Federal Reserve System.

In fiscal year 1996, the Mint Public Enterprise Fund was created to enable the Mint to operate as a revolving fund. All receipts deposited into the fund are available for the Mint operations and the cost of safeguarding government assets in the Mint's custody without fiscal year limitations. The Secretary of the Treasury must annually determine the amount of excess in the fund that is not needed for the Mint operations and programs. That excess is transferred to the Treasury General Fund for deposit as a miscellaneous receipt. For fiscal year 2006, the Mint transferred \$750 million to the Treasury General Fund. Even though the Mint is not dependent on appropriated funds, its spending authority is approved each fiscal year.

Potential Weaknesses Because their operations are financed through revolving funds, BEP and the Mint are subject to less Congressional oversight scrutiny through the federal budget process than appropriated agencies. The fund's legislation also accorded the Mint with greater flexibilities in conducting its procurement and personnel activities. For

OIG ISSUE AREAS AND PLANNED PROJECTS

Bill and Coin Manufacturing, Marketing, and Distribution Operations

example, the Mint is exempt from following the Federal Acquisition Regulation. In a 2002 audit, we noted weaknesses in the Mint's use of the fund authority to acquire leased space for its headquarters operations, including acquiring space in excess of its needs. In 2001, the Department reviewed the Mint's procurement operations, also noting significant weaknesses. Continued prudent use of its fund authority flexibilities is necessary to ensure a maximum return to the Treasury General Fund from the Mint's operations.

Three recent OIG audits noted various weaknesses in BEP security matters. In fiscal year 2003, we reported that among other things, employees did not always have the level of security clearance commensurate with their work assignments.¹¹ In fiscal year 2004, we reported that the dual reporting structure for security operations at its two currency facilities have resulted in inconsistent policies and practices. We also reported weaknesses with BEP police officer training and firearms re-qualifications and security system.¹² In a fiscal year 2007 audit performed at the Western Currency Facility, we concluded that failure to follow existing internal control procedures facilitated an October 2004 theft by an employee who removed at least \$5,000 of \$50 Federal Reserve Notes slated for destruction. We also noted that additional steps should be taken to enhance internal controls at the production facility.¹³

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

Potential Integrity Risks In addition to the weaknesses identified above, we believe there are several potential integrity risks associated with Treasury's manufacturing operations. Potential integrity risks exist from external parties—contractors or consultants, terrorists and hackers; and internal personnel—employee who can be disgruntled, unethical, untrained. For example, these personnel can (1) disrupt Treasury functions, (2) violate laws, (3) award contracts for less than best value, (4) receive bribes or kick-backs, (5) steal or reveal sensitive data, and (6) cost the taxpayer money through the theft of materials and machinery, finished products, and mutilated products.

¹¹ *General Management: The Bureau of Engraving and Printing's Controls Over Background Investigations Need to be Improved* (OIG-03-004).

¹² *General Management: Controls Over Security Need to be Improved at the Bureau of Engraving and Printing* (OIG-04-035).

¹³ *Bill and Coin Manufacturing: Control Weaknesses Need To Be Addressed at BEP's Western Currency Facility* (OIG-07-035).

OIG ISSUE AREAS AND PLANNED PROJECTS

Bill and Coin Manufacturing, Marketing, and Distribution Operations

In Progress and Planned Fiscal Year 2008 Projects

BEP Internal Controls at the Eastern Currency Facility (In Progress)

Audit Objective To determine (1) the internal control failures that allowed a theft discovered in 2006 at the BEP manufacturing facility to be perpetrated and (2) whether BEP has enhanced internal controls to prevent and detect the occurrence of such thefts in the future. We plan to issue separate reports on each facility. We anticipate that this project will require 400 hours to complete in fiscal year 2008.

Mint Production Scheduling (In Progress)

Audit Objective To examine how the Mint determines demand for its products and then schedules production to meet the expected demand. As part of our work, we plan to look at the Presidential \$1 Coin Program and the Mint's approach to implementing new coin programs. We also plan to review the actions taken by the Mint in response to our prior report, *Manufacturing Operations: The Mint Suspends Its FY 2002 Planned Production of Golden Dollar Coins* (OIG-02-066). We anticipate that this project will require 2,400 hours to complete in fiscal year 2008.

Mint Controls Over the Sales of Limited-Production, Investment-Grade Products

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

BEP Background Investigations of Personnel

Audit Objective To determine if BEP's background investigation procedures are adequate and implemented in an effective manner. As part of this audit, we will follow up on the recommendations in our prior report, *General Management: The Audit on the Bureau of Engraving and Printing's Controls Over Background Investigations Need to be Improved.*(OIG-03-004). We anticipate that this project will require 2,000 hours.

OIG ISSUE AREAS AND PLANNED PROJECTS

Bill and Coin Manufacturing, Marketing, and Distribution Operations

Projects Under Consideration for Future OIG Annual Plans

BEP Capital Investment Program

Audit Objective To determine whether BEP's capital investment program ensures that all capital needs are being identified and sufficient funds are being allocated to meet current and future capital needs. We estimate this project will require 2,000 hours.

BEP Police Officer Training and Firearms Re-qualification

Audit Objective To determine whether BEP policies for training and firearms re-qualification of police officers are consistent, appropriate, and followed at its two production facilities. As part of this audit, we will follow up on actions taken by BEP in response to our report, *General Management: Controls Over Security Need to be Improved at the Bureau of Engraving and Printing* (OIG-04-035). We anticipate that this project will require 1,200 hours.

Mint Leasing Practices

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

BEP Continuity of Operations Planning

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

BEP Employee Safety

Audit Objective To determine how BEP ensures safe working conditions in its production facilities. We plan to conduct separate audits of BEP's production facilities with the first being conducted at the Eastern Currency Facility. We anticipate that each audit will require 2,000 hours.

OIG ISSUE AREAS AND PLANNED PROJECTS

Bill and Coin Manufacturing, Marketing, and Distribution Operations

Mint Cycle Time

Audit Objective To determine the Mint's effectiveness at managing "cycle" time (the time it takes for raw materials to flow through the manufacturing processes to order fulfillment). We anticipate that this project will require 2,000 hours.

Mint Manufacturing and Inventory Initiative

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

BEP Evaluation of Contract Proposals

Audit Objective To determine if BEP has a methodology for documenting and reviewing bids received to ensure that it is receiving the best value. We anticipate that this project will require 1,600 hours.

Mint Procurement Operations

Audit Objective To determine whether the Mint follows logical and prudent business practices when procuring goods and services. We anticipate that this project will require 2,000 hours.

OIG ISSUE AREAS AND PLANNED PROJECTS

Domestic and International Assistance Programs

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Issue Area Discussion

Treasury plays an important role in a number of domestic and international assistance programs that have a significant impact on the economy. Domestic programs range from those that enhance the availability of financial education and of credit, investment capital, and financial services to communities around the U.S., to programs that assist in coping with the after-effects of the September 11, 2001, terrorist attacks. International programs address the role of international financial institutions and promote economic stability and growth in other countries.

Domestic Assistance Treasury provides assistance to promote economic growth and raise the standard of living in distressed communities in the U.S. by increasing the availability of business capital and financial services. The CDFI Fund, for example, promotes access to capital and local economic growth in the following ways: (1) through its CDFI Program by directly investing in, supporting and training CDFIs that provide loans, investments, financial services and technical assistance to underserved populations and communities; (2) through its Bank Enterprise Award Program by providing an incentive to banks to invest in their communities and in other CDFIs; and (3) through its Native Initiatives, by taking action to provide financial assistance, technical assistance, and training to Native CDFIs and other Native entities proposing to become or create Native CDFIs. Since inception, the CDFI Fund has awarded \$820 million to community development organizations and financial institutions under these programs. The New Markets Tax Credit (NMTC) program, one of the more recent initiatives in this arena, provides for a total of \$16 billion in tax incentives to help spur investments in low-income communities. During the first four award cycles under this program, the CDFI Fund designated 233 Community Development Entities and made available \$12.1 billion in tax credits. This includes \$600 million for use specifically in the Hurricane Katrina Gulf Opportunity Zone.

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

Treasury's Office of International Affairs oversees U.S. interests in international financial institutions. The U.S. participates in these institutions to support poverty

OIG ISSUE AREAS AND PLANNED PROJECTS

Domestic and International Assistance Programs

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

In our prior Annual Plan, we included a project related to IA's administration of funding for Tropical Forest Conservation Act activities. This purpose of this act is to facilitate greater protection of tropical forests by alleviating debt in countries where tropical forests are located. Assistance is provided to selected countries through negotiated agreements in the form of debt reduction, debt swap, or debt buy back. Once the agreements with the selected countries are negotiated, Treasury obligates the subsidy cost of the debt reduction for use by the U.S. Agency for International Development or the U.S. Department of Agriculture. The program's authorization expired at the end of fiscal year 2007. However, legislation is under consideration in the Congress to re-authorize the program through fiscal year 2010 and expand it to cover coral conservation. We will monitor the legislation and consider audit work for inclusion in future OIG Annual Plans as appropriate.

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

OIG ISSUE AREAS AND PLANNED PROJECTS

Domestic and International Assistance Programs

In Progress and Planned Fiscal Year 2008 Projects

Reports to Congress on Foreign Acquisitions and Industrial Espionage Involving U.S. Critical Technologies

Background Section 721(k) of the Defense Production Act of 1950, as amended, requires the President and such agencies as the President shall designate to provide a quadrennial report to Congress which (1) evaluates whether there is credible evidence of a coordinated strategy by one or more countries or companies to acquire U.S. companies involved in research, development, or production of critical technologies for which the U.S. is a leading producer; and (2) evaluates whether there are industrial espionage activities directed or directly assisted by foreign governments against private U.S. companies aimed at obtaining commercial secrets related to critical technologies. Treasury has in the past been delegated the responsibility to prepare the report.

Audit Objective To determine the facts and circumstances concerning each failure by Treasury to make the quadrennial report to Congress required under section 721(k). This audit is required by the Foreign Investment and National Security Act of 2007 and must be completed on or about April 21, 2008. We anticipate that this project will require 1,600 hours.

CDFI Fund Post-Award Grant Administration

Audit Objective To determine whether the CDFI Fund has effective policies, procedures, and controls in place to ensure that grant recipients are carrying out and reporting on grant activities in accordance with their assistance agreements and applicable laws and regulations. As part of this project, we plan to visit selected grantees to review their records and inspect funded projects. We also plan to follow up on corrective actions taken by the CDFI Fund in response to our prior report, *Financial Management/Compliance With the Federal Financial Management Improvement Act: Community Development Financial Institutions Fund Post-Award Administration Process* (OIG-02-122). We anticipate that this project will require 4,000 hours.

OIG ISSUE AREAS AND PLANNED PROJECTS

Domestic and International Assistance Programs

Projects Under Consideration for Future OIG Annual Plans

IA Oversight of Multilateral Development Banks' Anti-Corruption Programs

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

CDFI Fund Grant Award Process

Audit Objective To determine whether the CDFI Fund has adequate policies, procedures, and controls for its core programs (CDFI program, Bank Enterprise Award program, and Native Initiatives) to ensure that assistance awards are made in accordance with laws and regulations and in an equitable manner. We anticipate that this project will require 3,200 hours.

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

Background The legislation authorizing the NMTC program requires GAO to report to Congress on the program by January 31, 2004, 2007, and 2010. In January 2004, GAO reported that, according to CDFI Fund officials, not many NMTC projects were started by the end of 2003, and that they were unlikely to know the status of projects until early 2005. GAO also reported that the CDFI Fund and IRS have made progress in identifying data to use in monitoring NMTC compliance with allocation agreements and tax laws, respectively, and in developing and implementing systems to collect these data. However, many details remain to be settled on how these data will actually be used to monitor compliance. Additionally, in terms of evaluating the NMTC program, the CDFI Fund has decided to contract for an evaluation. GAO recommended that the CDFI Fund and IRS develop plans, including milestones, to ensure that compliance-monitoring processes are in place when needed.¹⁴ In January 2007, GAO reported that its survey and statistical analysis indicate that the NMTC may be increasing investment in low-income communities by participating investors. Investors indicated that they have increased their investment budgets in low-income communities as a result of the credit, and GAO's analysis indicates that businesses may be shifting investment funds from other types of assets to invest in the NMTC, while individual investors may be using at least some new funds to invest in the NMTC. Additionally, GAO reported that the CDFI Fund and IRS developed processes to monitor CDEs' compliance with their allocation agreements and the tax code. However,

¹⁴ *New Markets Tax Credit Program: Progress Made in Implementation, but Further Actions Needed to Monitor Compliance*; GAO-04-326.

OIG ISSUE AREAS AND PLANNED PROJECTS

Domestic and International Assistance Programs

IRS's study of CDE compliance does not cover the full range of NMTC transactions, focusing instead on transactions that were readily available, and may not support the best decisions about enforcement in the future. Moreover, IRS and the CDFI Fund are not collecting data that would allow IRS to identify credit claimants and amounts to be claimed.¹⁵

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

IA Performance Measures

Audit Objective To determine if IA's performance measures are meaningful and the reported performance data is reliable and complete. We anticipate this project will require 1,600 hours.

Treasury Oversight of the North American Development Bank

Audit Objective To assess IA's oversight of U.S. interests in the North American Development Bank. We anticipate that this project will require 1,600 hours.

¹⁵ *Tax Policy: New Markets Tax Credit Appears to Increase Investment by Investors in Low-Income Communities, but Opportunities Exist to Better Monitor Compliance*; GAO-07-296.

APPENDIX A:

OFFICE OF AUDIT FISCAL YEAR 2008 RESOURCE ALLOCATION

Our planned OIG audit staff resource utilization by the three priority areas for fiscal year 2008 is shown in the following table:

Audit Priority	Percent of Planned Audit Resources
Audit products mandated by law	43
Work requested by Congress or externally driven	8
Self-directed work in Treasury's highest-risk areas	49
Total	100

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

OIG Issue Area	Percent of Planned Audit Resources
Treasury general management and infrastructure support:	
Financial management	22
Information systems security	10
General management	1
Terrorist financing, money laundering, and foreign assets control	23
Government-wide financial services and debt management	11
Safety, soundness, and accessibility of financial services	11
Revenue collections and industry regulation	1
Bill and Coin manufacturing, marketing, and distribution operations	10
Domestic and international assistance programs	11
Total	100

APPENDIX A:

OFFICE OF AUDIT FISCAL YEAR 2008 RESOURCE ALLOCATION

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

Treasury Component	Percent of Planned Audit Resources
Departmental Offices:	
Office of the Assistant Secretary for Management and Chief Financial Officer	12
Office of the Chief Information Officer	3
FFB	1
TFI	2
OFAC	5
TEOAF	1
Office of Tax Policy	1
CDFI Fund	9
Office of International Affairs	3
Bureaus:	
FinCEN	15
FMS	13
BPD	2
OCC	6
OTS	12
TTB	2
BEP	4
Mint	9
Total	100

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ABBREVIATIONS

ARC	Administrative Resource Center
BEP	Bureau of Engraving and Printing
BPD	Bureau of the Public Debt
BSA	Bank Secrecy Act
CDFI	Community Development Financial Institutions Fund
DoD	Department of Defense
DOJ	Department of Justice
FDIC	Federal Deposit Insurance Corporation
FFMIA	Federal Financial Management Improvement Act of 1996
FinCEN	Financial Crimes Enforcement Network
FISMA	Federal Information Security Management Act
FMS	Financial Management Service
FOIA	Freedom of Information Act
GAO	U.S. Government Accountability Office
GMRA	Government Management Reform Act
HSPD-12	Homeland Security Presidential Directive 12
IA	Office of International Affairs
IG	Inspector General
IPA	independent public accountant
IRS	Internal Revenue Service
IT	information technology
MCA	managerial cost accounting
MOU	memorandum of understanding
MSB	money services business
NIST	National Institute of Science and Technology
NMTC	New Markets Tax Credit
OCC	Office of the Comptroller of Currency
ODNI	Office of the Director of National Intelligence
OFAC	Office of Foreign Assets Control
OIG	Treasury Office of Inspector General
OMB	Office of Management and Budget
OTS	Office of Thrift Supervision
SAR	Suspicious Activity Report
TEOAF	Treasury Executive Office for Asset Forfeiture
TFI	Office of Terrorism and Financial Intelligence
TIGTA	Treasury Inspector General for Tax Administration
TTB	Alcohol and Tobacco Tax and Trade Bureau

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