# Audit Report

OIG-18-015

**FINANCIAL MANAGEMENT**

**Audit of the Department of the Treasury's Consolidated Financial Statements for Fiscal Years 2017 and 2016**

November 15, 2017

Office of Inspector General
Department of the Treasury

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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

OFFICE OF
INSPECTOR GENERAL

November 15, 2017

**INFORMATION MEMORANDUM FOR SECRETARY MNUCHIN**

**FROM:** Eric M. Thorson /s/
Inspector General

**SUBJECT:** Audit of the Department of the Treasury's Consolidated Financial Statements for Fiscal Years 2017 and 2016

## INTRODUCTION

The Chief Financial Officer's Act, as amended, requires the Department of the Treasury's (Treasury) Inspector General or an independent auditor, as determined by the Inspector General, to audit Treasury's consolidated financial statements. We contracted with the independent certified public accounting firm of KPMG LLP (KPMG) to audit the consolidated financial statements of Treasury as of September 30, 2017 and 2016, and for the years then ended, to provide a report on internal control over financial reporting, to report instances in which Treasury's financial management systems did not substantially comply with the requirements of the Federal Financial Management Improvement Act of 1996 (FFMIA), and to report any reportable noncompliance with laws, regulations, contracts, and grant agreements tested. The contract required that the audit be performed in accordance with U.S. generally accepted government auditing standards and Office of Management and Budget (OMB) Bulletin No. 17-03, *Audit Requirements for Federal Financial Statements*.

## RESULTS OF INDEPENDENT AUDIT

In its audit of Treasury, KPMG found

- the consolidated financial statements were fairly presented, in all material respects, in accordance with U.S. generally accepted accounting principles;
- a material weakness in internal control over unpaid tax assessments and a significant deficiency in internal control over financial reporting systems identified by the auditor of the Internal Revenue Service, collectively representing a material weakness for Treasury as a whole;
- deficiencies in internal control over debt management information systems at the Bureau of Fiscal Service, representing a significant deficiency for Treasury as a whole;
- noncompliance with certain requirements of FFMIA related to Federal financial management systems requirements and Federal accounting standards; and
- no instances of reportable noncompliance with laws, regulations, contracts, and grant agreements tested.

**EVALUATION OF AUDITORS' PERFORMANCE**

In connection with the contract, we reviewed KPMG's report and related documentation and inquired of its representatives. Our review, as differentiated from an audit in accordance with U.S. generally accepted government auditing standards, was not intended to enable us to express, and we do not express, an opinion on Treasury's consolidated financial statements or conclusions about the effectiveness of internal control; whether Treasury's financial management systems substantially complied with FFMIA; and compliance with laws, regulations, contracts, and grant agreements. KPMG is responsible for the attached auditor's report dated November 15, 2017, and the conclusions expressed in the report. However, our review disclosed no instances where KPMG did not comply, in all material respects, with U.S. generally accepted government auditing standards.

I appreciate the courtesy and cooperation extended to KPMG and my staff during the audit. Should you or your staff have questions, you may contact me at (202) 622-1090 or Deborah L. Harker, Assistant Inspector General for Audit, at (202) 927-5400.

Attachment

cc: Kody H. Kinsley
Assistant Secretary for Management

Carole Y. Banks
Deputy Chief Financial Officer

# SECTION I –

# Independent Auditors' Report and Management's Response

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KPMG LLP
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1801 K Street, NW
Washington, DC 20006

## Independent Auditors' Report

Inspector General
Department of the Treasury:

### Report on the Financial Statements

We have audited the accompanying consolidated financial statements of the Department of the Treasury (Department), which comprise the consolidated balance sheets as of September 30, 2017 and 2016, and the related consolidated statements of net cost, consolidated statements of changes in net position, combined statements of budgetary resources and statements of custodial activity for the years then ended, and the related notes to the consolidated financial statements (hereinafter referred to as "consolidated financial statements").

#### *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

#### *Auditors' Responsibility*

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the financial statements of the Internal Revenue Service (IRS), a component entity of the Department, which statements reflect total assets of $60.3 and $57.2 billion, net cost of operations of $12.1 and $12.0 billion before applicable eliminating entries, budgetary resources of $12.8 and $12.8 billion, and custodial activity of $3,420 and $3,341 billion, as of and for the years ended September 30, 2017 and September 30, 2016, respectively. Those statements were audited by other auditors, whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for IRS, is based solely on the report of the other auditors.

We also did not audit the financial statements of the Office of Financial Stability (OFS), a component entity of the Department, which statements reflect total assets of $19.5 and $24.2 billion, net cost of operations of $4.1 and $4.1 billion before applicable eliminating entries, and budgetary resources of $447 million and $3.9 billion, as of and for the years ended September 30, 2017 and September 30, 2016, respectively. Those statements were audited by other auditors, whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for OFS, is based solely on the report of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America, in accordance with the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and in accordance with Office of Management and Budget (OMB) Bulletin No. 17-03, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 17-03 require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the

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assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

***Opinion on the Financial Statements***

In our opinion, based on our audits and the reports of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Department of the Treasury as of September 30, 2017 and 2016, and its net costs, changes in net position, budgetary resources and custodial activity for the years then ended in accordance with U.S. generally accepted accounting principles.

***Emphasis of Matter***

As discussed in Notes 9 and 10, the Department is a participant in significant legislation and transactions whose purpose is to assist in stabilizing the financial markets. Also as discussed in Note 1A, the consolidated financial statements do not include the assets, liabilities, or results of operations of commercial entities in which the Department has a significant equity interest as it has determined that none of these entities meet the criteria for inclusion as a federal entity and are therefore not included in the consolidated financial statements. Furthermore, as discussed in Notes 1V, 9, and 10, the value of certain investments, loans, and commitments is based on estimates. These estimates are inherently subject to substantial uncertainty arising from the likelihood of future changes in general economic, regulatory, and market conditions. In addition, there are significant uncertainties related to the amounts that the Department will realize from its investments. As such, there will likely be differences between the estimated value of these investments, loans, and commitments as of September 30, 2017 and 2016, and the amounts that may ultimately be realized from these assets or may be required to settle these commitments. Such differences may be material and will also affect the ultimate cost of these programs. Our opinion is not modified with respect to these matters.

***Other Matters***

*Interactive Data*

Management has elected to reference to information on websites or other forms of interactive data outside the Agency Financial Report to provide additional information for the users of its financial statements. Such information is not a required part of the basic consolidated financial statements or supplementary information required by the Federal Accounting Standards Advisory Board. The information on these websites or the other interactive data has not been subjected to any of our auditing procedures, and accordingly we do not express an opinion or provide any assurance on it.

*Required Supplementary Information*

U.S. generally accepted accounting principles require that the information in the *Management's Discussion and Analysis* and *Required Supplementary Information* sections be presented to supplement the basic consolidated financial statements. Such information, although not a part of the basic consolidated financial statements, is required by the Federal Accounting Standards Advisory Board who considers it to be an essential part of financial reporting for placing the basic consolidated financial statements in an appropriate operational, economic, or historical context. We, and the other auditors, have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic

consolidated financial statements, and other knowledge we obtained during our audits of the basic consolidated financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

*Other Information*

Our audits were conducted for the purpose of forming an opinion on the basic consolidated financial statements as a whole. The *Message from the Secretary of the Treasury,* the *Message from the Assistant Secretary for Management and Deputy Chief Financial Officer,* and the *Other Information* sections are presented for purposes of additional analysis and are not a required part of the basic consolidated financial statements. Such information has not been subjected to the auditing procedures applied in the audits of the basic consolidated financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

**Other Reporting Required by *Government Auditing Standards***

***Internal Control Over Financial Reporting***

In planning and performing our audit of the consolidated financial statements as of and for the year ended September 30, 2017, we considered the Department's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control. This report includes our consideration of the results of the other auditors' testing of internal control over financial reporting that are reported on separately by those other auditors. However, this reporting, insofar as it relates to the results of the other auditors, is based solely on the reports of the other auditors. We, and the other auditors, did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. However, as described below, we and the other auditors identified certain deficiencies in internal control that we consider to be a material weakness and a significant deficiency.

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

**A. Material Weakness in Internal Control Over Financial Reporting at the Internal Revenue Service (Repeat Condition)**

IRS needs to improve internal control over financial reporting and systems to ensure reliable and timely financial information is obtained, maintained, and reported in accordance with OMB Circular A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*. The other auditors reported a material weakness in internal control over unpaid tax assessments and a significant deficiency in internal control over financial reporting systems that we collectively considered a material weakness at the Department level. The other auditors performed an audit of IRS's internal control over financial reporting for the purpose of providing an opinion on the effectiveness of internal control. Because of the material weakness, the other auditors' opinion on IRS's internal control over financial reporting stated that IRS did not maintain, in all material respects, effective internal control over financial reporting as of September 30, 2017, and thus a reasonable possibility exists that a material misstatement of IRS's financial statements could occur and not be prevented or detected and corrected on a timely basis. IRS internal control deficiencies are summarized as follows:

1. Unpaid Tax Assessments

   IRS continued to have system limitations in its subsidiary ledger and supporting financial systems and other control deficiencies that led to errors in tax payer accounts. As a result, IRS financial reporting systems did not provide timely reliable, and complete transaction-level financial information necessary to enable IRS to classify and report unpaid assessments balances in accordance with federal accounting standards and to effectively manage these amounts on a daily basis throughout the year. IRS applied a statistical estimation process to compensate for limitations in its financial reporting systems that render the systems unable to readily distinguish between federal taxes receivable, compliance assessments, and write-offs in order to accurately classify unpaid tax assessments in the proper categories for financial reporting purposes. In addition, IRS management and reporting of unpaid assessments continued to be hindered by inaccurate tax records resulting from IRS not recording information in taxpayer's accounts accurately and timely. As a result of these system limitations and inaccurate tax records, IRS recorded multi-billion dollar adjustments to the year end balances of unpaid tax assessments generated by its subsidiary ledger in order to produce reliable amounts for reporting its federal taxes receivables, compliance assessments, and write-offs.

2. Financial Reporting Systems

   IRS made progress in addressing previously reported control deficiencies related to its financial reporting systems, however, IRS continued to have information security program control deficiencies that limit IRS's effectiveness in protecting the confidentiality integrity, and availability of sensitive taxpayer data and financial information. Specifically, IRS continued to have control deficiencies in (1) monitoring activities to reasonably assure compliance with security policies and procedures; (2) limiting or preventing unnecessary access and unauthorized changes to systems; (3) change controls over tax and financial management processing on the mainframe; (4) segregating incompatible duties; (5) reasonably assuring that software was supported by the vendor and updated to protect against known vulnerabilities; and (6) developing and implementing effective policies and procedures as part of IRS's security management program.

**Recommendation**

The other auditors separately provided IRS management a report detailing the conditions identified and their recommendations to address the above material weakness. We recommend that the Assistant Secretary for Management (ASM) and Deputy Chief Financial Officer (DCFO) ensure that IRS implements corrective actions to resolve this material weakness.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiency described below to be a significant deficiency.

**B. Significant Deficiency in Internal Control Over Debt Management Information Systems**

Effective information system controls and security programs over financial systems are essential to protecting information resources in accordance with OMB Circular No. A-130, *Managing Information as a Strategic Resource*. The Bureau of the Fiscal Service (Fiscal Service) relies on a number of information technology systems to manage the federal debt. Fiscal Service either had not developed and implemented adequate policies and procedures or was not consistently following them. For example, within the distributed environment, there were instances in which: (1) known vulnerabilities for servers were not being remediated on a timely basis and some vulnerabilities remained unresolved for more than a year, (2) servers could be accessed through generic local administrator accounts, and (3) servers were being scanned against outdated benchmarks resulting in ineffective monitoring of implemented configuration settings against baseline security requirements. Within the mainframe environment, there were a number of instances in which mainframe security controls were not employed in accordance with the concept of least privilege, some of which represent potentially significant security exposures. Additionally, within both the distributed and mainframe environments there were instances in which Fiscal Service was using information system components that are no longer supported by the vendor.

Ongoing reorganization within Fiscal Service, particularly within Information and Security Services (ISS) which is the organization responsible for managing many of the information system controls, continued in fiscal year 2017 and a number of key ISS positions were vacant during portions of the year. Ongoing change can introduce the risk that controls will not be performed as designed because of unclear assignment of responsibilities for certain processes, which may have contributed to some of the new control deficiencies. These control deficiencies increase the risk of unauthorized access to, modification of, or disclosure of sensitive data and programs and disruption of critical operations.

**Recommendations**

A separate report with additional details and recommendations for corrective action will be provided separately to Fiscal Service management. We recommend that the ASM and DCFO ensure that the Fiscal Service (1) increase its focus on assessing risks associated with continued change, design and implement effective controls to address such risks, and monitor the effectiveness of controls; and (2) implement requisite corrective actions to resolve control deficiencies over its information systems.

***Compliance and Other Matters***

As part of obtaining reasonable assurance about whether the Department's consolidated financial statements are free from material misstatement, we, and the other auditors, performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests and those of the other auditors disclosed no instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 17-03.

We, and the other auditors, also performed tests of its compliance with certain provisions referred to in Section 803(a) of the *Federal Financial Management Improvement Act of 1996* (FFMIA). Providing an opinion on compliance with FFMIA was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests and those of the other auditors disclosed instances described below, in which the Department's financial management systems did not substantially comply with the Federal financial management systems requirements and applicable Federal accounting standards. The results of our tests and those of the other auditors disclosed no instances in which the Department's financial management systems did not substantially comply with the United States Government Standard General Ledger at the transaction level.

**C. Noncompliance with *Federal Financial Management Improvement Act of 1996* (Repeat Condition)**

The Department's financial management systems did not substantially comply with the following FFMIA requirements:

1. Federal Financial Management Systems Requirements

   As discussed in finding A. Material Weakness in Internal Control Over Financial Reporting at the Internal Revenue Service (Repeat Condition), the Department continues to have deficiencies in IRS's financial management systems. Specifically, IRS did not consistently design, implement, and operate information system controls and security programs over its financial systems in accordance with the federal financial management system requirements.

2. Applicable Federal Accounting Standards

As discussed in finding A. Material Weakness in Internal Control Over Financial Reporting at the Internal Revenue Service (Repeat Condition), the Department has a material weakness at IRS that affected the Department's ability to prepare its financial statements in accordance with the federal accounting standards. Specifically, IRS financial reporting systems did not provide timely reliable, and complete transaction-level financial information necessary to enable IRS to classify and report unpaid assessments balances in accordance with federal accounting standards.

**Recommendation**

The other auditors separately provided IRS management with recommendations to address the above noncompliance with FFMIA. We recommend that the ASM and DCFO ensure that IRS implements its remediation plan outlining actions to be taken to resolve noncompliance with the FFMIA requirements and the resources and responsible organizational units for such planned actions.

***Department's Response to Findings***

The Department indicated in a separate letter immediately following this report that it concurs with the findings and recommendations presented in our report. Further, the Department responded that it will take necessary corrective actions to address each of the matters presented. The Department's response was not subjected to the auditing procedures applied in the audit of the consolidated financial statements and, accordingly, we express no opinion on the response.

***Purpose of the Other Reporting Required by* Government Auditing Standards**

The purpose of the communication described in the Other Reporting Required by *Government Auditing Standards* section is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the Department's internal control or compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

Washington D.C.
November 15, 2017

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

ASSISTANT SECRETARY

November 15, 2017

KPMG LLP
1801 K Street, NW
Washington, DC 20006

Ladies and Gentlemen:

On behalf of Secretary Mnuchin, we are responding to your audit report on the Department of the Treasury's fiscal year 2017 consolidated financial statements. Our bureaus and program offices are proud of the Department's success in achieving an unmodified audit opinion on the Department's financial statements for the eighteenth consecutive year.

The high level of professionalism, technical expertise, and integrity demonstrated by KPMG in conducting this year's audit contributed greatly to Treasury's successful fiscal year 2017 results. We also appreciate the expertise and commitment demonstrated by the other organizations involved in the audit process – the Office of Inspector General, Government Accountability Office (GAO), and the firms that audited several of our bureaus.

We acknowledge the one material weakness and one significant deficiency at the Department level, and the one instance of noncompliance with laws and regulations described in your report. We agree with your recommendations, and will focus on necessary corrective actions to address each of the issues.

Overall, we have made strong progress in enhancing our internal control environment. We are very proud of our progress, and remain committed to ensuring high standards of integrity and transparency in reporting our financial performance.

Kody H. Kinsley
Assistant Secretary for Management

Carole Y. Banks
Deputy Chief Financial Officer

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# SECTION II –

# Department of the Treasury
# Fiscal Year 2017
# Agency Financial Report

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DEPARTMENT OF THE TREASURY

# Agency Financial Report

## Fiscal Year 2017

## Website Information

- Treasury ........ www.treasury.gov
- Alcohol and Tobacco Tax and Trade Bureau ........ www.ttb.gov
- Bureau of Engraving & Printing ........ www.bep.gov
- Fiscal Service ........ www.fiscal.treasury.gov
- Community Development Financial Institutions Fund ........ www.cdfifund.gov
- Financial Crimes Enforcement Network ........ www.fincen.gov
- Internal Revenue Service ........ www.irs.gov
- Office of the Comptroller of the Currency ........ www.occ.gov
- U.S. Mint ........ www.usmint.gov
- The Financial Stability Plan ........ www.financialstability.gov
- Making Home Affordable Program ........ www.makinghomeaffordable.gov
- The Recovery Act ........ www.recovery.gov
- Office of Inspector General ........ www.treasury.gov/oig
- Treasury Inspector General for Tax Administration ........ www.tigta.gov
- Special Inspector General for the Troubled Asset Relief Program ........ www.sigtarp.gov

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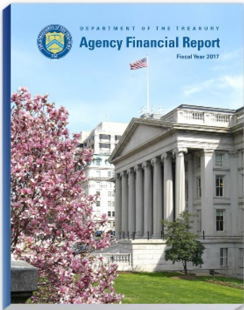
DEPARTMENT OF THE TREASURY

# Agency Financial Report

## Fiscal Year 2017

# About This Report



Our *Agency Financial Report* (AFR) for Fiscal Year (FY) 2017 presents the Department of the Treasury's (Treasury, Department, or our) financial information relative to our vital mission and stewardship of the resources entrusted to us. The AFR also highlights our priorities, accomplishments, and challenges implementing programs that promote conditions for sustaining economic growth and stability at home and abroad, protecting the integrity of our nation's financial system, and effectively managing the United States (U.S.) government's finances and resources. In accordance with Office of Management and Budget's (OMB) Circular A-136, *Financial Reporting Requirements,* we produce the following reports: *(i)* an *AFR* issued on November 15, 2017 and *(ii)* an *Annual Performance Report* (APR) submitted with Treasury's congressional budget justification, to be issued by February 1, 2018. The AFR will be available online at http://www.treasury.gov/about/budget-performance/annual-performance-plan/Pages/default.aspx. The APR will be available online at http://www.treasury.gov/about/budget-performance/Pages/cj-index.aspx.

# How This Report Is Organized

Our AFR provides financial and performance information for the FY beginning October 1, 2016, and ending on September 30, 2017, with comparative prior year data, where appropriate. The AFR demonstrates our commitment to our mission and accountability to Congress and the American people. This report presents Treasury's operations, accomplishments and challenges. The AFR begins with a message from the Secretary of the Treasury, Steven T. Mnuchin. This introduction is followed by three main section.

**Part 1: Management's Discussion and Analysis**

Provides a high-level overview of our organizational structure, strategic framework, programmatic and financial performance, and management assurances related to Treasury's internal controls

**Part 2: Financial Section**

Begins with a message from the Assistant Secretary for Management and Deputy Chief Financial Officer, followed by the Independent Auditors' Report, audited financial statements and notes, and supplementary information.

**Part 3: Other Information**

Contains various information including Management and Performance Challenges identified by the Inspectors General and the Secretary's response, along with information related to tax gap and tax burden, improper payments, and other relevant information.

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# MESSAGE FROM THE SECRETARY OF THE TREASURY

## MISSION STATEMENT

*Maintain a strong economy and create economic and job opportunities by promoting conditions that enable economic growth and stability at home and abroad; strengthen national security by combating threats and protecting the integrity of the financial system; and manage the U.S. government's finances and resources effectively.*

This year's Agency Financial Report offers an opportunity to review the steps that the Department has taken in the past year towards fulfilling the promise of prosperity and security for the American people. The new Administration has set forth a bold reform agenda to return this country to higher and more sustainable levels of economic growth. Some of the most important aspects of this program are being carried out at Treasury.

First and foremost, Treasury has led the push for tax reform — a proposal to overhaul and modernize the tax system to make it work for all Americans. This includes lowering business and individual tax rates, closing loopholes, and simplifying the tax code. It also includes reforming our system of international taxation, encouraging companies to bring trillions of dollars currently offshore back to America to invest in jobs and foster economic growth.

A second key aspect of Treasury's reform program is regulatory relief. President Trump's Executive Order 13772 called for a comprehensive review of financial regulations to ensure they are consistent with important core principles. In June, Treasury released the first of these reports on the depository system and, in October, we released additional reports on capital markets and on asset management and insurance. These reports recommend legislative and regulatory solutions to provide certainty for individuals and businesses so that they can spend more of their time and money creating opportunities for American consumers, workers, and their families. In response to Executive Order 13789, Treasury also carried out a thorough review of the burdens imposed by recent tax regulations. We released recommendations on how to ease these burdens.

A central component of Treasury's mission is using its unique financial tools and authorities to target national security and foreign policy threats, as well as protect the U.S. and international financial system from abuse by illicit actors. Treasury's Office of

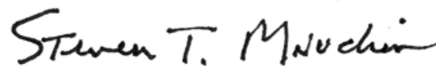
Terrorism and Financial Intelligence plays a critical role in national security matters by strategically applying our policy, intelligence, enforcement, and regulatory tools, including financial sanctions. It is the strategic use of these tools that allows us to target terrorist groups, rogue nations, and weapons of mass destruction proliferators, as well as drug kingpins and money launderers. This year alone we have taken significant actions to: (1) stop the flow of funds to North Korea; (2) counter Iran's malign activities, including its continued support for terrorism, human rights abuses, and its development of ballistic missiles; (3) stem the flow of terrorist financing by establishing the Terrorist Financing Targeting Center with our international partners; (4) increase significant economic pressure on Venezuela's Maduro regime for its assault on democracy; (5) combat the flow of drugs and illicit money through expansive trafficking networks in Mexico and other South American countries; and (6) take actions against human rights violators around the globe, among many other priorities.

On the international front, Treasury's Office of International Affairs is playing an integral role in advancing the President's vision of international policies that improve conditions for American workers and companies. Treasury works with other federal agencies, foreign governments, and international financial institutions to promote economic growth and global stability. Treasury also chairs the Committee on Foreign Investment in the United States, which focuses exclusively on identifying and addressing national security concerns in cross-border transactions. Treasury participates in multilateral development banks and other multilateral forums, where we encourage policies to promote global growth, sound management of public finances and transparency, and sound monetary policy.

As responsible stewards of the resources of the American taxpayers, one of our most important duties is to practice fiscal responsibility and transparency. To that end, Treasury received an unmodified audit opinion on its consolidated financial statements, and validated its financial and performance data as complete and reliable. Treasury strengthened its management controls, made progress towards correcting material weaknesses, and made progress toward achieving all U.S. financial systems and control objectives. We provide this report as a comprehensive review of the Department's important work and finances.

These accomplishments, and the results to come, are due to the hard work of the dedicated women and men of the Department. The intelligence and professionalism exhibited here on a daily basis is what makes this such an important and effective American institution.

In the months ahead, we will release the Department's Strategic Plan for fiscal years 2018 – 2022, which will outline how we plan to continue to work towards a more secure and prosperous future for all Americans. I look forward to our progress.



Steven T. Mnuchin
Secretary of the Treasury
November 15, 2017

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DEPARTMENT OF THE TREASURY

# PART 1: Management's Discussion and Analysis

(Unaudited)


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THE
ALEXANDER HAMILTON

# TREASURY AT A GLANCE

## FOUNDATION

After the American Revolution, Congress realized that funding a war without proper infrastructure and financial discipline presented an enormous challenge to our country's economic stability. Out of the necessity to levy and collect taxes and manage the U.S. government's finances, Congress established the Department of the Treasury on September 2, 1789. President George Washington appointed Alexander Hamilton as Treasury's first Secretary. Since then, 77 Secretaries have led the Department.

Throughout history, Treasury was the foundation for other federal agencies. The U.S. Postal Service, U.S. Customs Service, Secret Service, Federal Law Enforcement Training Center, and U.S. Coast Guard—to name a few—were all, at one point, under Treasury's jurisdiction.

*U.S. Department of the Treasury building, Washington, D.C.(current)*
DEPARTMENT OF THE TREASURY

*Treasury building in the late 1800s. The Treasury building colonnade from the southeast side shows the bustle of pedestrian traffic on 15th Street as they passed in front of the Treasury building.*
DEPARTMENT OF THE TREASURY

## TODAY'S TREASURY AND HOW WE SERVE THE NATION

Treasury remains as one of the premier financial institutions, responsible for the nation's debt management, cash production, loans made to other federal agencies, tax collection, and economic policy formulation. We are a trusted policy advisor to the President, formulating and recommending domestic and international financial, economic, and tax policy. Our contributions to policy development shape America's economic health and security.

The Department also performs a critical and far-reaching role in enhancing national security and reducing our exposure to international terrorism. We do this by employing the Department's national security tools and authorities—including sanctions—to identify, disrupt, and dismantle priority national security and foreign policy threats.

Additionally, we identify and reduce vulnerabilities in the U.S. and international system to prevent abuse by illicit actors. We also leverage our relationships with our federal partners and the private sector to identify cutting-edge technologies to identify, detect, and prevent threats to our economic stability before they occur.

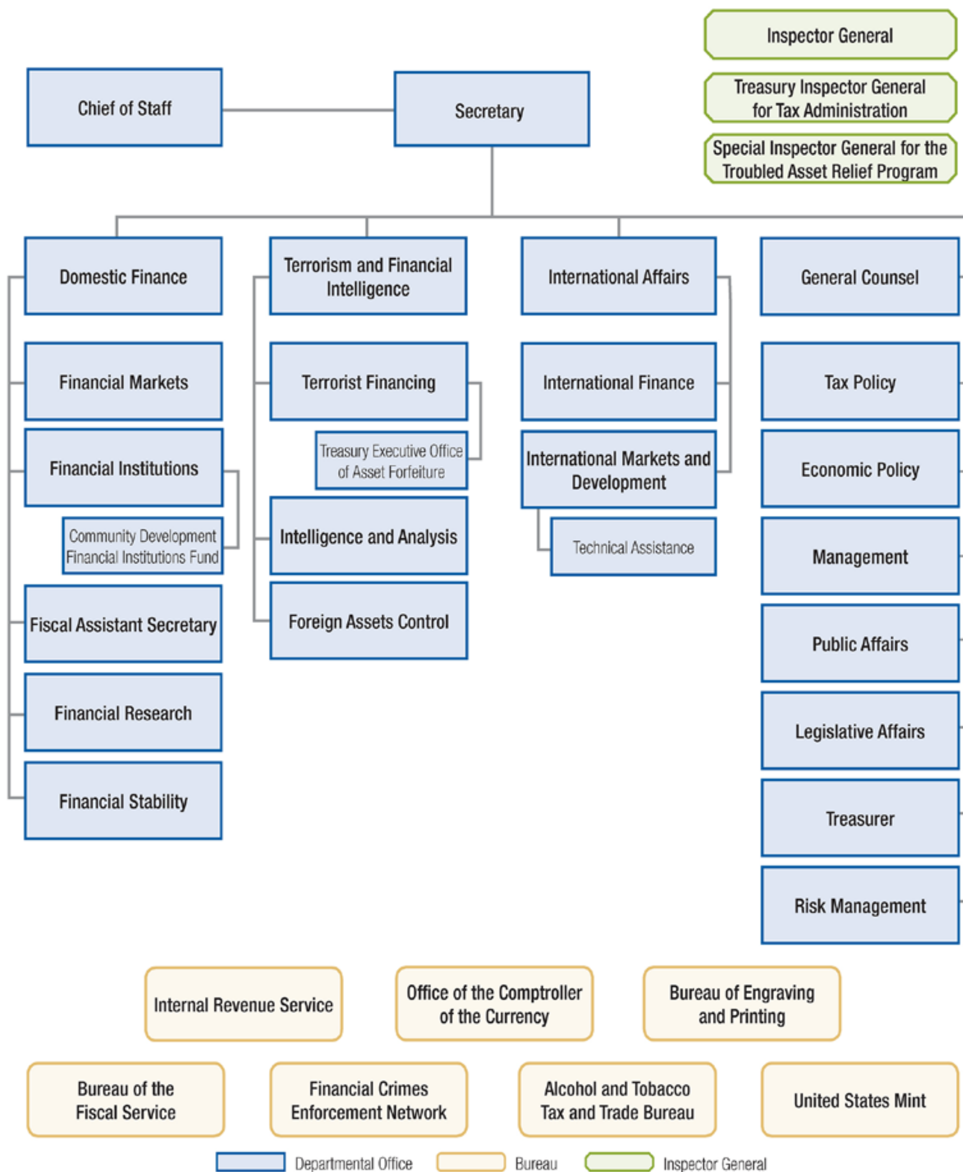
In recent years, we worked to increase opportunities for small businesses, which are the backbone of our economy; helped to create jobs to improve the well-being of U.S. citizens; and led the safeguarding and growth of our national economy. We have been a continuously influential part of the government's service to the American people, growing and developing to meet the nation's needs.

Globally, Treasury represents the U.S. in key economic forums and international financial institutions, including the Group of Seven (G-7) and the Group of Twenty (G-20), which hold annual summits with heads of state to discuss global foreign policy issues. Treasury plays a vital role in promoting stability and growth in the global economy via our leadership roles in the International Monetary Fund, the World Bank, the regional development banks, and other multilateral organizations, like the Financial Stability Board and the Financial Action Task Force.

Although Treasury has evolved to meet the nation's needs, our core mission has remained the same since 1789. Today, with approximately 100,000 employees, we remain steadfast in our commitment to promote conditions that enable economic growth and stability at home and abroad, protect the integrity of the financial system, and effectively manage the U.S. government's finances and resources. We remain the principal steward of the U.S. economy—collecting revenue, meeting financial obligations, and, when appropriate, borrowing.

# ORGANIZATION

Treasury is organized into the Departmental Offices, seven bureaus, and three offices of inspector general. The Departmental Offices are primarily responsible for policy formulation, while the bureaus are the operating units of the organization.



## DEPARTMENTAL OFFICES

Domestic Finance works to preserve confidence in the U.S. Treasury securities market, strengthen financial institutions and markets, and promote access to credit, in service to long-term economic strength and stability.

Terrorism and Financial Intelligence (TFI) uses unique policy, intelligence, enforcement and regulatory tools and authorities to disrupt and disable terrorists, criminals, and other national security threats while also safeguarding the financial system against abuse by illicit actors.

International Affairs protects economic prosperity and national security by working to foster a most favorable external environment for sustained jobs and economic growth.

Tax Policy develops and implements tax policies and programs, reviews regulations and rulings to administer the Internal Revenue Code, and provides revenue estimates for the President's Budget.

Economic Policy reports on economic developments and assists in the determination of appropriate economic policies. Reviews and analyzes domestic economic issues and financial market developments.

The Treasurer of the United States serves as a principal advisor to the Secretary and leads the Office of Consumer Policy, which provides policy leadership, research, and analysis in the areas of fostering economic growth and financial security for American families in a robust consumer marketplace. The Treasurer also oversees the U.S. Mint, including advising the Secretary on coinage matters and liaising with the Federal Reserve.

The Office of Management, including the Chief Financial Officer, manages the Department's financial resources and oversees Treasury-wide programs, including human capital, organizational performance, information technology, acquisition, and diversity issues and inclusion.

The Office of Risk Management oversees the development and implementation of an integrated risk management framework for the Department, advising Treasury leaders on managing credit, market, liquidity, fraud, operational, and reputational risks.

Other offices within Departmental Offices include the General Counsel, Legislative Affairs, and Public Affairs.

## INSPECTORS GENERAL

Three Inspectors General – the Office of Inspector General (OIG), the Treasury Inspector General for Tax Administration (TIGTA), and the Special Inspector General for the Troubled Asset Relief Program (SIGTARP) – provide independent audits, investigations, and oversight of Treasury and our programs.

## BUREAUS

The Alcohol and Tobacco Tax and Trade Bureau (TTB) collects federal excise taxes on alcohol, tobacco, firearms, and ammunition. Enforces and administers laws covering production, use, and distribution of alcohol and tobacco products.

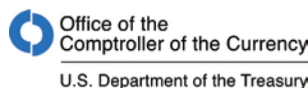
The Bureau of Engraving and Printing (BEP) develops and produces U.S. currency notes, as well as secure documents for government use.

The Financial Crimes Enforcement Network (FinCEN) safeguards the financial system from illicit use and combats money laundering. Promotes national security through the collection, analysis, and dissemination of financial intelligence and strategic use of financial authorities.

The Bureau of the Fiscal Service (Fiscal Service) provides central payment services to federal agencies, operates the U.S. government's collections and deposit systems, and delivers administrative shared services to federal agencies. Provides government-wide accounting and reporting, and manages the collection of delinquent debt. Borrows money needed to operate the U.S. government through the sale of marketable, savings, and special purpose U.S. Treasury securities. Accounts for and services the public debt.

The Internal Revenue Service (IRS) determines, assesses, and collects U.S. tax revenue. Helps taxpayers understand their tax responsibilities and combats tax-related fraud.

The United States Mint (U.S. Mint) designs, mints, and issues U.S. circulating numismatic and bullion coins. Strikes Congressional gold medals and other medals of national significance. Maintains physical custody and protection of most of the nation's gold and all of its silver assets.




The Office of the Comptroller of the Currency (OCC) ensures that the federal banking system operates safely and soundly, provides fair access to financial services, treats customers fairly, and complies with applicable laws and regulations. The OCC charters, regulates, and supervises national banks and federal savings associations, and licenses and supervises federal branches and agencies of foreign banks.

# FY 2017 PROGRESS TOWARD REFORM

Treasury has taken steps in the past year to promote the reform agenda of the new Administration, which, in part, calls for higher and more sustainable levels of economic growth for all Americans. In FY 2017, we advanced several key policies in support of this goal in the areas of tax reform, national security, and regulatory reform. We have begun and will continue to study, develop, and implement regulatory reform policies under the new *Core Principles for Regulating the United States Financial System* (Executive Order 13772), issued on February 3, 2017. At the same time, we are making full use of existing economic and financial instruments, both at the domestic and international level, to address national security.

ADOBESTOCK

### A Competitive Tax System

The United States now has the highest corporate tax rate among the 35 advanced economies in the Organisation for Economic Cooperation and Development, 15.9 percentage points higher than the worldwide average. Tax reform will make the U.S. corporate tax rate competitive again.

## TAX REFORM

We continue to advocate improvements to the U.S. tax system by supporting sound tax policies, focusing on the President's priority of reforming the tax code. We also continue to work with Congress on fundamental tax reform. In September 2017, together with Congress, we jointly released a Unified Tax Reform Framework to deliver on this priority, which:

- Lowers taxes for individuals and families;
- Doubles the Standard Deduction and enhances the Child Tax Credit;
- Eliminates loopholes for the wealthy;
- Repeals the Estate Tax and Alternative Minimum Tax (AMT);
- Creates a new lower tax rate for small businesses;
- Lowers the corporate tax rate to create jobs and promote competitiveness;
- Allows "expensing" of capital investments to boost the economy;
- Moves to an American model for competitiveness by removing incentives to offshore jobs and to keeping foreign profits overseas; and
- Brings profits back home by imposing a one-time, low tax rate on earnings overseas.

Reducing and alleviating taxpayers' compliance burdens is also a significant aspect of the Administration's reform agenda. We focused this year on making the tax system simple, fair, efficient, and pro-growth. In addition to proposing actions to modify or revoke specific regulations identified earlier this year, we identified numerous regulations for potential revocation to eliminate or reduce burdens imposed on taxpayers.

## NATIONAL SECURITY

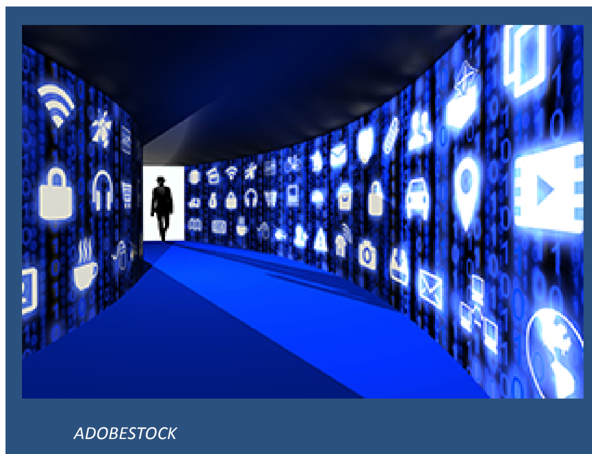
Treasury serves a distinct role in enhancing the security of the nation's financial and economic system. The American people depend on our economic and financial tools, such as sanctions and authorities under the *Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001* (or USA PATRIOT Act). We use these tools to protect the U.S. and international financial system from abuse, as well as to counter the financial networks that support terrorists, organized transnational crime, weapons of mass destruction (WMD) proliferators, and other threats to international security. In FY 2017, our continued focus on countering these illicit actors, monitoring of national security impacts of foreign business investments, and cybersecurity all played a pivotal role in protecting taxpayers.

### National Security Tools and Authorities

Treasury maintains a significant complement of targeted national security tools and authorities that help further the nation's security objectives, including countering the financial networks that support terrorists, organized transnational crime, WMD proliferators, and other threats to international security. The unique tools and authorities we maintain to address domestic and international threats are established in the Office of Terrorism and Financial Intelligence (TFI).

Critical to our continued safety and financial stability, in 2017, TFI continued to deploy an array of targeted financial tools to freeze accounts of terrorists and proliferators, enforce sanctions on rogue nations, and stamp out illicit activities throughout the U.S. and international financial systems.

A key element of TFI's continued success in addressing national security challenges was ensuring that the various components—the Financial Crimes Enforcement Network (FinCEN), the Office of Foreign Assets Control (OFAC), the Office of Intelligence and Analysis (OIA), and the Office of Terrorist Financing and Financial Crimes (TFFC)—were properly integrated, working closely together, and deploying the tools and authorities best suited to each challenge. TFI has a broad range of powerful tools. By using these tools in a complementary and mutually reinforcing way, we increased their impact and better addressed national security concerns.



*ADOBESTOCK*

**Protecting the U.S. Financial System through Cybersecurity**

We must store, process, transmit, and share large volumes of highly sensitive financial and personal information affecting the transaction of trillions of dollars. In FY 2017, as a frame of reference, Treasury managed $22 trillion in assets.

For example, TFI has adopted this integrated approach to countering North Korea, one of the highest priority threats facing the U.S. and its allies and partners.

All components of TFI worked on attacking North Korea's key financial vulnerabilities. Treasury's OIA provided expert analysis of North Korea's financial networks, identifying key nodes to target for disruptive action.

OFAC tirelessly investigated and targeted individuals and entities that support North Korea's WMD and ballistic missile programs. OFAC also undertook high-profile enforcement actions to make clear that doing prohibited business with North Korea would result in heavy penalties.

FinCEN exercised its information gathering and analytical tools in novel ways to track the financial flows of North Korean entities and front companies, and has used Section 311 of the USA PATRIOT Act to further restrict North Korea's access to the U.S. financial system.

TFFC led our international engagement efforts to work with partner countries, thereby hardening the defenses worldwide and depriving North Korea of alternative financial avenues.

Our goal continues to be to strategically and tactically cut off North Korea's revenue sources and safeguard the international financial system from North Korea's illicit financial activity.

Our approach to North Korea is just one example of this focus on integration. With every national security and law enforcement challenge we face, each component will be thinking about how it can be aggressive in using its authorities in novel, impactful, and complementary ways.

We also focused on better integrating our efforts with those of our allies and partners. For example, earlier this year, the U.S. and Saudi Arabia announced the creation of the Terrorist Financing Targeting Center (TFCT), a collaborative approach to addressing the evolving threats arising from terrorist financing.

The TFTC is a joint effort by the U.S., Saudi Arabia, and others in the Gulf Cooperation Council, and represents a new step forward in sharing information and coordinating joint disruptive actions against terrorism. The creation of the new TFTC focuses our efforts on disrupting the financial and support networks that enable terrorists.

Overall, in FY 2017, we worked to curb terrorist financing, and implemented sanctions and other financial measures to combat the threats our nation faces from Iran, North Korea, Syria, Venezuela, and Russia, among other countries. Our targeted efforts continued against Islamic State in Iraq and Syria (ISIS) global financial and facilitation networks. We also aggressively targeted ISIS, al-Qaida, and Hezbollah leadership, financiers, and financial structures to disrupt their ability to plan and execute terrorist attacks.

Moreover, we produced financial analysis on organized crime groups in the U.S. related to narcotics and third-party money laundering networks, and issued intelligence assessments on the exploitation of emerging payment systems. Illustrative of this work, in August 2017, collaborating with U.S. and Mexican law enforcement actions, the Office of Foreign Assets Control identified 22 Mexican nationals and 43 entities in Mexico as significant foreign narcotics traffickers.

## Foreign Investment in the U.S.

Treasury plays a key role in protecting U.S. national security. We help protect the security of our nation's government, military, businesses, investors, and consumers by safeguarding the United States from threats posed by foreign investment.

To that end, the Committee on Foreign Investment in the U.S. (CFIUS) is an inter-agency committee chaired by the Secretary of the Treasury. CFIUS is authorized to review business transactions (e.g., mergers and acquisitions) that could result in control of a U.S. business by a foreign person, called "covered transactions."

In FY 2017, CFIUS initiated review of approximately 230 notices of covered transactions. CFIUS cleared those transactions that did not pose any national security concerns. CFIUS required the parties to adopt mitigation measures in a number of other instances in which the transactions posed a national security risk. In other instances in which CFIUS identified a national security risk, but concluded that the risk could not be mitigated, CFIUS informed the parties that it was prepared to refer the matter to the President for action. Parties generally voluntarily abandon transactions in such circumstances.

In the one instance in which the parties did not voluntarily abandon their transaction, CFIUS recommended that the President prohibit the transaction. In that instance, consistent with the Administration's commitment to take all actions necessary to ensure the protection of U.S. national security, the President issued an order prohibiting the acquisition of a company called Lattice Semiconductor Corporation. The national security risk posed by the transaction related primarily to the potential transfer of intellectual property to a foreign acquirer and the Chinese government's role in supporting this transaction.

## Cybersecurity

The cybersecurity threat to our nation's critical infrastructure is growing, and represents one of the most significant challenges to our country's national and economic security. Increasing cyber-attacks against U.S. financial institutions could lead to a loss in confidence in our financial system and present significant economic challenges.

Our mission involves addressing a wide range of evolving cybersecurity risks, in collaboration with private and other public sector organizations. Our risks include: (1) limitations of available authentication technologies; (2) reliance on externally managed critical infrastructure; (3) continuing discovery of new vulnerabilities; (4) inadequate information sharing; and (5) a decentralized technology landscape.

The cybersecurity risk facing the Department and, more broadly, the U.S. financial services sector, is magnified by the continuous evolution in technology, as well as the volume, sophistication, and frequency of cyber threats directed against both. As the presidentially-designated agency for the financial services sector, the Department's Office of Critical Infrastructure Protection and Compliance Policy (OCIP) has an all-hazards mission to enhance the security and resilience of the financial services sector's critical infrastructure. We work collaboratively with our public and private sector partners, as well as international partners, to address the hazards that pose an operational risk to the financial services sector, including cyber and physical events, via naturally-occurring and man-made causes.

To mitigate these threats, the *Federal Information Security Modernization Act of 2014* (FISMA) requires that agencies have an annual independent evaluation performed of their information security programs and practices to determine their effectiveness and to report the results to the Office of Management and Budget (OMB). In FY 2017, Treasury implemented FISMA requirements around policies, procedures, and strategy, and will continue to improve safeguards around information technology. Additionally, OCIP coordinates efforts to reduce risk within the financial sector through a focus on: (1) prioritization and collaboration; (2) information sharing; (3) baseline protections; and (4) response and recovery.

Further improving our cybersecurity posture, in FY 2017, we established a Department-wide Cybersecurity Enhancement Account to strategically focus our cybersecurity efforts and avoid fragmentation of information technology management across our bureaus. The new account leads to cost efficiencies and improves our ability to quickly respond in the event of a cyber-attack.

## Financial Regulatory Reform

Outside of national security and tax reform, we focused on addressing the Administration's Core Principles for reforming the financial regulatory system through a series of planned reports. In FY 2017, we directed our attention to improving the financial regulatory system and economy consistent with Executive Order 13772.

The Core Principles include empowering Americans to make independent financial decisions, save for retirement and build wealth, and discourages taxpayer-funded bailouts. The principles also include promoting American competitiveness—both at home and abroad—while making regulation efficient, effective and appropriately tailored.

ADOBESTOCK

### Core Principles to Address our Financial Regulatory Structure

Treasury's recommendations seek to improve financial regulation and remove duplication and overlap. In 2016, the Government Accountability Office (GAO) released a report that concluded that significant fragmentation, overlap, and duplication exists within the regulatory framework. Specifically, GAO found the existing structure does not always ensure efficient and effective oversight, consistent financial oversight, and consistent consumer protections.

Per the direction of Executive Order 13772, we issued the first in a series of reports in June 2017 applying these Core Principles to an examination of the U.S. financial regulatory system for depository institutions. We detailed executive actions and recommendations for regulatory reform to provide relief to consumers and businesses.

Given the breadth of the financial system and a complex regulatory environment, we divided our review of the financial system into a series of planned reports with the following subject areas: (1) the depository system; (2) capital markets; (3) asset management and insurance industries, and retail and institutional investment; and (4) non-bank financial institutions, financial technology, and financial innovation.

The U.S. banking system is the strongest in the world, and is critical in supporting the U.S. economy. In our first report, we recognize the unique role of the depository system, banks, and credit unions. In particular, we recommend that capital, liquidity, and leverage rules be simplified to increase the flow of credit so that our banks remain globally competitive, among other recommendations.

We released the second and third reports in response to Executive Order 13772 in October 2017. These reports detail our recommendations of how to streamline and reform the U.S. regulatory system impacting the capital markets and the asset management and insurance industries. Our evaluation found that there are significant reforms possible to promote growth and a healthy financial system, while maintaining strong investor protections.

These reports detail recommendations to streamline disclosure requirements to reduce costs incurred by companies while providing investors key information needed for investment decisions. For example, our reports outline that disclosure and other requirements can be better tailored for companies going public based on their size. We also recommend re-examining the 2012 *Jumpstart Our Business Startups Act* (JOBS Act) to identify how its tools can be improved.

As we continue to evaluate and generate more recommendations for the U.S. financial system, we will programmatically align our operations, to the maximum extent possible, to achieve outcomes within our purview around these findings.

# FY 2017 OPERATIONAL PERFORMANCE MEASURES

In FY 2017, we continued to deliver value to our customers, the American taxpayer. Our performance measures present data on service and operational outcomes for our core programs.

Table 1 contains trend information for key measures used to assess our performance in core services and operations—programs that are critical to the proper functioning of the U.S. government.

For each measure, we provide definitional information and briefly explain the trend in performance over the past four years. A full discussion of performance trends for all of our programs is included in the APR.

## TABLE 1: SELECT PERFORMANCE MEASURES

| Bureau | Measure | FY 14 | FY 15 | FY 16 | FY 17 | FY 17 Target | FY 17 Result vs Target |
|---|---|---|---|---|---|---|---|
| BEP | Manufacturing costs for currency – dollar costs per thousand notes produced | $42.0 | $42.4 | $44.3 | $43.6 | $50.0 | Exceeded |
| | This measure calculates the actual manufacturing cost for currency notes, which include direct labor costs, the cost of raw materials used, and related manufacturing overhead charges. The FY 2017 cost was lower than anticipated due to savings resulting from decreased spoilage, as well as the recovery of Series 2009 $100 notes through the Single Note Inspection process. | | | | | | |
| U.S. MINT | Seigniorage per dollar issued | $0.37 | $0.49 | $0.52 | $0.45 | $0.48 | Unmet |
| | This measure calculates the difference between the face value and the cost of minting and issuing circulating coins. "Seigniorage per dollar issued" is the seigniorage generated from each dollar of circulating coinage shipped to Federal Reserve Banks. FY 2017 results fell below the target and prior year performance as a result of a 14 percent decrease in circulating shipment volumes combined with a four percent increase in the cost of metal. | | | | | | |
| TTB | Percent of permit applications processed within service standards | 58% | 47% | 32% | 48% | 85% | Unmet |
| | This measure indicates how often TTB processes permit applications within the established customer service standard for new businesses seeking to engage in alcohol or tobacco manufacturing or distribution to ensure timely market entry for qualified individuals. TTB maintained its 75-day service standard for permit applications in FY 2017. TTB continues to face challenges in timely service due to resource constraints combined with a high volume of applications. | | | | | | |
| | Percent of label and formula applications processed within service standards | 67% | 75% | 75% | 62% | 85% | Unmet |
| | This measure indicates how often TTB processes alcohol beverage label and formula applications within the established customer service standards to improve consistency and reliability for the business community served. TTB established new service standards of 10 days for both labels and formulas in FY 2017. This marked a significant departure from the 30-day standard for labels and 45-day standard for formulas in place in FYs 2014 - 2016. Through the effective deployment of additional staffing resources, as well as the elimination of formula filing requirements, TTB made significant progress toward achieving the new 10-day standard for 85 percent of label and formula applications. | | | | | | |

## TABLE 1: SELECT PERFORMANCE MEASURES (CONTINUED)

| Bureau | Measure | FY 14 | FY 15 | FY 16 | FY 17 | FY 17 Target | FY17 Result vs Target |
|---|---|---|---|---|---|---|---|
| Fiscal Service | Percentage of Treasury payments and associated information made electronically | 94.4% | 94.8% | 94.9% | 95.1% | 95.2% | Unmet |
| Fiscal Service | Percentage of total dollar amount of U.S. government receipts settled electronically | 98.0% | 98.0% | 98.2% | 98.3% | 98.0% | Exceeded |
| Fiscal Service | Fiscal Service has been promoting the Paperless Treasury initiative for several years in an effort to disburse payments, as well as receive and settle collections, through electronic means. Fiscal Service added a third Digital Wallet provider (Amazon Pay) and expanded agency adoption of Digital Wallet collections by adding 22 agencies in FY 2017. In FY 2017, Fiscal Service increased adoption of public-facing mobile apps by six agencies, and increased adoption of agency-facing mobile apps by eight agencies. | | | | | | |
| IRS | Percentage of individual returns processed electronically | 84.1% | 85.3% | 86.4% | 86.9% | 87.0% | Unmet |
| IRS | This measure reflects the number of electronically filed individual tax returns divided by the total individual returns filed. The IRS exceeded actual prior year performance but fell slightly short of the annual target for individual returns processed electronically. The IRS will continue to process individual returns as efficiently as possible to meet the FY 2018 plan. | | | | | | |
| IRS | Taxpayer Self-Assistance Rate | 84.7% | 88.7% | 89.0% | 79.0% | N/A | N/A |
| IRS | This measure identifies the percentage of taxpayer assistance requests resolved using self-assisted automated services. Starting in FY 2017, the IRS modified the Taxpayer Self-Assistance Rate measures to include additional self-assistance applications, including Get Transcript and payment applications, such as Direct Pay and Online Payment Agreements. Any new self-assistance applications provided to the public will be added to the methodology. | | | | | | |
| IRS | Full-year Customer Service Representative Level of Service | 64.4% | 38.1% | 53.4% | 77.1% | 64.0% | Exceeded |
| IRS | This measure indicates the number of toll free callers that either speak to a Customer Service Representative or receive information messages divided by the total number of attempted calls during the full fiscal year. Level of Service was better than planned due to the demand being lower than expected. Through extensive communication, the IRS encouraged taxpayers to use the Web or automated tools and alternate channels to get their concerns resolved quickly and efficiently. In addition, FY 2018 volumes of demand and successful automation/web activities will also be monitored and reported out on a recurring basis. | | | | | | |
| FinCEN | Percentage of users finding that financial intelligence collected by FinCEN pursuant to its regulations provides valuable information | 81% | 83% | 84% | 86% | 85% | Exceeded |
| FinCEN | This measure reflects the value of FinCEN's BSA data to law enforcement and evaluates whether the data provided unknown investigative information, supplemented or expanded known investigative information, verified information, or helped identify new leads. In FY 2017, 86 percent of users found the intelligence valuable, thereby surpassing the FY 2017 target of 85 percent. FinCEN will continue to emphasize improvements in data quality and filing information, as well as continued training efforts to improve understanding and utilizing the FinCEN Query tool for the bureau's unique cases and situations. | | | | | | |
| Management | Federal Employee Viewpoint Survey (FEVS) Engagement Index – 1 to 100 | 66% | 66% | 67% | 68% | 67% | Exceeded |
| Management | The FEVS Engagement Index is comprised of three Office of Personnel Management (OPM) calculated indices — Leaders Lead, Supervisors, and Intrinsic Work Experiences. The Engagement Index denotes the extent to which employees are engaged in their work and motivated by their organization's leadership. Treasury's Engagement Index showed a one percent increase from 67 percent to 68 percent between 2016 and 2017. Nine out of eleven Treasury components continued to show increases in their Engagement Index by one to six points from 2016 to 2017. The increase in Treasury's Engagement Index can be attributed to gains in all three OPM indices. | | | | | | |
| Management | Treasury-wide Footprint in Thousands of Sq. Ft. | 36,418 | 35,439 | 34,894 | TBD | 34,310 | TBD |
| Management | This measures the total square footage occupied by Treasury's owned and leased buildings. The Department's real property footprint was reduced by an estimated 1.5 percent (approximately 500,000 square feet) during FY 2016. The reduction was achieved through better use of existing office space, consolidations and co-locations, increased use of telework, and the implementation of new space design standards. The Department projects that the footprint will be reduced by another 500,000 square feet in FY 2017. The final FY 2017 footprint data is expected to be available in late December 2017. | | | | | | |

# STRATEGIC MANAGEMENT

## FRAMEWORK

*The Government Performance and Results Act* (GPRA) and the *GPRA Modernization Act of 2010* require agencies to identify goals, report progress against targets, and conduct data-driven reviews. These practices serve two key purposes for stakeholders within and outside of the organization — to assess the organization's health and impact, and to enhance effective decision-making and strategy, including resource allocation. In this spirit, we developed a strategic framework using best-in-class organizational performance practices to ultimately help achieve our strategic goals and objectives.

## ORGANIZATIONAL PERFORMANCE REVIEW CYCLE

Our organizational performance reviews provide a regular forum for open dialogue and coordination between departmental, bureau, and policy office leadership. We bring together different perspectives to set and align priorities, identify and solve problems, review agency performance, and drive results. The cycle integrates statutory requirements to conduct quarterly performance reviews of agency goals and a Strategic Objective Annual Review (SOAR), which analyzes cross-cutting performance and identifies a set of strategic objectives as priority focus areas.

At certain points throughout the fiscal year, we set annual priorities, evaluate progress, problem-solve around risks and challenges, and assess funding options in the context of performance outcomes. Treasury's process and framework for managing to our strategic objectives and performance outcomes is described in Table 2 below.

## FY 2018 OUTLOOK

Our FY 2018 – 2022 Strategic Plan will be published in February 2018. In this plan, we will describe the long-term goals and objectives we aim to achieve during this Administration, building from the progress made and challenges identified in FY 2017.

Our FY 2017 SOAR outlined several focus areas that will shape the development of our future priorities: (1) pursuing tax reform and improving the execution of the tax code; (2) increasing the efficiency and transparency of federal financial management; and (3) supporting effective data-driven decision-making.

Looking ahead, we will shape our strategic goals around five key priority areas: (1) boosting U.S. economic growth; (2) promoting financial stability; (3) enhancing national security; (4) transforming federal financial stewardship; and (5) achieving operational excellence within our department.

### TABLE 2: STRATEGIC FRAMEWORK

| Sessions | Fall (October – November) | Winter (February - March) | Spring (April – May) | Summer (June – July) |
|---|---|---|---|---|
| Focus | **Organizational Performance** | **SOAR** | **Organizational Performance** | **Budget** |
| Chair | Assistant Secretary for Management/Performance Improvement Officer (ASM/PIO) | ASM/PIO and Deputy PIO | ASM/PIO | ASM/PIO |
| Goals/Outcomes | • Review prior year's performance at the bureau/office level<br>• Set priorities for year ahead<br>• Recognize successes | • Evaluate cross-agency progress toward strategic objectives<br>• Identify strategic shifts/ validate Treasury priorities<br>• Outline potential topics for annual review with OMB | • Assess progress on priorities<br>• Identify necessary adjustments/near-term improvements<br>• Surface problems or assistance needed<br>• Recognize successes | • Connect priorities to future funding<br>• Explore performance impacts<br>• Strengthen information technology acquisition budgeting accountability |

# ENTERPRISE RISK MANAGEMENT

## FRAMEWORK

In July 2016, OMB released an updated Circular No. A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control* to ensure federal managers are effectively managing risks to achieve strategic objectives. Management, together with the Chief Risk Officer (CRO), is responsible for establishing a governance structure to effectively implement a robust process of risk management and internal control. Successful implementation requires us to establish and foster an open, transparent culture that encourages people to communicate information about potential risks and other concerns with their superiors.

To this end, the CRO chairs regular Risk Management Committee meetings which bring together leaders from across Departmental Offices. The Office of Risk Management (ORM) has also established an Enterprise Risk Management (ERM) Council, chaired by the CRO, which brings together risk managers from each of our bureaus on a regular basis. In FY 2017, ORM worked with offices and bureaus across Treasury to develop a risk profile, which will be updated annually.

Beyond its work at Treasury, ORM led an effort to author a playbook to assist federal agencies in their implementation of an ERM governance structure in accordance with the OMB Circular's guidelines. This playbook was published in July 2016. After the release of the playbook, ORM worked to establish an ERM Point of Contact Working Group. This government-wide working group, comprised of representatives from federal agencies and their key components, meets on a regular basis to discuss common risks and various methods of implementing the guidelines of the Circular.

## ENTERPRISE RISKS AND CHALLENGES

Through the FY 2017 the SOAR and enterprise risk management process, we identified the following cross-cutting risks and challenges that will be reflected in Treasury's FY 2018 – 2022 strategic goals and objectives.

**Human Capital –Workforce Planning/Recruitment:** Issues within the human capital lifecycle (e.g., recruitment, development, and retention), coupled with the lengthy security clearance process, routinely present challenges for achieving the organization's mission. Additionally, expanding the use of workforce planning and metrics to proactively forecast and meet workforce needs proves challenging, particularly in the enforcement, analytics, and regulatory fields.

**Program Oversight and Alignment to Mission:** We identified a need to better understand and meet customer expectations, and to better measure the impact of our programs across a range of mission areas.

**Cybersecurity:** Continued growth of increasingly sophisticated threats requires constant vigilance (enabled by state-of-the-art monitoring, implementation of cyber hygiene, and an insider threat program) and retention and recruitment of top talent (enabled by the use of strategic workforce planning) to ensure proper baseline protections.

**Aging Infrastructure:** We must address risks associated with outdated information technology infrastructure, facilities, and equipment to safeguard employees and systems.

# FINANCIAL HIGHLIGHTS – FINANCIAL OVERVIEW

The financial highlights below are an analysis of the information included in our consolidated financial statements that appear within Part 2, "Financial Section" of this report. Our principal financial statements have been prepared to report Treasury's financial position and results of operations, pursuant to the requirements of 31 USC 3515(b). These consolidated financial statements have been prepared from our books and records in accordance with Generally Accepted Accounting Principles (GAAP) for federal entities and the formats prescribed by OMB. The consolidated financial statements are in addition to the financial reports used to monitor and control budgetary resources, which are prepared from the same books and records. The financial statements are for a component of the U.S. government, a sovereign entity.

The chart below presents changes in key financial statement line items as of and for the fiscal year ended September 30, 2017, compared to September 30, 2016.

### Summary Financial Information (*$ in billions*)

| | 2017 | 2016 | $ Change | % Change |
|---|---|---|---|---|
| Total Assets | $ **22,686.2** | $ 22,170.9 | $ 515.3 | 2.3% |
| Total Liabilities | $ **22,188.8** | $ 21,667.0 | $ 521.8 | 2.4% |
| Total Net Position | $ **497.4** | $ 503.9 | $ (6.5) | (1.3)% |
| Total Net Cost of Treasury Operations | $ **20.1** | $ 17.7 | $ 2.4 | 13.6% |
| Net Federal Debt Interest Costs | $ **413.3** | $ 385.7 | $ 27.6 | 7.2% |
| GSEs Non-Entity Revenue, Net | $ **(9.4)** | $ (13.8) | $ (4.4) | (31.9)% |
| Total Net Cost of Treasury Operations and Non-Entity Costs | $ **438.6** | $ 403.6 | $ 35.0 | 8.7% |
| Total Budgetary Resources | $ **818.5** | $ 797.3 | $ 21.2 | 2.7% |
| Agency Outlays, Net | $ **420.5** | $ 400.3 | $ 20.2 | 5.0% |
| Net Revenue Received (Custodial) | $ **3,087.3** | $ 3,048.7 | $ 38.6 | 1.3% |

**Financial Overview.** Our financial performance as of and for the fiscal year ended September 30, 2017, reflects several major trends. Most significantly, the outstanding federal debt, including interest, rose by $674.5 billion to $20.3 trillion to finance the U.S. government's operations.

Additionally, our "Total Net Cost of Treasury Operations and Non-Entity Costs" for FY 2017 increased by $35.0 billion, primarily stemming from non-entity activity, including $27.6 billion of higher net federal debt interest costs and $4.4 billion of lower revenue from our investments in two Government Sponsored Enterprises (GSEs) — Fannie Mae and Freddie Mac — pursuant to our Senior Preferred Stock Purchase Agreements, as amended (refer to the *GSEs Non-Entity Revenue, Net* discussion below).

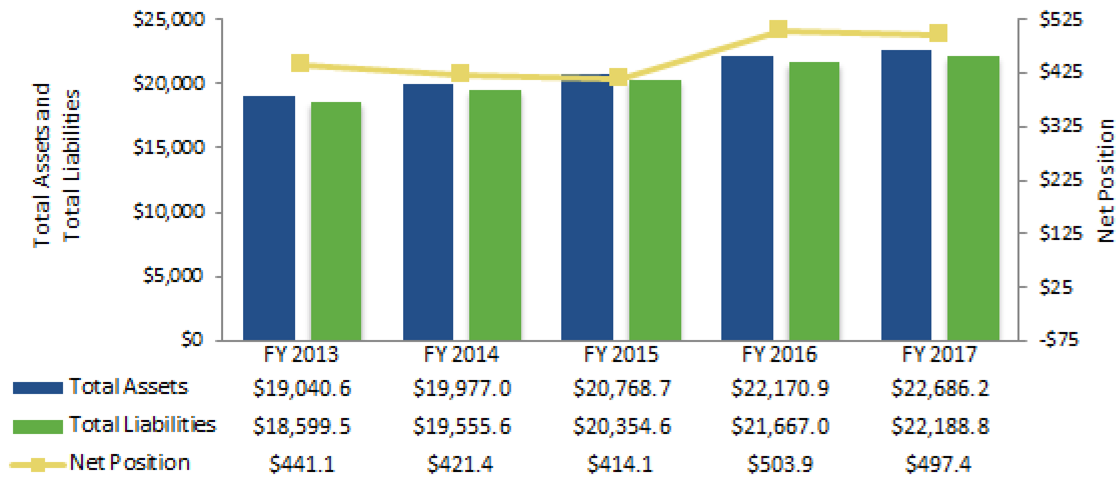



**Figure 1: Total Assets, Total Liabilities, and Net Position (*in billions*)**

Total Assets of $22.7 trillion at September 30, 2017 consist of a receivable due from the General Fund of the U.S. Government (General Fund) of $20.4 trillion, intra-governmental loans and interest receivable of $1.5 trillion, and fund balance and various other assets totaling $856.8 billion (Figure 2).

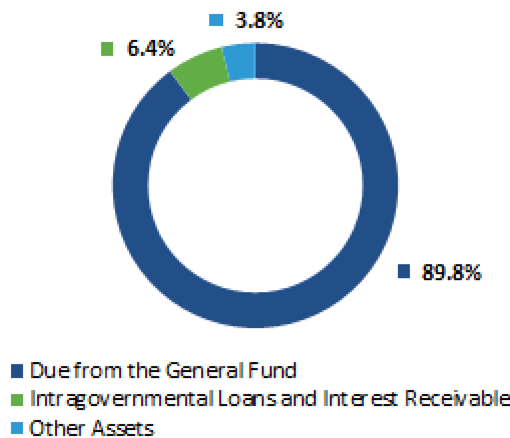



**Figure 2: FY 2017 Total Assets (Composition)**

The $515.3 billion (or 2.3 percent) increase in total assets at the end of FY 2017 over the prior year is primarily due to a $674.6 billion increase in the "*Due From the General Fund*" account. Of this increase, $674.5 billion corresponds to an increase in federal debt and related interest payable. The "*Due From the General Fund*" asset account, represents future funds required from the General Fund to pay borrowings from the public and other federal agencies.

Intra-governmental loans and interest receivable represent loans issued primarily by the Fiscal Service to other federal agencies for their own use or for the agencies to loan to private sector borrowers whose loans are guaranteed by the federal agencies. This receivable grew by $55.0 billion (or 3.9 percent) to $1.5 trillion at the end of FY 2017 due to increased borrowings by various federal agencies — such as the Departments of Education, Homeland Security, and Transportation — to fund their existing programs.

Among other things, other assets include operating cash balances (held on behalf of the U.S. government), foreign currency investments and Special Drawing Rights, as well as investments in, and credit program receivables due from, certain financial institutions for which we provide financial assistance in an effort to stabilize financial markets. Other assets decreased by $214.3 billion, largely reflecting a decrease in the U.S. government's operating cash balances, offset by an increase in borrowings from the public. Operating cash balances held in depository institutions and Federal Reserve Bank accounts decreased primarily due to adjustments in borrowing in FY 2017 driven by the delay in raising the statutory debt limit.

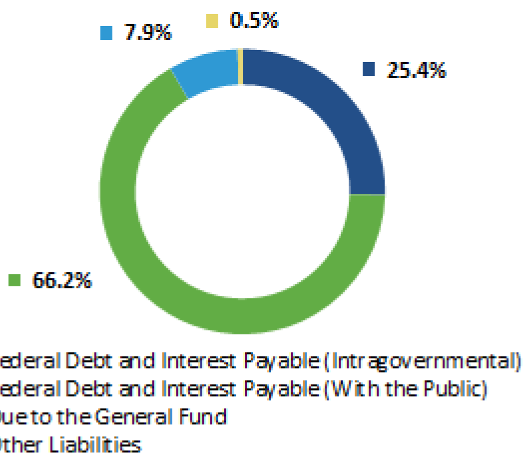
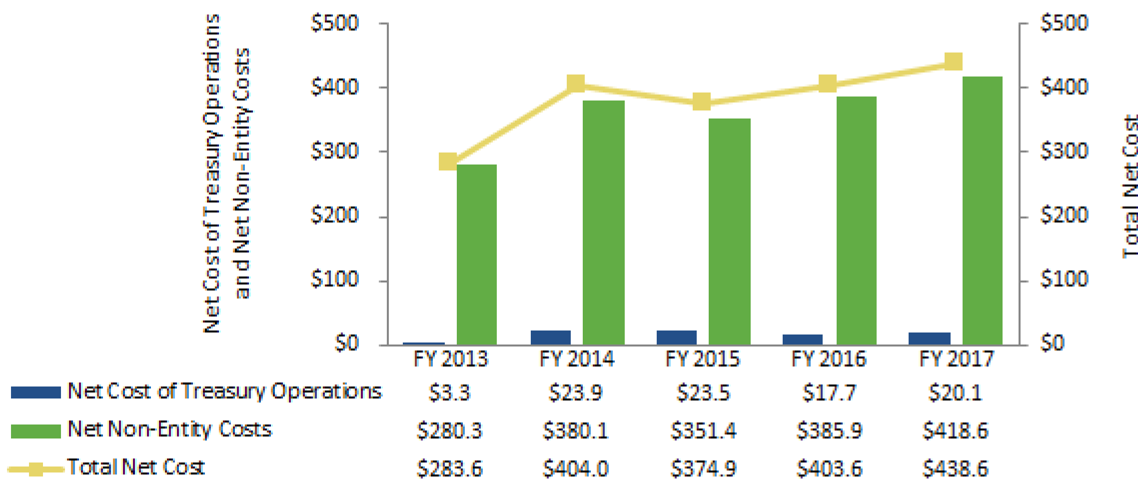



**Figure 3: FY 2017 Total Liabilities (Composition)**

**Total Liabilities** of $22.2 trillion at September 30, 2017 principally consist of the federal debt held by the public, including interest, of $14.7 trillion (Figure 3), which was mainly issued as Treasury Notes and Bills. Liabilities also include intra-governmental liabilities totaling $7.4 trillion (of which $5.6 trillion represents principal and interest on federal debt in the form of Treasury securities held by federal agencies), and various other liabilities totaling $83.3 billion. The $521.8 billion (or 2.4 percent) increase in total liabilities over the prior year is attributable to a $674.5 billion increase in federal debt, including interest, held by the public and federal agencies that was needed to finance the U.S. government's budget deficits.

The increase in federal debt, including interest, held by the public and federal agencies was offset by a $151.6 billion decrease in the "*Due to the General Fund*" account, which corresponds primarily to decreases in the U.S. government's operating cash balances, as discussed above. Through the Fiscal Service, we account for and report on the principal borrowings from and repayments to the General Fund, as well as the related interest due to the General Fund.

**Total Net Position** of $497.4 billion at September 30, 2017 represents the combined total of our cumulative results of operations and unexpended appropriations at the end of the fiscal year. The $6.5 billion (1.3 percent) decrease in the net position at the end of FY 2017 was principally attributable to normal business operations.




| | FY 2013 | FY 2014 | FY 2015 | FY 2016 | FY 2017 |
|---|---|---|---|---|---|
| Net Cost of Treasury Operations | $3.3 | $23.9 | $23.5 | $17.7 | $20.1 |
| Net Non-Entity Costs | $280.3 | $380.1 | $351.4 | $385.9 | $418.6 |
| Total Net Cost | $283.6 | $404.0 | $374.9 | $403.6 | $438.6 |

**Figure 4: Net Cost of Treasury Operations and Non-Entity Costs (*in billions*)**

**Total Net Cost of Treasury Operations and Non-Entity Costs**, is presented on our Consolidated Statements of Net Cost (Figure 4). *"Net Cost of Treasury Operations"* represents the gross costs, net of earned revenues, we incurred related to our own entity activities comprising both operating bureaus and Departmental Offices that are consolidated with the Department. *"Net Non-Entity Costs"* represent the gross costs, net of earned revenues, we incurred on behalf of the U.S. government (or General Fund), and primarily include federal debt interest costs, net of GSE non-entity revenues. *"Total Net Cost of Treasury Operations and Non-Entity Costs"* totaled

$438.6 billion and $403.6 billion for FY 2017 and 2016, respectively, an increase of $35.0 billion (or 8.7 percent) over the prior year. *"Net Non-Entity Costs"* and *"Net Cost of Treasury Operations"* contributed $32.6 billion (primarily driven by net federal debt interest costs and GSE net revenue) and $2.4 billion, respectively, to the year-over-year increase in net costs.

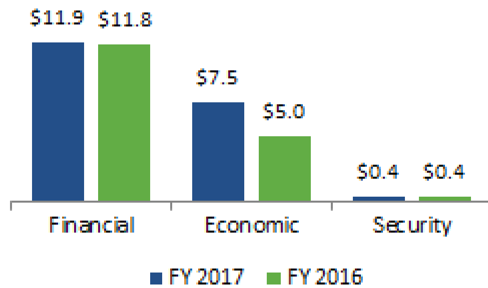



**Figure 5 : Net Cost of Treasury Operations by Strategic Program (*in billions*)**

**Net Cost of Treasury Operations** is presented on our Consolidated Statements of Net Cost by strategic program. There are three main categories of strategic programs presented — financial, economic, and security — as well as a management strategic program which is combined with the financial program due to the immateriality of the management program (Figure 5). Our Net Cost of Treasury Operations totaled $20.1 billion for FY 2017 compared to $17.7 billion for FY 2016, an increase of $2.4 billion (or 13.6 percent). This increase is primarily a result of increased valuation losses associated with our foreign denominated investments due to weakening currency exchange rates on certain foreign currencies against the U.S. dollar.

**Net Federal Debt Interest Costs** ***(a non-entity cost)*** primarily reflects interest expense on the federal debt which increased $26.7 billion (or 6.3 percent) in FY 2017. The higher cost was primarily attributable to an increase in outstanding debt held by the public, as well as an increased inflation adjustments associated with Treasury Inflation-Protected Securities which are driven by increases in the Consumer Price Index.

**GSEs Non-Entity Revenue, Net** totaled $9.4 billion for 2017 compared to $13.8 billion for 2016. The $4.4 billion decrease in this net revenue in 2017 was driven by an $18.2 billion year-to-year decrease in the fair value of our GSE investments. The value of these investments decreased by $15.9 billion at the end of FY 2017, compared to an increase of $2.3 billion at the end of FY 2016. The change in value is attributable mainly to a higher discount rate which was driven by a higher long-term Treasury rate. This decrease in revenue was offset by a $13.8 billion year-to-year increase in senior preferred stock dividends received from the two GSEs due to higher combined GSE earnings in 2017.

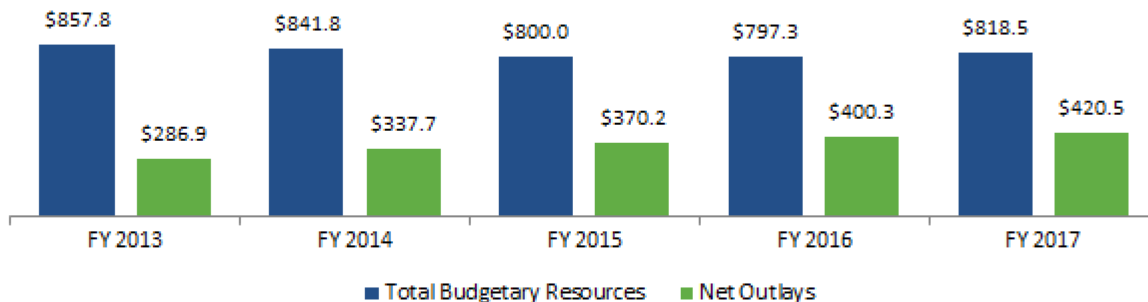



**Figure 6 : Total Budgetary Resources and Agency Outlays, Net (*in billions*)**

**Total Budgetary Resources** of $818.5 billion in FY 2017 (Figure 6) increased by $21.2 billion (or 2.7 percent), primarily due to a $19.0 billion increase in appropriations received to pay interest on the public debt.

**Agency Outlays, Net** of $420.5 billion were higher in FY 2017 (Figure 6) by $20.2 billion (or 5.0 percent), primarily due to a $19.0 billion increase in interest payments on public debt.

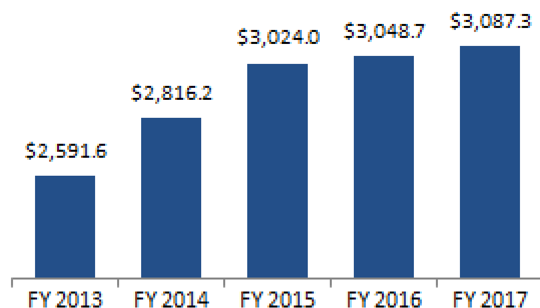



**Figure 7 : Net Revenue Received (Custodial) (*in billions*)**

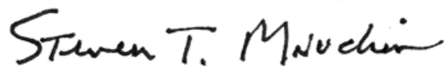
Net Revenue Received (Custodial), representing the net revenue we collected on behalf of the U.S. government, includes various taxes, primarily income taxes, as well as user fees, fines and penalties, and other revenue. Over 90 percent of these revenues are related to income and social security taxes. Net revenue received was $3.1 trillion for FY 2017, an increase of $38.6 billion (or 1.3 percent) over the prior fiscal year. This increase is attributable mainly to an overall growth in individual income tax collections, partially offset by reduced estate and corporate income tax collections and deposit of earnings from the Federal Reserve System.

# MANAGEMENT ASSURANCES

## THE SECRETARY'S ASSURANCE STATEMENT

The Department of the Treasury's management is responsible for managing risks and maintaining effective internal control and financial management systems that meet the objectives of the *Federal Managers' Financial Integrity Act* (FMFIA). We have evaluated our management controls, internal controls over financial reporting, and compliance with federal financial systems standards. As part of the evaluation process, we considered results of extensive testing and assessment across the Department and independent audits.

We can provide reasonable assurance that the objectives of Section 2 of the FMFIA for financial reporting and operations have been achieved, except for the material weaknesses noted below. Additionally, we are in substantial conformance with Section 4 of the FMFIA for Financial Management System Requirements. In accordance with Appendix A to the OMB Circular A-123, *Internal Control over Financial Reporting*, we can provide a modified assurance that internal control over financial reporting was operating effectively as of June 30, 2017 based on the results of our assessment. We are not in substantial compliance with the *Federal Financial Management Improvement Act* (FFMIA) due to the IRS material weakness related to unpaid tax assessments.



Steven T. Mnuchin
Secretary of the Treasury
November 15, 2017

As of September 30, 2017, Treasury had two FMFIA material weaknesses as follows:

**Operations:** The Fiscal Service needs to improve internal controls over the processes used to prepare the U.S. Consolidated Financial Statements

**Financial Reporting:** The IRS needs to improve internal controls over unpaid tax assessments

We continue to make progress on these weaknesses, and will remain committed to focusing management attention and resources on appropriate corrective actions. Overall, we continue our efforts to maintain high standards, minimize internal control weaknesses, and meet federal financial management requirements. Additional information on the material weakness can be found in Part 3, Section E, of this report.

# SYSTEMS, CONTROLS AND LEGAL COMPLIANCE

## FMFIA

### Background

The FMFIA requires Executive branch agencies to establish and maintain internal control to ensure that federal programs operate efficiently, effectively, and in compliance with applicable laws. The management control objectives under FMFIA are to reasonably ensure that:

- Obligations and costs are in compliance with applicable laws;
- Funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and
- Revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the assets.

FMFIA requires agencies to evaluate and report on the effectiveness of the organization's internal controls to achieve the objectives of effective and efficient operations, reliable financial reporting, and compliance with applicable laws and regulations (FMFIA Section 2). Additionally, agencies are required to assess whether financial management systems comply with federal financial management systems requirements (FMFIA Section 4). Significant deficiencies that are material and affect our ability to meet these objectives are deemed "material weaknesses." Additional information on our reported material weaknesses can be found in Part 3, Section D, of this report.

### Internal Control over Reporting

In accordance with Appendix A to OMB Circular A-123, *Internal Control over Reporting*, and GAO's *Standards for Internal Control in the Federal Government,* we use an annual testing and assessment methodology that identifies and documents internal controls over financial reporting and incorporates operational effectiveness. For FY 2017, our components completed their testing and assessment of internal controls for material transactions as of June 30, 2017. Based on the results of this assessment which reported two material weaknesses, we provided a modified statement of assurance regarding the effectiveness of our internal control over financial reporting as of June 30, 2017. Additional information on the material weaknesses can be found in Part 3, Section D of this report.

In conjunction with our OMB Circular A-123, Appendix A, FY 2017 Guidance and Implementation Plan, our components documented their compliance with applicable laws and regulations. Based on our assessment of this documentation, we are in compliance with applicable laws and regulations for FY 2017 with the exception of the FFMIA as addressed below and in Part 3, Section D, of this report.

## FFMIA AND FINANCIAL MANAGEMENT SYSTEMS

### FFMIA

The FFMIA requires federal agencies to implement and maintain financial management systems that substantially comply with federal financial management systems requirements, applicable federal accounting standards, and the U.S. Standard General Ledger at the transaction level. A financial management system includes an agency's overall financial operation, reflecting the people, processes, and technology to capture, classify, summarize, and report data in a meaningful manner to support business decisions.

The FFMIA Section 803(c) (1) requires us to make an annual determination of the agency's substantial compliance with Section 803(a) of the Act based on review of relevant factors. We assess our financial management systems annually for conformance with the requirements of Appendix D to OMB Circular A-123, *Compliance with the FFMIA*, and other federal financial system requirements. Our assessment process includes the use of the FFMIA Compliance Determination Framework, which incorporates a risk model of risk levels against common goals and compliance indicators. OMB Circular A-123, Appendix D contains an outcome-based approach to assessing FFMIA compliance through a series of financial management goals that are common to all agencies.

In addition, we assess available information from audit reports and other relevant and appropriate sources, such as FISMA compliance activities, to determine whether our financial management systems substantially comply with FFMIA. We also assess improvements and ongoing efforts to strengthen financial management systems and the impact of instances of noncompliance on overall financial management system performance. Based on the results of our overall assessment, we concluded that Treasury's financial management systems are substantially compliant with the FFMIA requirements, with the exception of the IRS.

The IRS did not substantially comply with federal financial management systems requirements or applicable federal accounting standards. The IRS has established a robust remediation plan to achieve compliance with the FFMIA requirements. The IRS received agreement from OMB that the current remediation plan satisfies the requirements of Appendix D to OMB Circular A-123, replacing the need for a waiver from OMB for remediating a material weakness taking longer than three years under FMFIA. The remediation plan is updated and reviewed by the IRS and Treasury executives on a quarterly basis. Additionally, the progress of the remediation plan is reviewed annually by TIGTA.

### Financial Management Systems

Our financial management systems framework consists of two foundational components: (1) financial and mixed systems maintained by Treasury bureau components, and (2) the Treasury-wide Financial Analysis and Reporting System (FARS). Bureaus process and record detailed financial transactions and submit summary-level information to the FARS, which maintains the key financial data necessary for Treasury-wide consolidated financial reporting. This framework satisfies the financial operational and reporting needs of our reporting entities as well as our internal and external reporting requirements. The FARS framework plays a key role in the Department's efforts to obtain an unmodified audit opinion.

The FARS includes the following financial applications:

- Treasury Information Executive Repository (TIER) — a financial data repository used to consolidate and validate bureau financial data
- TIER Financial Statements (TFS) — a reporting application used to produce monthly and annual financial statements, notes, and other supporting reports

Our bureaus submit summary-level financial data to TIER on a monthly basis. The TFS application uses the bureau data to produce financial statements and report on a Treasury-wide and component level basis.

Fifteen of our bureaus and offices use centralized financial management, budget formulation and performance management, and IT hosting provided by the Fiscal Service's Administrative Resource Center (ARC). This shared service approach enables bureaus and offices to have access to core financial systems without having to maintain the necessary technical and systems architectures. ARC also provides administrative services in the areas of financial management transaction processing, human resources, procurement, and travel to our bureaus and offices and to other federal entities to support core business activities. Using a shared service reduces the need for Treasury to maintain duplicative financial management systems, thereby promoting efficiency and cost savings while enhancing the quality, timeliness, and accuracy of financial management processes.

In FY 2017, ARC continued to refine financial management and procurement system services to its first cabinet-level customer agency, the Department of Housing and Urban Development. ARC took steps to invest in an application to automate the servicing of customer financial statements and made progress on its service-oriented architecture.

## Goals and Supporting Strategies

Our financial system goals and supporting strategies focus on improving, streamlining, and integrating the current bureau financial management systems, as well as the current FARS applications in order to support new financial requirements and to provide management with data-driven financial decision making. In FY 2017, we continued refining TIER and TFS to meet new and evolving reporting requirements, including the reporting of financial and award data to support compliance with the *Digital Accountability and Transparency Act* (P.L. 113–101) (DATA Act). Supported by new business and system processes, we successfully submitted and certified the required DATA Act financial and award files for display to the public in FY 2017 on https://beta.usaspending.gov/#/. We will continue to refine our reporting efforts and will leverage any insights from the Treasury's OIG and GAO to enhance transparency pursuant to their DATA Act implementation review.

Additionally, in FY 2017, we migrated the FARS applications from the Main Treasury building to the IRS data centers in Memphis, Tennessee, and Martinsburg, West Virginia. The migration supports our data center consolidation initiative and incorporates new physical hardware for hosting the FARS.

Along with bureau financial systems, the TIER and TFS applications form a unified financial governance solution that focuses on improving financial processes and controls. These systems and applications help us to reduce operating costs, provide assurance over the quality of our financial data, improve the timeliness and quality of financial management processes and reporting, enhance internal controls, and improve transparency in the entire reporting process.

We have established and maintained an information security program and practices for its financial systems consistent with applicable FISMA requirements, OMB policy and guidance, and National Institute of Standards and Technology standards and guidelines. Our systems undergo annual security reviews, and security weaknesses identified through those reviews are then remediated by developing and implementing plans of action and milestones. We monitor bureau conformance to government-wide information technology security targets and provides roll-up reports quarterly to OMB. The Department's compliance with FISMA is evaluated annually by representatives of the OIG.

## IMPROPER PAYMENTS

### Background

The *Improper Payments Elimination and Recovery Improvement Act* (IPERIA) of 2012 requires agencies to annually report on all programs and activities, identify those that may be susceptible to significant improper payments, estimate annual improper payments in the susceptible programs and activities, and report the results of their improper payment activities. An improper payment is any payment (including overpayments and underpayments) that should not have been made or that was made in an incorrect amount.

Appendix C to OMB Circular A-123, *Requirements for Effective Estimation and Remediation of Improper Payments,* defines "significant improper payments" as gross annual improper payments in a program exceeding both the threshold of 1.5 percent of program outlays and $10 million of all program or activity payments or $100 million regardless of the improper payment percentage. Appendix C also requires agencies with programs susceptible to significant improper payments to implement corrective action plans that include improper payment root cause identification, reduction targets, and identification of accountable officials.

### Risk Assessments and Results

In FY 2017, we completed a full program inventory and performed risk assessments to identify programs that have a significant risk of improper payments. We performed our assessment of each program, excluding the Earned Income Tax Credit (EITC), using the nine qualitative risk factors identified in Appendix C. We also performed quantitative risk assessments and assessed risks related to the amounts of payments processed relative to the OMB specified threshold amounts which define payment programs susceptible to improper payments. As a result of the risk assessments, we determined that the agency's programs and activities, except for EITC, were deemed not susceptible to improper payments.

### EITC Program

The EITC is deemed a high priority program by OMB, because it is susceptible to significant improper payments. The EITC is a refundable tax credit that offsets income tax owed by low-income taxpayers. If the credit exceeds the amount of taxes due, the IRS provides a refund payment to those who qualify. The IRS estimates that for FY 2017, 24% ($16.2 billion) of the total EITC program payments of $67.9 billion were improper. The IRS has a robust enforcement program for the EITC which consists of examinations and audits, math error notices, and document matching. Additional information on the IRS's EITC program can be found in Part 3, Section E, of this report.

### Payment Recapture Audits

The *Improper Payments Elimination and Recovery Act of 2010* (IPERA) requires agencies to conduct payment recapture audits (also known as recovery audits) for each program and activity that expends $1 million or more annually, if conducting such audits would be cost-effective. We performed the payment recapture activities in accordance with OMB Circular A-123, Appendix C. Details on our improper payments and payment recapture program activities and results can be found in Part 3, Section E, of this report.

### Do Not Pay Initiative

Our Do Not Pay Working System (hereafter referred to as "Working System") is the legislatively mandated and OMB designated source of centralized data and analytic services to help agencies verify eligibility and to identify and prevent potential fraud, waste, and abuse associated with improper payments. The results of the checks against these data sources provide information that an agency should consider in pre-award or prepayment assessments to help prevent improper payments. Fiscal Service, our shared service provider, compares our records in the financial system with payee records in the Working System. We review potential matches on an ongoing basis to prevent improper payments, and incorporate a pre-

award check on potential contractors against the Working System. Additional information on the Do Not Pay initiative can be found in Part 3, Section E, of this report.

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DEPARTMENT OF THE TREASURY

# PART 2: Financial Section

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# MESSAGE FROM THE ASSISTANT SECRETARY FOR MANAGEMENT AND DEPUTY CHIEF FINANCIAL OFFICER

Kody H. Kinsley
Assistant Secretary for Management

Carole Y. Banks
Deputy Chief Financial Officer

In Fiscal Year 2017, Treasury pursued an aggressive set of management initiatives designed to manage the U.S. government's finances efficiently and responsibly. Treasury led and supported government-wide efforts to increase productivity, reduce waste, and modernize processes and systems. Treasury embraced the Administration's call to comprehensively reform the federal government, embracing bold ideas to propel the Department and the federal government into the 21st century.

In Fiscal Year 2017, Treasury also demonstrated prudent fiscal and management leadership by:

- Continuing to strengthen our internal cybersecurity through critical review of our High Value Assets, expansion of our education and awareness programs, and deploying insider threat detection more broadly;
- Developing a budget strategy to better enable Treasury's physical and Information Technology infrastructure to be properly funded;
- Continuing to centralize procurement activities to streamline processes and maximize category management;
- Making significant progress toward consolidating numerous Treasury human resources systems into a single Integrated Talent Management system; and
- Receiving an "A" on our small business report card for the seventh consecutive year.

The Department received an unmodified audit opinion on its consolidated financial statements for the 18th consecutive year. Treasury continues to make steady progress toward resolving the two Federal Managers' Financial Integrity Act material weaknesses remaining open as of September 30, 2017 (Internal Revenue Service – Unpaid Tax Assessments, and Bureau of the Fiscal Service – Systems, Controls, and Procedures to Prepare the Government-wide Financial Statements). Despite the complexity of Treasury's financial systems contributing to these material weaknesses, we continue to make considerable progress towards closing the issues.

As we lead Treasury's management programs and initiatives, we will continue to ensure that the Department can deliver its mission efficiently and provide the best value to the American people.

| | |
|---|---|
| Kody H. Kinsley | Carole Y. Banks |
| Assistant Secretary for Management | Deputy Chief Financial Officer |
| November 15, 2017 | November 15, 2017 |

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## Consolidated Balance Sheets

## As of September 30, 2017 and 2016

| (in millions) | 2017 | 2016 |
|---|---|---|
| **ASSETS** | | |
| **Intra-governmental Assets** | | |
| Fund Balance (Note 2) | $ **426,396** | $ 435,246 |
| Loans and Interest Receivable (Note 3) | **1,455,625** | 1,400,654 |
| Advances to Trust Funds (Note 4) | **9,021** | 8,558 |
| Due From the General Fund (Note 4) | **20,373,777** | 19,699,152 |
| Other Intra-governmental Assets | **818** | 455 |
| **Total Intra-governmental Assets** | **22,265,637** | 21,544,065 |
| | | |
| Cash, Foreign Currency, and Other Monetary Assets (Note 5) | **218,830** | 410,098 |
| Gold and Silver Reserves (Note 6) | **11,062** | 11,062 |
| Reserve Position in the International Monetary Fund (Note 7) | **11,509** | 9,570 |
| Taxes, Interest, and Other Receivables, Net (Note 8) | **53,496** | 50,306 |
| Credit Program Receivables, Net (Note 9) | **5,293** | 7,058 |
| Loans and Interest Receivable, Net (Note 7) | **7,380** | 8,627 |
| Investments in Government Sponsored Enterprises (GSEs) (Note 10) | **92,640** | 108,550 |
| Investments in Multilateral Development Banks (Note 11) | **7,708** | 7,648 |
| Other Investments and Related Interest (Note 12) | **8,559** | 9,860 |
| Property, Plant, and Equipment, Net (Note 13) | **3,060** | 3,005 |
| Other Assets | **986** | 1,059 |
| **Total Assets (Note 14)** | $ **22,686,160** | $ 22,170,908 |
| | | |
| Heritage Assets (Note 13) | | |

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

## Consolidated Balance Sheets
## As of September 30, 2017 and 2016

| (in millions) | 2017 | 2016 |
|---|---|---|
| **LIABILITIES** | | |
| **Intra-governmental Liabilities** | | |
| Federal Debt and Interest Payable (Notes 4 and 15) | $ **5,637,950** | $ 5,466,422 |
| Liability for Restoration of Federal Debt Principal and Interest (Notes 4 and 15) | **660** | - |
| Other Debt and Interest Payable (Note 16) | **11,543** | 13,125 |
| Due To the General Fund (Note 4) | **1,755,057** | 1,906,623 |
| Other Intra-governmental Liabilities (Note 18) | **613** | 462 |
| **Total Intra-governmental Liabilities** | **7,405,823** | 7,386,632 |
| | | |
| Federal Debt and Interest Payable (Notes 4 and 15) | **14,699,687** | 14,196,734 |
| Certificates Issued to the Federal Reserve (Note 5) | **5,200** | 5,200 |
| Allocation of Special Drawing Rights (Note 5) | **49,912** | 49,294 |
| Gold Certificates Issued to the Federal Reserve Banks (Note 6) | **11,037** | 11,037 |
| Refunds Payable (Notes 4 and 22) | **3,074** | 2,993 |
| D.C. Federal Pension and Judicial Retirement Actuarial Liability (Note 17) | **8,682** | 8,836 |
| Other Liabilities (Note 18) | **5,420** | 6,268 |
| **Total Liabilities (Note 18)** | **22,188,835** | 21,666,994 |
| Commitments and Contingencies (Note 26) | | |
| | | |
| **NET POSITION** | | |
| **Unexpended Appropriations:** | | |
| Funds from Dedicated Collections (Note 23) | **200** | 200 |
| Other Funds | **427,129** | 434,446 |
| **Subtotal** | **427,329** | 434,646 |
| **Cumulative Results of Operations:** | | |
| Funds from Dedicated Collections (Note 23) | **46,851** | 47,110 |
| Other Funds | **23,145** | 22,158 |
| **Subtotal** | **69,996** | 69,268 |
| | | |
| **Total Net Position - Funds from Dedicated Collections (Combined Totals) (Note 23)** | **47,051** | 47,310 |
| **Total Net Position - Other Funds (Combined Totals)** | **450,274** | 456,604 |
| **Total Net Position (Note 19)** | **497,325** | 503,914 |
| **Total Liabilities and Net Position** | $ **22,686,160** | $ 22,170,908 |

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

## Consolidated Statements of Net Cost
## For the Fiscal Years Ended September 30, 2017 and 2016

| (in millions) | 2017 | 2016 |
|---|---|---|
| **Cost of Treasury Operations:** | | |
| **Financial Program** | | |
| Gross Cost | $ **15,343** | $ 14,969 |
| Less Earned Revenue | **(3,415)** | (3,129) |
| Net Program Cost | **11,928** | 11,840 |
| | | |
| **Economic Program** | | |
| Gross Cost | **19,217** | 12,045 |
| Less Earned Revenue | **(11,750)** | (7,078) |
| Net Program Cost | **7,467** | 4,967 |
| | | |
| **Security Program** | | |
| Gross Cost | **436** | 412 |
| Less Earned Revenue | **(5)** | (3) |
| Net Program Cost | **431** | 409 |
| | | |
| **Total Program Gross Costs** | **34,996** | 27,426 |
| **Total Program Gross Earned Revenues** | **(15,170)** | (10,210) |
| **Total Net Program Cost before Changes in Actuarial Assumptions** | **19,826** | 17,216 |
| (Gain)/Loss on Pension, ORB, or OPEB Assumption Changes | **264** | 501 |
| **Total Net Cost of Treasury Operations (Note 20)** | **20,090** | 17,717 |
| | | |
| **Non-Entity Costs:** | | |
| Federal Debt Interest | **454,197** | 427,479 |
| Restoration of Foregone Federal Debt Interest (Note 15) | **1,587** | 635 |
| Less Interest Revenue from Loans | **(42,483)** | (42,384) |
| Net Federal Debt Interest Costs | **413,301** | 385,730 |
| Accrued Restoration of Foregone Federal Debt Interest (Note 15) | **660** | - |
| Other Federal Costs, Net (Note 20) | **14,725** | 14,554 |
| GSEs Non-Entity Revenue, Net (Note 10) | **(9,439)** | (13,802) |
| Other, Net | **(689)** | (575) |
| **Total Net Non-Entity Costs** | **418,558** | 385,907 |
| **Total Net Cost of Treasury Operations and Non-Entity Costs** | $ **438,648** | $ 403,624 |

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

## Consolidated Statements of Changes in Net Position
## For the Fiscal Years Ended September 30, 2017 and 2016

| (in millions) | 2017 | 2016 |
|---|---|---|
| **CUMULATIVE RESULTS OF OPERATIONS (Note 19)** | | |
| **Beginning Balance** | **$ 69,268** | $ 70,891 |
| **Budgetary Financing Sources** | | |
| Appropriations Used | **481,720** | 464,156 |
| Non-Exchange Revenue | **444** | 253 |
| Donations and Forfeitures of Cash/Equivalent | **117** | 416 |
| Transfers In/Out Without Reimbursement | **(272)** | (48) |
| Other | **8** | (67) |
| **Other Financing Sources (Non-Exchange)** | | |
| Donation/Forfeiture of Property | **106** | 158 |
| Accrued Interest and Discount on Debt | **11,266** | 3,456 |
| Accrued Interest on Restoration of Federal Debt Principal (Note 15) | **660** | (2,052) |
| Transfers In/Out Without Reimbursement | **-** | (3) |
| Imputed Financing Sources (Note 20) | **552** | 681 |
| Transfers to the General Fund and Other (Note 19) | **(55,225)** | (64,949) |
| **Total Financing Sources** | **439,376** | 402,001 |
| Net Cost of Treasury Operations and Non-Entity Costs | **(438,648)** | (403,624) |
| Net Change | **728** | (1,623) |
| **Cumulative Results of Operations** | **69,996** | 69,268 |
| | | |
| **UNEXPENDED APPROPRIATIONS (Note 19)** | | |
| **Beginning Balance** | **434,646** | 343,223 |
| **Budgetary Financing Sources** | | |
| Appropriations Received (Note 19) | **488,588** | 565,550 |
| Appropriations Transferred In/Out | **-** | 35 |
| Other Adjustments (Note 19) | **(14,185)** | (10,006) |
| Appropriations Used | **(481,720)** | (464,156) |
| **Total Budgetary Financing Sources** | **(7,317)** | 91,423 |
| **Total Unexpended Appropriations** | **427,329** | 434,646 |
| **Net Position** | **$ 497,325** | $ 503,914 |

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

## Combined Statement of Budgetary Resources
## For the Fiscal Year Ended September 30, 2017

| (in millions) | Budgetary | Non-Budgetary Financing | 2017 Total |
|---|---|---|---|
| **BUDGETARY RESOURCES** | | | |
| Unobligated balance brought forward, October 1 | $ 316,775 | $ 434 | $ 317,209 |
| Recoveries of unpaid prior year obligations | 396 | - | 396 |
| Other changes in unobligated balance | (574) | (739) | (1,313) |
| Unobligated balance from prior year budget authority, net | 316,597 | (305) | 316,292 |
| Appropriations (discretionary and mandatory) (Note 19) | 493,425 | 1 | 493,426 |
| Borrowing authority (discretionary and mandatory) (Note 21) | - | 268 | 268 |
| Spending authority from offsetting collections (discretionary and mandatory) | 7,569 | 962 | 8,531 |
| **Total Budgetary Resources** | $ 817,591 | $ 926 | $ 818,517 |
| | | | |
| **STATUS OF BUDGETARY RESOURCES** | | | |
| New obligations and upward adjustments (Note 21) | $ 501,405 | $ 664 | $ 502,069 |
| Unobligated balance, end of year: | | | |
| Apportioned, unexpired accounts | 274,033 | 49 | 274,082 |
| Exempt from apportionment, unexpired accounts | 1,616 | - | 1,616 |
| Unapportioned, unexpired accounts | 40,003 | 213 | 40,216 |
| Unexpired unobligated balance, end of year | 315,652 | 262 | 315,914 |
| Expired unobligated balance, end of year | 534 | - | 534 |
| Unobligated balance, end of year | 316,186 | 262 | 316,448 |
| **Total Status of Budgetary Resources** | $ 817,591 | $ 926 | $ 818,517 |
| | | | |
| **CHANGE IN OBLIGATED BALANCE** | | | |
| **Unpaid Obligations:** | | | |
| Unpaid obligations, brought forward, October 1 | $ 75,010 | $ 803 | $ 75,813 |
| New obligations and upward adjustments (Note 21) | 501,405 | 664 | 502,069 |
| Outlays (gross) | (505,166) | (582) | (505,748) |
| Recoveries of prior year unpaid obligations | (396) | - | (396) |
| Unpaid obligations, end of year | 70,853 | 885 | 71,738 |
| **Uncollected Payments:** | | | |
| Uncollected payments, Federal sources, brought forward, October 1 | (197) | 1 | (196) |
| Change in uncollected payments, Federal sources | 29 | (1) | 28 |
| Uncollected payments, Federal sources, end of year | (168) | - | (168) |
| **Obligated Balance, End of Year** | $ 70,685 | $ 885 | $ 71,570 |
| **Obligated Balance, Start of Year** | $ 74,813 | $ 804 | $ 75,617 |
| | | | |
| **BUDGET AUTHORITY AND OUTLAYS, NET** | | | |
| Budget authority, gross (discretionary and mandatory) | $ 500,994 | $ 1,231 | $ 502,225 |
| Actual offsetting collections (discretionary and mandatory) | (7,869) | (2,271) | (10,140) |
| Change in uncollected payments, Federal sources (discretionary and mandatory) | 29 | (1) | 28 |
| Recoveries of prior year paid obligations (discretionary and mandatory) | 67 | - | 67 |
| **Budget Authority, Net (Discretionary and Mandatory)** | $ 493,221 | $ (1,041) | $ 492,180 |
| | | | |
| Outlays, gross (discretionary and mandatory) | $ 505,166 | $ 582 | $ 505,748 |
| Actual offsetting collections (discretionary and mandatory) | (7,869) | (2,271) | (10,140) |
| Outlays, net (discretionary and mandatory) | 497,297 | (1,689) | 495,608 |
| Distributed offsetting receipts | (75,089) | - | (75,089) |
| **Agency Outlays, Net (Discretionary and Mandatory)** | **$ 422,208** | **$ (1,689)** | **$ 420,519** |

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

## Combined Statement of Budgetary Resources
## For the Fiscal Year Ended September 30, 2016

| (in millions) | Budgetary | Non-Budgetary Financing | 2016 Total |
|---|---|---|---|
| **BUDGETARY RESOURCES** | | | |
| Unobligated balance brought forward, October 1 | $ 323,170 | $ 572 | $ 323,742 |
| Recoveries of unpaid prior year obligations | 7,034 | 89,424 | 96,458 |
| Other changes in unobligated balance | (8,355) | (89,508) | (97,863) |
| Unobligated balance from prior year budget authority, net | 321,849 | 488 | 322,337 |
| Appropriations (discretionary and mandatory) (Note 19) | 465,346 | - | 465,346 |
| Borrowing authority (discretionary and mandatory) (Note 21) | - | 365 | 365 |
| Spending authority from offsetting collections (discretionary and mandatory) | 8,144 | 1,107 | 9,251 |
| **Total Budgetary Resources** | $ 795,339 | $ 1,960 | $ 797,299 |
| | | | |
| **STATUS OF BUDGETARY RESOURCES** | | | |
| New obligations and upward adjustments (Note 21) | $ 478,564 | $ 1,526 | $ 480,090 |
| Unobligated balance, end of year: | | | |
| Apportioned, unexpired accounts | 274,048 | 42 | 274,090 |
| Exempt from apportionment, unexpired accounts | 1,505 | - | 1,505 |
| Unapportioned, unexpired accounts | 40,591 | 392 | 40,983 |
| Unexpired unobligated balance, end of year | 316,144 | 434 | 316,578 |
| Expired unobligated balance, end of year | 631 | - | 631 |
| Unobligated balance, end of year | 316,775 | 434 | 317,209 |
| **Total Status of Budgetary Resources** | $ 795,339 | $ 1,960 | $ 797,299 |
| | | | |
| **CHANGE IN OBLIGATED BALANCE** | | | |
| **Unpaid Obligations:** | | | |
| Unpaid obligations, brought forward, October 1 | $ 83,228 | $ 90,171 | $ 173,399 |
| New obligations and upward adjustments (Note 21) | 478,564 | 1,526 | 480,090 |
| Outlays (gross) | (479,748) | (1,470) | (481,218) |
| Recoveries of prior year unpaid obligations | (7,034) | (89,424) | (96,458) |
| Unpaid obligations, end of year | 75,010 | 803 | 75,813 |
| **Uncollected Payments:** | | | |
| Uncollected payments, Federal sources, brought forward, October 1 | (196) | (407) | (603) |
| Change in uncollected payments, Federal sources | (1) | 408 | 407 |
| Uncollected payments, Federal sources, end of year | (197) | 1 | (196) |
| **Obligated Balance, End of Year** | $ 74,813 | $ 804 | $ 75,617 |
| **Obligated Balance, Start of Year** | $ 83,032 | $ 89,764 | $ 172,796 |
| | | | |
| **BUDGET AUTHORITY AND OUTLAYS, NET** | | | |
| Budget authority, gross (discretionary and mandatory) | $ 473,490 | $ 1,472 | $ 474,962 |
| Actual offsetting collections (discretionary and mandatory) | (8,563) | (9,833) | (18,396) |
| Change in uncollected payments, Federal sources (discretionary and mandatory) | (1) | 408 | 407 |
| Recoveries of prior year paid obligations (discretionary and mandatory) | 110 | - | 110 |
| **Budget Authority, Net (Discretionary and Mandatory)** | $ 465,036 | $ (7,953) | $ 457,083 |
| | | | |
| Outlays, gross (discretionary and mandatory) | $ 479,748 | $ 1,470 | $ 481,218 |
| Actual offsetting collections (discretionary and mandatory) | (8,563) | (9,833) | (18,396) |
| Outlays, net (discretionary and mandatory) | 471,185 | (8,363) | 462,822 |
| Distributed offsetting receipts | (62,565) | - | (62,565) |
| **Agency Outlays, Net (Discretionary and Mandatory)** | $ 408,620 | $ (8,363) | $ 400,257 |

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

## Statements of Custodial Activity
## For the Fiscal Years Ended September 30, 2017 and 2016

| (in millions) | 2017 | 2016 |
|---|---|---|
| **Sources of Custodial Revenue (Note 22)** | | |
| Individual Income and FICA Taxes | $ **2,976,444** | $ 2,874,877 |
| Corporate Income Taxes | **338,529** | 345,552 |
| Estate and Gift Taxes | **23,780** | 22,337 |
| Excise Taxes | **85,333** | 97,931 |
| Railroad Retirement Taxes | **5,957** | 5,941 |
| Unemployment Taxes | **8,284** | 8,440 |
| Deposit of Earnings, Federal Reserve System | **81,287** | 115,672 |
| Fines, Penalties, Interest and Other Revenue | **5,040** | 4,389 |
| **Total Revenue Received** | **3,524,654** | 3,475,139 |
| Less Refunds and Other Payments | **(437,323)** | (426,481) |
| **Net Revenue Received** | **3,087,331** | 3,048,658 |
| Non-Cash Accrual Adjustment | **3,061** | 8,257 |
| **Total Custodial Revenue** | **3,090,392** | 3,056,915 |
| | | |
| **Disposition of Custodial Revenue (Note 22)** | | |
| Amounts Provided to Fund Non-Federal Entities | **370** | 425 |
| Amounts Provided to Fund the Federal Government | **3,086,961** | 3,048,233 |
| Non-Cash Accrual Adjustment | **3,061** | 8,257 |
| **Total Disposition of Custodial Revenue** | **3,090,392** | 3,056,915 |
| **Net Custodial Revenue** | $ **-** | $ - |

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

# NOTES TO THE FINANCIAL STATEMENTS

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# 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

## A. REPORTING ENTITY

The accompanying financial statements include the operations of the Department of the Treasury, one of 24 Chief Financial Officers (CFO) Act agencies of the Executive Branch of the United States (U.S.) government, and certain custodial activities the Department manages on behalf of the entire U.S. government. Except where the content clearly indicates otherwise, the use of the terms "Department", "Treasury", "we", "us", or "our" refers to the Department of the Treasury, including its Departmental Offices (DO) and operating bureaus which are further discussed below. The following paragraphs describe the activities of the reporting entity.

We were established by an Act of Congress approved on September 2, 1789. Many subsequent acts affected our development, delegating new duties to our charge and establishing the numerous bureaus and divisions that now comprise the Department. As a major policy advisor to the President, the Secretary of the Treasury (Secretary) has primary responsibility for formulating and managing the domestic and international tax and financial policies of the U.S. government.

Further, the Secretary is responsible for recommending and implementing U.S. domestic and international economic and fiscal policy; governing the fiscal operations of the U.S. government; maintaining foreign assets control; managing the federal debt; collecting income and excise taxes; representing the U.S. on international monetary, trade, and investment issues; overseeing our overseas operations; and directing the manufacture of coins, currency, and other products for customer agencies and the public.

Our reporting entities include DO and seven operating bureaus. For financial reporting purposes, DO is composed of: Community Development Financial Institutions (CDFI) Fund, Office of D.C. Pensions (ODCP), Exchange Stabilization Fund (ESF), Federal Financing Bank (FFB), Government Sponsored Enterprises (GSEs) Program, International Assistance Programs (IAP), Office of Financial Research (OFR), Office of Financial Stability (OFS), Office of Inspector General (OIG), Small Business Lending Fund (SBLF), Special Inspector General for the Troubled Asset Relief Program (SIGTARP), Treasury Forfeiture Fund (TFF), Treasury Inspector General for Tax Administration (TIGTA), and the DO policy offices.

Our seven operating bureaus are: Bureau of Engraving and Printing (BEP), Bureau of the Fiscal Service (Fiscal Service), Financial Crimes Enforcement Network (FinCEN), Internal Revenue Service (IRS), U.S. Mint (Mint), Office of the Comptroller of the Currency (OCC), and Alcohol and Tobacco Tax and Trade Bureau (TTB). Our consolidated financial statements reflect the reporting of our entity activities, comprising both our operating bureaus and DO. This includes appropriations received to conduct our operations and revenue generated from those operations. They also reflect the reporting of certain non-entity (custodial) functions we perform on behalf of the U.S. government and others. Non-entity activities include collecting certain federal revenue, servicing the federal debt, disbursing certain federal funds, and maintaining certain assets and liabilities for the U.S. government (refer to Notes 4 and 14), as well as for other federal entities. Our reporting entity does not include the General Fund of the U.S. Government (General Fund), which maintains receipt, disbursement, and appropriation accounts for all federal agencies.

Following U.S. Generally Accepted Accounting Principles (GAAP) for federal entities, we do not consolidate into our financial statements the assets, liabilities, or results of operations of any financial organization or commercial entity in which we hold either a direct or indirect majority equity investment, unless they constitute a part of the reporting entity per GAAP. Even though some of the equity investments are significant, these entities meet the criteria of "bailed out" entities under paragraph 50 of Statement of Federal Financial Accounting Concepts (SFFAC) No. 2, *Entity and Display*, which directs that such "bailout" investments should not be consolidated into the *Financial Report of the U.S. Government*, either in part or as a whole.

## B. Basis of Accounting and Presentation

The financial statements have been prepared from our accounting records in conformity with GAAP, and Office of Management and Budget (OMB) Circular No. A-136, *Financial Reporting Requirements,* as revised. Accounting principles generally accepted for federal entities are the standards prescribed by the Federal Accounting Standards Advisory Board (FASAB). The American Institute of Certified Public Accountants recognizes FASAB as the official accounting standards-setting body for the U.S. government.

These financial statements consist of the Consolidated Balance Sheets, the Consolidated Statements of Net Cost, the Consolidated Statements of Changes in Net Position, the Combined Statements of Budgetary Resources, and the Statements of Custodial Activity. The statements and the related notes are prepared in a comparative form to present both fiscal year (FY) 2017 and 2016 information.

To provide additional clarity to our financial statements, we have presented additional financial statement line items on the Consolidated Balance Sheets and Consolidated Statements of Changes in Net Position than are required by the guidance in OMB Circular No. A-136. The following summarizes how our additional financial statement line items relate to the financial statement guidelines of the OMB Circular No. A-136. For the Consolidated Balance Sheets: (*i*) "*Advances to Trust Funds"* and *"Due From the General Fund"* represent other intra-governmental assets; *(ii*) "*Gold and Silver Reserves*" and the "*Reserve Position in the International Monetary Fund*" (IMF) represent other monetary assets; (*iii*) *"Loans and Interest Receivable, Net"* (non-intra-governmental) represents other assets; (*iv*) *"Liability for Restoration of Federal Debt Principal and Interest"* (intra-governmental) and *"Due To the General Fund"* represent other intra-governmental liabilities; (*v*) *"Certificates Issued to the Federal Reserve," "Allocation of Special Drawing Rights," "Gold Certificates Issued to the Federal Reserve Banks," "Refunds Payable,"* and the *"D.C. Federal Pension and Judicial Retirement Actuarial Liability"* represent other liabilities. For the Consolidated Statements of Changes in Net Position, *"Accrued Interest and Discount on Debt," "Accrued Interest on Restoration of Federal Debt Principal,"* and *"Transfers to the General Fund and Other*" represent other non-exchange financing sources.

We have eliminated transactions and balances among our entities from the Consolidated Balance Sheets, Consolidated Statements of Net Cost, and Consolidated Statements of Changes in Net Position. We present the Statement of Budgetary Resources on a combined basis; therefore, intra-departmental transactions and balances have not been eliminated from these statements.

While these financial statements have been prepared from our accounting records in accordance with the formats prescribed by OMB, these financial statements are in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same accounting records.

Intra-governmental assets and liabilities are those due from or to other federal entities. Intra-governmental earned revenues are collections or accruals of revenue from other federal entities, and intra-governmental costs are payments or accruals of expenditures to other federal entities.

The financial statements should be read with the realization that we are a component of the U.S. government, a sovereign entity and, accordingly, our liabilities not covered by budgetary resources cannot be liquidated without the legislative enactment of an appropriation, and that the payment of all liabilities other than for contracts can be abrogated by the sovereign entity. Liabilities represent the probable and measurable future outflow or other sacrifice of resources as a result of past transactions or events. Liabilities covered by budgetary resources are those liabilities for which Congress has appropriated funds or funding is otherwise available to pay amounts due. Liabilities not covered by budgetary or other resources represent amounts owed in excess of available, congressionally appropriated funds or other amounts, and there is no certainty that the appropriations will be enacted.

We have reclassified certain FY 2016 activity and balances presented on the financial statements to conform to the presentation in the current year, the effects of which are immaterial. There are numerous acronyms used throughout the notes herein as well as other sections of this Agency Financial Report (AFR). Refer to the *"Glossary of Acronyms"* located in the Appendix of this report for a complete listing of these acronyms and their definitions.

## C. FUND BALANCE

"*Fund Balance*" is the aggregate amount of our accounts with the U.S. government's central accounts from which we are authorized to make expenditures and pay liabilities. It is an asset because it represents our claim to the U.S. government's resources. "*Fund Balance*" is not equivalent to unexpended appropriations because it also includes non-appropriated revolving and enterprise funds, suspense accounts, and custodial funds such as deposit funds, special funds, and trust funds.

## D. LOANS AND INTEREST RECEIVABLE

### Intra-Governmental

Intra-governmental entity loans and interest receivable from other federal agencies represent the principal and related interest receivable on loans we issue through FFB. We do not record loan loss allowance for credit reform subsidy costs for loans purchased from federal agencies or for guaranteed loans made to non-federal borrowers because those agencies guarantee the outstanding balances (interest and principal).

Intra-governmental non-entity loans and interest receivable from other federal agencies represent the principal and related interest receivable on loans we issue, through the Fiscal Service. We act as an intermediary issuing these loans because the agencies receiving these loans lend these funds to third parties to carry out various programs of the U.S. government. Because of our intermediary role in issuing these loans, we do not record a loan loss allowance related to these non-entity intra-governmental loans. Instead, the ultimate lender, the federal agency that issued the loans to the public, recognizes loan loss allowances and subsidy costs. We accrue interest revenue on intra-governmental loans when earned.

### Public

Public loans and interest receivable primarily represent supplemental borrowing arrangements between the U.S. and the IMF (refer to Note 7). These loans are denominated in Special Drawing Rights (SDRs) and recorded at the equivalent U.S. dollar amount (refer to the accounting policy below entitled "*Special Drawing Rights*"). We periodically adjust the value of these loans, due to fluctuations in the value of the U.S. dollar with respect to the SDR, to maintain the amount of these loans in dollar terms. We do not record a loan loss allowance for these loans as we do not anticipate any defaults on the repayment of these loans.

## E. Advances to Trust Funds

### Advances to the Unemployment Trust Fund

The General Fund issues advances to the Department of Labor's (DOL) Unemployment Trust Fund for states to pay unemployment benefits. The Fiscal Service accounts for the advances issued on behalf of the General Fund. As outlined in 42 United States Code (USC) 1323, *Repayable Advances to Federal Unemployment Account*, these advances bear an interest rate that is computed as the average interest rate as of the end of the calendar month preceding the issuance date of the advance for all interest-bearing obligations of the U.S. that form the public debt, to the nearest lower 1/8 of 1.0 percent. Interest on the advances is due on September 30 of each year. DOL repays advances when the Secretary, in consultation with the Secretary of the DOL, determines that the balance in the Unemployment Trust Fund is adequate to allow repayment.

### Advances to the Federal Supplementary Medical Insurance Trust Fund

The General Fund issues advances to the Department of Health and Human Services' (HHS) Federal Supplementary Medical Insurance Trust Fund to temporarily replace the reduction in Medicare Part B participants' premiums. The Fiscal Service accounts for the advances issued on behalf of the General Fund. As outlined in 42 USC 1395, *Prohibition Against Any Federal Interference*, these advances do not bear any interest. HHS repays advances over time from amounts collected from certain participants' increase in premiums until the balance due reaches zero.

## F. Cash, Foreign Currency, and Other Monetary Assets

Substantially all of our operating cash is non-entity government-wide cash held in depository institutions and Federal Reserve Bank (FRB) accounts. Agencies deposit funds that are submitted to them directly into either a Federal Reserve Treasury General Account (TGA) or a local TGA depositary. We transfer the balances in these TGA accounts into the Federal Reserve Bank of New York's (FRBNY) TGA throughout the day.

Operating cash of the U.S. government represents balances from tax collections, customs duties, other revenue, federal debt receipts, and other various receipts, net of cash outflows for budget outlays and other payments held in the FRBs and in foreign and domestic financial institutions. Outstanding checks net against operating cash until they clear the Federal Reserve System (FR System).

The FRBNY maintains the TGA, which functions as the U.S. government's checking account for deposits and disbursements of public funds. Cash in the TGA is restricted for government-wide operations.

We classify our foreign currency investments having original maturities of three months or less as cash equivalents. SDR holdings comprise most of the other monetary assets (refer to the accounting policy below entitled "*Special Drawing Rights*").

## G. TAXES, INTEREST, AND OTHER RECEIVABLES, NET

We do not accrue federal taxes receivable, net, and the corresponding liability due to the General Fund, until related tax returns are filed or assessments are made by the IRS and agreed to by either the taxpayer or the court. Additionally, prepayments are netted against liabilities. We make accruals to reflect penalties and interest on taxes receivable through the balance sheet date.

Taxes receivable consist of unpaid assessments (taxes and associated penalties and interest) due from taxpayers. The existence of a receivable is supported by a taxpayer agreement, such as filing of a tax return without sufficient payment, or a court ruling in favor of the IRS. We record an allowance for doubtful accounts to reflect an estimate of the portion of total taxes receivable deemed to be uncollectible.

Compliance assessments are unpaid assessments which neither the taxpayer nor a court has affirmed the taxpayer owes to the U.S. government. Examples include assessments resulting from an IRS audit or examination in which the taxpayer does not agree with the results. Compliance assessment write-offs consist of unpaid assessments for which the IRS does not expect further collections due to factors such as taxpayers' bankruptcy, insolvency, or death. We do not report compliance assessments and related write-offs on the balance sheet. Statutory provisions require the accounts to be maintained until the statute for collection expires.

## H. CREDIT PROGRAM RECEIVABLES, NET

We account for all of our credit program receivables under the provisions of credit reform accounting pursuant to the Federal Credit Reform Act (FCRA). Credit programs include loans or equity securities associated with our state and local Housing Finance Agency (HFA) initiative programs, SBLF program, CDFI Fund programs, and the Troubled Asset Relief Program (TARP) (refer to Note 9).

To account for our credit program receivables, we apply the accounting provisions of Statement of Federal Financial Accounting Standards (SFFAS) No. 2, *Accounting for Direct Loans and Loan Guarantees*, as amended. SFFAS No. 2 requires measurement of the asset or liability at the net present value of the estimated future cash flows. The cash flow estimates for each credit program transaction reflect the actual structure of the instruments. For each of these instruments, we estimate cash inflows and outflows related to the program over the estimated term of the instrument. Further, each cash-flow estimate reflects the specific terms and conditions of the program, technical assumptions regarding the underlying assets, risk of default or other losses, and other factors as appropriate. The measurement of assets within these programs is primarily derived from inputs which generally represent market data and, when such data is not available, management's best estimate of how a market participant would assess the asset's inherent risk.

The primary purpose of the FCRA is to measure the cost of federal credit programs, and to place the cost of such credit programs on a basis equivalent with other federal spending. FCRA requires that the ultimate costs of a credit program be calculated and the budgetary resources be obtained before incurring the direct loan obligations. To accomplish this, we first predict or estimate the future performance of direct and guaranteed loans when preparing our annual budget. We re-estimate the data used for these budgetary estimates at the fiscal year-end to reflect changes in actual loan performance and actual interest rates in effect when the loans were issued. The re-estimated data reflect adjustments for market risks, asset performance, and other key variables and economic factors. We then use the re-estimated data to report the cost of the loans disbursed under the direct or guaranteed loan program as a "*Program Cost*" in our Consolidated Statements of Net Cost.

Cash flows associated with our credit programs generally include disbursements, repayments, repurchases, fees, recoveries, interest, dividends, proceeds from sales of instruments, borrowings from Treasury, negative subsidy, and the subsidy cost received from the program accounts. We draw security-level data and assumptions used as the basis for cash flow model forecasts and program performance from widely available market sources, as well as information published by investees. Key inputs and assumptions to the cash flow forecasts include, but are not limited to:

- Security characteristics such as unpaid principal balance, coupon rate, weighted-average loan age, issued bond balance, credit rating, maturity date, sinking fund schedules, principal and interest payment schedules, and performance of underlying collateral;
- Discount rate and Market Adjusted Discount Rate (MADR);
- Department actions, as well as changes in legislation;
- Forecast dividend payments, late payments, prepayment rates and default rates;
- Expected escrow conversion and return rates;
- Default and recovery reports published by Moody's and Standard and Poor's; and
- Other third-party market sources.

The recorded subsidy cost associated with each of our credit programs represents the difference between our projected costs of the program and the future cash flows we anticipate receiving. The subsidy allowance specifically takes into consideration projected repayments and defaults, and the projected cost of borrowings. We amortize the allowance to reflect the difference between projected and actual financing costs.

Our actions, as well as changes in legislation, may impact estimated future cash flows and related subsidy costs. We recognize the cost or cost savings of a modification in subsidy costs when the terms of a program are modified. Workouts are actions taken to maximize repayments of existing credit programs, and the expected effects on cash flows are included in the original estimate and re-estimates of the subsidy cost. Subsidy costs are also impacted by re-estimates which may occur as a result of updates to the original program subsidy cost estimates to reflect actual cash flows experience, as well as changes in forecasts of estimated future cash flows associated with the credit program.

## I. INVESTMENTS

### Investments in GSEs

We hold senior preferred stock and warrants for the purchase of common stock of two GSEs: the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac). We present these non-federal investment holdings at their fair value. We record changes in the valuation of these investments as non-entity exchange transactions on the Consolidated Statements of Net Cost. We also record dividends related to these investments as non-entity exchange transactions, and accrue when declared.

The GSE Senior Preferred Stock Purchase Agreements (SPSPAs), which we entered into with each GSE when the GSEs were placed under conservatorship, require that we increase our investment in the GSEs' senior preferred stock if, at the end of any quarter, the Federal Housing Finance Agency (FHFA), acting as the conservator, determines that the liabilities of either GSE exceed its respective assets. Since funding to the GSEs to pay their excess liabilities is appropriated directly to us, we report such payments, as needed, as entity expenses within the "*Economic Program*" on the Consolidated Statements of Net Cost, and in the line item, "*Cumulative Results of Operations*," on the Consolidated Balance Sheets. These payments also result in an increase to the non-entity investment in the GSEs' senior preferred stock, with a corresponding increase to "*Due To the General Fund*", as we hold the investment on behalf of the General Fund.

### Investments in Multilateral Development Banks

On behalf of the U.S., we invest in Multilateral Development Banks (MDBs) to support poverty reduction, private sector development, transitions to market economies, and sustainable economic growth and development, thereby advancing U.S. economic, political, and commercial interests abroad. As a participating member country, we provide a portion of the capital base of the MDBs, through subscriptions to capital, which allows the MDBs to issue loans at market-based rates to middle-income developing countries. These paid-in capital investments are non-marketable equity investments valued at cost on our Consolidated Balance Sheets.

In addition, on behalf of the U.S., we contribute funding to MDBs to finance grants and extend credit to poor countries at below market-based interest rates. We report these U.S. contributions, also referred to as "concessional window" contributions, as an expense within the "*Economic Program*" on our Consolidated Statements of Net Cost.

### Other Investments and Related Interest

The ESF holds most of our foreign currency investments. We classify the ESF's other foreign currency denominated assets and investment securities as either available-for-sale or trading securities recorded at fair value. These holdings are normally invested in interest-bearing securities issued or held through foreign governments or monetary authorities. We recognize interest on investments, amortization of premiums, and accretion of discounts on an accrual basis, and amortize or accrete premiums and discounts over the life of the related investment security as an adjustment to yield using the effective interest method.

## J. PROPERTY, PLANT, AND EQUIPMENT, NET

### General

Property, plant, and equipment (PP&E) is composed of capital assets used in providing goods or services. It also includes assets acquired through capital leases, which are initially recorded at the amount recognized as a liability for the capital lease at its inception. PP&E is stated at full cost, including costs related to acquisition, delivery, and installation, less accumulated depreciation. Major alterations and renovations, including leasehold and land improvements, are capitalized, while maintenance and repair costs are charged to expense as incurred. Costs for construction projects are recorded as construction-in-progress until completed, and are valued at actual (direct) cost plus applied overhead and other indirect costs.

Internal-use software encompasses software design, development, and testing of projects adding significant new functionality and long-term benefits. We accumulate costs for developing internal-use software in work-in-development until we place a project into service and testing and final acceptances are successfully completed. Once completed, we transfer the costs to depreciable property.

We lease land and buildings from the General Services Administration (GSA) to conduct most of our operations. We have no material leases that meet capital lease requirements for financial reporting purposes. GSA charges a standard level user fee which approximates commercial rental rates for similar properties.

Our bureaus are diverse both in size and in operating environment. Accordingly, our capitalization policy provides minimum capitalization thresholds, which generally range from $25,000 to $50,000 for all property categories except for internal-use software. Minimum capitalization thresholds for internal-use software generally range from $50,000 to $250,000 (except for the IRS, for which minimum capitalization thresholds generally ranges from $10 million to $50 million). We also use a capitalization threshold for bulk purchases, which generally ranges from $50,000 to $500,000 for non-manufacturing bureaus, and $25,000 to $50,000 for manufacturing bureaus. Bureaus determine the individual items that comprise bulk purchases based on our guidance.

Depreciation is expensed on a straight-line basis over the estimated useful life of the asset with the exception of leasehold improvements and capital leases. We depreciate leasehold improvements over the term of the lease or the useful life of the improvement, whichever is shorter. We depreciate capital leases over the estimated life of the asset or term of the lease, whichever is shorter. Service life ranges (2 to 50 years) are wide due to the diversity of our PP&E. We do not depreciate land and land improvements, construction-in-progress, and internal-use software in development. We record impairment costs related to a significant and permanent decline in the service utility of general PP&E and construction-in-progress in the period incurred.

### Heritage Assets

Heritage assets are of historical significance. Multi-use heritage assets are those heritage assets for which the predominant use is general government operations. We capitalize all acquisition, reconstruction, and betterment costs for our multi-use heritage asset buildings as general PP&E, and depreciate these costs over their service life.

## K. Federal Debt and Interest Payable

We issue federal debt in the form of Treasury securities. This debt relates to monies borrowed from the public and certain other federal agencies to fund the operations of the U.S. government. We issue certain federal debt at a discount or premium. We amortize these discounts and premiums over the term of the security using an interest method for all long-term securities and the straight-line method for short-term securities. Interest costs accrue as an expense as incurred and are reported on the Consolidated Statements of Net Cost as non-entity costs.

## L. Commitments and Contingencies

Through FFB, we make loan commitments with federal agencies, or private sector borrowers with loans guaranteed by federal agencies, to extend credit for their own use (refer to the accounting policy above entitled "*Loans and Interest Receivable, Intra-Governmental*"). We establish loan commitments when FFB and other parties fully execute promissory notes or bonds in which we become obligated to issue such loans immediately or at some future date. We reduce loan commitments when we issue the loans or when the commitments expire. Most of our obligations give a borrower the contractual right to a loan or loans immediately or at some point in the future within an agreed upon timeframe.

On behalf of the U.S., we subscribe to capital for certain MDBs, portions of which are capital commitments which are callable under certain limited circumstances to meet the obligations of the respective MDB. The callable capital commitments become binding on the U.S. when we issue instruments of subscription stating our intention to subscribe to the U.S. portion of callable capital, subject to the amounts provided for in appropriations acts.

Additionally, on behalf of the U.S., we have established financial commitments through our participation in the IMF through a quota subscription and certain borrowing arrangements that supplement IMF resources. U.S. financial commitments to the IMF become binding when the U.S. consents to an increase in its participation as an IMF member country, and all other conditions to the increase have been met. The outstanding financial commitment in the U.S. quota decreases or increases when the IMF draws upon or repays funding obtained pursuant to a letter of credit established by the U.S. to make domestic currency available to the IMF as needed. The outstanding financial commitment in the supplemental borrowing arrangements decrease or increase when the IMF borrows and repays loans under this supplemental funding arrangement (refer to Note 7).

In accordance with SFFAS No. 5, *Accounting for Liabilities of the Federal Government*, we recognize material contingent liabilities meeting the following criteria:

- A past event or exchange transaction has occurred;
- A future cash outflow is probable; and
- A future cash outflow is measurable.

The estimated liability we record is either a specific amount or within a range of amounts. If some amount within the range is a better estimate than any other amount within the range, that amount is recognized. If no amount within the range is a better estimate than any other amount, we recognize the minimum amount in the range, and we disclose the range and a description of the nature of the contingency. We follow this policy in recording a contingent liability, if any, related to the GSE SPSPA program (refer to Note 10), and loss contingencies that may arise from claims, assessments, litigations, fines, penalties, and other sources (refer to Note 26).

If one or more, but not all, of the above criteria for recognition are met, and there is a reasonable possibility of loss, we will disclose, if material, the nature of the contingent liability, along with a range of possible loss, if estimable, and a description of the nature of the contingency.

## M. Special Drawing Rights

The SDR is an international reserve asset created by the IMF to supplement its member countries' official reserves. Under its Articles of Agreement, the IMF may allocate SDRs to member countries in proportion to their IMF quotas. Pursuant to the *Special Drawing Rights Act of 1968*, as amended, the ESF holds all SDRs allocated to or otherwise acquired by the U.S.

### Allocations and Holdings

We record the SDR holdings as part of "*Cash, Foreign Currency, and Other Monetary Assets*," and we record the SDR allocations as a liability entitled "*Allocation of Special Drawing Rights*" when the IMF allocates SDRs to the Department. We carry this liability since the SDRs may be withdrawn as needed by the IMF unless the following occurs: a withdrawal by the U.S. from the IMF membership, cancellation of the SDRs, or liquidation of the IMF or SDR Department of the IMF.

SDR holdings increase primarily as a result of IMF SDR allocations. We record SDR transactions as incurred, and include acquisitions and sales of SDRs, interest received on SDR holdings, interest charges on SDRs allocations, and valuation adjustments. The U.S. government also receives remuneration in SDRs from the IMF based on claims on the IMF as represented by the U.S. Reserve Position in the IMF and loans receivable from supplemental borrowing arrangements. We credit remuneration to the ESF, which transfers to the TGA account an equivalent amount of dollars plus nominal interest. The allocations and holdings are revalued monthly based on the SDR valuation rate as calculated by the IMF, resulting in the recognition of unrealized gains or losses on revaluation that are reported on the Consolidated Statements of Net Cost.

### Certificates Issued to the Federal Reserve

The *Special Drawing Rights Act of 1968* authorizes the Secretary to issue certificates, not to exceed the value of SDR holdings, to the FRB in return for dollar amounts equal to the face value of certificates issued. We issue certificates to finance the acquisition of SDRs from other countries or to provide U.S. dollar resources to finance other ESF operations. Certificates issued are redeemed by us at such times and in such amounts as the Secretary may determine, and do not bear interest. We report certificates issued to the FRB at their face value which approximates their carrying value since, under the terms of the agreement, there is no set repayment date and no interest accrued while certificates remain outstanding.

## N. Refunds Payable

Refunds payable arise in the normal course of tax administration when it is determined that taxpayers have paid more than the actual taxes they owe. We record amounts concluded to be valid refunds owed to taxpayers as a liability entitled "*Refunds Payable*" on the Consolidated Balance Sheets, with a corresponding receivable from the General Fund included in the line entitled "*Due From the General Fund*."

## O. Federal Employee Benefits Payable – FECA Actuarial Liability

The *Federal Employees' Compensation Act* (FECA) provides income and medical cost protection to covered federal civilian employees injured on the job, and employees who have incurred a work-related injury or occupational disease. The FECA program is administered by the DOL which pays valid claims and subsequently seeks reimbursements from us for these paid claims. Generally, we reimburse the DOL within two to three years once funds are appropriated. The FECA liability consists of two components. The first component is based on actual claims paid by the DOL but not yet reimbursed by us. The second component is the estimated liability for future workers compensation as a result of past events. We report both components in "*Other Liabilities*" on the Consolidated Balance Sheets. These future workers' compensation estimates are generated by applying actuarial procedures developed to estimate the liability for FECA benefits. The actuarial liability estimates for FECA benefits include the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases.

## P. Annual, Sick, and Other Leave

We report annual and compensatory leave earned by our employees, but not yet used, as an accrued liability. We adjust the accrued balance annually to reflect current pay rates. Any portion of the accrued leave for which funding is not available is recorded as an unfunded liability as reported in "*Other Liabilities*" on the Consolidated Balance Sheets. We expense sick and other leave as taken and do not record a liability for such amounts, because employees do not vest in sick and other leave benefits.

## Q. Pension Costs, Other Retirement Benefits, and Other Post-Employment Benefits

### Federal Pension Costs, Other Retirement Benefits, and Other Post-Employment Benefits

We recognize the full cost of our employees' pension benefits, including recognizing imputed cost for the difference between the estimated service cost and the sum of participants' pension benefit withholdings and agency contributions. However, the Office of Personnel Management (OPM) rather than the Department recognizes the assets and liabilities associated with these benefits.

Most of our employees hired prior to January 1, 1984 participate in the Civil Service Retirement System (CSRS), and employees hired between January 1, 1984 and December 31, 1986 are covered under the CSRS Offset System, to which we contribute 7.0 percent and 7.5 percent of pay for regular and law enforcement employees, respectively. On January 1, 1987, the Federal Employees' Retirement System (FERS) went into effect pursuant to the *Federal Employees' Retirement System Act of 1986,* Public Law (P.L.) 99-335. FERS is a three-tiered retirement system consisting of a Basic Benefit Plan, Thrift Savings Plan (TSP), and Social Security Benefits. For the FERS Basic Benefit Plan, we contribute between 11.9 percent and 13.7 percent for regular employees, and between 28.4 percent and 30.1 percent for law enforcement officers. The TSP under FERS is a 401(k)-type savings plan in which we automatically contribute one percent of base pay and match any employee contributions up to an additional four percent of base pay. For most employees hired after December 31, 1983, we also contribute the employer's matching share for Social Security.

Similar to federal retirement plans, OPM, rather than the Department, reports the assets and liability for future payments to retired employees who participate in the Federal Employees Health Benefits Program (FEHBP) and Federal Employees Group Life Insurance (FEGLI) Program. We report the full cost of providing other retirement benefits (ORB). We also recognize an expense and a liability for other post-employment benefits (OPEB), which includes all types of benefits, provided to former or inactive (but not retired) employees, their beneficiaries, and covered dependents. Additionally, one of our bureaus, OCC, separately sponsors a defined life insurance benefit plan for current and retired employees, and is the administrator for a private defined benefit retirement plan, the Pentegra Defined Benefit Plan (PDBP), that provides retirement, disability, and death benefits for certain retired employees who meet eligibility requirements. In addition to the TSP, the OCC separately sponsors a 401(k) plan.

### District of Columbia Federal Pension and Judicial Retirement Plans

Pursuant to Title XI of the *Balanced Budget Act of 1997*, as amended, we became responsible for benefit payments to certain District of Columbia (D.C.) police officers, firefighters, teachers and judges under D.C. retirement plans (refer to Note 17). The actuarial cost method used to determine costs and actuarial liability for the retirement plans is the Individual Entry Age Normal Funding Method, which approximates the methodology specified by the Aggregate Entry Age Normal Actuarial Cost Method. The methodology bases actuarial liability on long-term economic assumptions. The pension benefit costs incurred by the plans are included on the Consolidated Statements of Net Cost.

The economic assumptions used for the valuation of the D.C. Federal Pension and Judicial retirement plans differ from those used by the OPM for the following reasons: *(i)* the annual rate of salary increase assumptions are based on different plan member experience; *(ii)* the annual rate of inflation and cost-of-living adjustment assumptions are based on different statutory requirements (applicable Consumer Price Index [CPI] and period of calculation); and *(iii)* for the annual rate of investment return assumption, OPM and the D.C. Federal Pension and Judicial retirement plans use the same underlying yield curve but, unlike the D.C. Federal Pension plan, OPM converts to a single equivalent rate.

## R. REVENUE AND FINANCING SOURCES

Our activities are financed either through exchange revenue we receive from others or through non-exchange revenue and financing sources (such as appropriations provided by the Congress and penalties, fines, and certain user fees collected). User fees primarily include collections from the public for the IRS costs to process installment agreements, letter ruling and determinations, and income verification. We recognize exchange revenue when earned, i.e., goods are delivered or services are rendered. We recognize revenue from reimbursable agreements when providing services. We record non-exchange revenues when received or when accrued due to a legal claim. We recognize appropriations used as financing sources when related expenses are incurred or assets are purchased.

We also incur certain costs paid in total or in part by other federal entities, such as pension costs, the FEHBP, and any un-reimbursed payments made from the Treasury Judgment Fund on our behalf. We recognize these subsidized costs on the Consolidated Statements of Net Cost, and we recognize the imputed financing for these costs on the Consolidated Statements of Changes in Net Position. As a result, there is no effect on net position. We also recognize other non-exchange financing sources, such as donations and transfers of assets without reimbursements, for the period in which they occurred on the Consolidated Statements of Changes in Net Position.

We recognize revenue we receive from disposition of forfeited property as non-exchange revenue on the Consolidated Statements of Changes in Net Position. We report costs related to the Forfeiture Fund program on the Consolidated Statements of Net Cost. The TFF is the special fund account for depositing non-tax forfeiture proceeds received pursuant to laws enforced or administered by law enforcement bureaus that participate in the TFF. We report forfeited property balances in "*Other Assets*" on the Consolidated Balance Sheets.

## S. Custodial Revenues

Non-entity revenue reported on our Statements of Custodial Activity includes cash we collected, primarily from taxes. It does not include revenue collected by other federal agencies, such as user fees and other receipts, which are remitted for general operating purposes of the U.S. government or are dedicated for certain trust funds. We present the Statements of Custodial Activity on the "modified accrual basis." We recognize revenues as cash is collected, and record a "non-cash accrual adjustment" representing the net increase or decrease during the reporting period in net revenue-related assets and liabilities, mainly taxes receivable.

## T. Appropriations and Other budgetary Activity

### Combined Statement of Budgetary Resources Activity

We record appropriations when authorized by legislation. Incurred obligations of appropriations are recorded when we place an order or sign a contract for goods and services, award a grant, or take other actions that require us to make payments to the public or another federal entity. Outlays are recorded when disbursements are made.

### Permanent and Indefinite Appropriations

We use permanent and indefinite appropriations to disburse tax refunds, income tax credits, and child tax credits. We recognize refund payment funding as appropriations are used. Permanent indefinite authority for refund activity is available for an unlimited period of time in the amount necessary to cover the refund and/or credit. We report tax refunds and credits as a custodial activity of the Department, since they are, in substance, a custodial revenue-related activity resulting from taxpayer overpayments of their tax liabilities.

We have two permanent and indefinite appropriations related to debt activity. One permanent and indefinite appropriation is used to pay interest on the public debt securities, and the other is used to redeem securities that are matured, called, or eligible for early redemption. These accounts are not annual appropriations and do not have refunds. We report debt redemption appropriations related to our liability on our Consolidated Balance Sheets. We record interest appropriations at the beginning of the fiscal year and again at mid-year, if necessary, and we return any unused authority to the General Fund at the end of the fiscal year. Permanent indefinite authority for debt redemptions and related interest is available for an unlimited period of time.

We also have permanent and indefinite appropriations to fund increases in the projected subsidy costs of credit programs as determined by the re-estimation process required by the FCRA, and to also cover our renewable energy project.

Additionally, we have other permanent and indefinite appropriations to make certain payments on behalf of the U.S. government. We receive these appropriations to make payments to the FRB for fiscal services provided, and to the financial institutions for services provided as financial agents of the U.S. government. They also include appropriations provided to make other disbursements on behalf of the U.S. government, including payments made to various parties as a result of certain claims and judgments rendered against the U.S.

## U. Income Taxes

As an agency of the U.S. government, we are exempt from all income taxes imposed by any governing body, whether it is a federal, state, commonwealth, local, or foreign government.

## V. Use of Estimates

We have made certain estimates and assumptions relating to the reporting of assets, liabilities, revenues, expenses, and the disclosure of contingent liabilities to prepare our financial statements. Actual results may differ from these estimates. Adverse changes in the outlook for the key assumptions underlying management's estimates may materially affect the results of our operations, cash flows and/or our financial position in future periods. Transactions subject to estimates principally include loan and credit program receivables, credit reform subsidy costs, investments in GSEs and other non-federal securities and related impairment, tax receivables, loan guarantees, depreciation, actuarial liabilities, cost and earned revenue allocations, as well as contingencies and any related recognized liabilities. The following is a discussion of certain significant transactions subject to estimation.

We account for all of our credit program receivables in accordance with credit reform accounting (refer to the accounting policy above entitled "*Credit Program Receivables, Net*" and Note 9). These receivables are derived using credit reform modeling, which is subject to the use of estimates and forecasts that have inherent uncertainty. We recognize the sensitivity of credit reform modeling to slight changes in certain model assumptions such as general economic conditions, specific stock price volatility of the entities in which we have an equity interest, estimates of expected default, and prepayment rates.

We use regular review of model factors, statistical modeling, and annual re-estimates to reflect the most accurate cost of the credit programs to the U.S. government. The purpose of re-estimates is to update original program subsidy cost estimates to reflect actual cash flow experience as well as changes in forecasts of future cash flows. We update forecasts of future cash flows based on actual program performance to date, additional information about the portfolio, additional publicly available relevant historical market data on securities performance, revised expectations for future economic conditions, and enhancements to cash flow projection methods.

We perform annual calculations, as of September 30, to assess our need for recording an estimated liability in accordance with SFFAS No. 5 related to our funding commitment to the GSEs under the SPSPAs. Liability recognition is predicated on the probable future occurrence of an excess of liabilities and minimum capital reserve amounts, as defined, over the assets of either GSE at the end of any reporting quarter. The occurrence of future GSE deficits, which ultimately determines our liability to the GSEs, is most sensitive to future changes in the housing price index and, to a lesser extent, future changes in guarantee fees received by the GSEs on single family mortgages and interest rates.

The annual valuation as of September 30 of the preferred stock and warrants comprising the "*Investments in Government Sponsored Enterprises*" line item on the Consolidated Balance Sheets incorporates various forecasts, projections and cash flow analyses to develop an estimate of the assets' fair value. The value of the senior preferred stock is estimated by first estimating the fair value of the total equity of each GSE (which, in addition to the senior preferred stock, is comprised of other equity instruments including common stock, common stock warrants, and junior preferred stock). The fair value of the total equity is based on a discounted cash flow valuation methodology, whereby the primary input is the present value of the projected quarterly dividend payments. The fair value of the GSEs' other equity instruments is then deducted from its total equity, with the remainder representing the fair value of the senior preferred stock. The primary input into the warrants valuation is the market value of the shares of common stock of the GSEs which, along with the junior preferred stock, are traded on the over-the-counter (OTC) Bulletin Board. We evaluate the need for adjusting our OTC market-based valuation of the warrants for the effects, if any, of significant events occurring after the close of the market but before the end of the measurement date. We record any changes in valuation, including impairment, and disclose changes in accordance with SFFAS No. 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting,* as amended. Since the valuation is an annual process, we deem changes in valuation of the preferred stock and

warrants as usual and recurring. Note 10 includes a detailed discussion of the results of the asset valuation and estimated liability assessment.

Estimation of such complex and long-duration receivables, investments, and contingencies is subject to uncertainty. It is possible that new developments will adversely impact the value of receivables, investments, and contingencies, as well as ultimate amounts we are required to fund. Except as expressly noted herein, we have not revalued or included in our estimates as of September 30, 2017 the effects of any new developments that may have occurred subsequent to September 30, 2017. Refer to the accounting policy entitled "*Pension Costs, Other Retirement Benefits, and Other Post-Employment Benefits"* above and Note 8 for additional discussion related to the estimation of actuarial liabilities and tax receivables, respectively.

## W. Other-Than-Temporary Impairments

A decline in the market value (either due to credit, price, or currency) of any investment below cost that is deemed to be other-than-temporary is accounted for as an impairment, and the carrying value is reduced to fair value for financial reporting purposes. To determine whether an impairment is other-than-temporary, we consider whether we have the ability and intent to hold the investment until a market price recovery, and consider whether evidence indicating the cost of the investment is recoverable outweighs evidence to the contrary.

## X. Credit, Market and Foreign Currency Risk

Credit risk is the potential, no matter how remote, for financial loss from a failure of a borrower or counterparty to perform in accordance with underlying contractual obligations. We take on possible credit risk when we make direct loans or guarantees to non-federal entities, provide credits to foreign entities, or become exposed to institutions which engage in financial transactions with foreign countries (refer to Note 12). Our following programs entail credit risk: monetary assets held; committed but undisbursed direct loans; funding commitment to the GSEs; GSE obligations obtained under the HFA initiative (the New Issue Bond Program); investments, loans, and other credit programs including the CDFI Fund programs, SBLF, and TARP.

Our activities generally focus on the underlying problems in the credit markets. We developed these programs to provide credit where borrowers are not able to get access to credit with reasonable terms and conditions. Because these programs attempt to correct for a market imperfection, it can expose us to potential costs and losses. Additional risk of costs and losses could result from terrorist attacks under the Terrorism Risk Insurance Program. The extent of the risk we assumed is described in more detail in the notes to the financial statements and, where applicable, is factored into credit reform models and reflected in fair value measurements (refer to Notes 9, 10, and 26).

For *Emergency Economic Stabilization Act* (EESA) programs, the statute requires calculation of budgetary costs of the troubled assets and guarantees of troubled assets by adjusting the discount rate for market risks. We adjust our cost estimates for the TARP programs based on a MADR to reflect the additional return required by the market to compensate for variability around the expected losses reflected in the cash flows. Consistent with SFFAS No. 2, market risk relative to asset type is factored in the cash flow estimates. The inclusion of the MADR is the mechanism for deriving a fair value of the assets.

We face certain risks and uncertainties as a result of holding securities denominated in foreign currency. The price of holdings of such securities may widely fluctuate as a result of volatility in foreign currency markets and changes in real and perceived credit risk of our counterparties.

## Y. Funds from Dedicated Collections

We account for revenues and other financing sources for funds from dedicated collections (FDC) separately from other funds. Such funds are financed by specifically identified revenues provided to the U.S. government by non-federal sources, often supplemented by federal and other financing sources, which remain available over time. Statute requires use of these specifically identified revenues and other financing sources for designated activities, benefits, or purposes. We apply the following criteria for purposes of designating funds as dedicated collections: (*i*) a statute committing the U.S. government to use specifically identified revenues and/or other financing sources that are originally provided to the U.S. government by a non-federal source only for designated activities, benefits, or purposes; (*ii*) explicit authority for the fund to retain revenues and/or other financing sources not used in the current period for future use to finance the designated activities, benefits, or purposes; (*iii*) a requirement to account for and report on the receipt, use, and retention of the revenues and/or other financing sources that distinguishes the fund from the U.S. government's general revenues; and (*iv*) for funds comprised of both federal and non-federal sources, such funding is predominantly non-federal, or the non-federal funding is material to our financial statements.

## Z. Allocation Transfers

We are a party to allocation transfers with other federal agencies as both a transferring (parent) entity and/or a receiving (child) entity. Allocation transfers are legal delegations by one department of its authority to obligate budget authority and outlay funds to another department. A separate fund account (allocation account) is created in Treasury as a subset of the parent fund account for tracking and reporting purposes. All allocation transfers of balances are credited to this account, and subsequent obligations and outlays incurred by the child entity are charged to this allocation account as they execute the delegated activity on behalf of the parent. Parent federal agencies report both the proprietary and budgetary activity and the child agency does not report any financial activity related to budget authority allocated from the parent federal agency to the child federal agency. However, OMB guidance requires the child to report the activity when we receive allocation transfers, as the child, from the Executive Office of the President (See Circular No. A-136, II.4.2, question 5 for two exceptions).

We allocate funds, as the parent, to the Department of Energy and HHS. Also, we receive allocation transfers, as the child, from the Agency for International Development, HHS, Department of Transportation, Executive Office of the President, and GSA.

## AA. Fiduciary Activities

Fiduciary activities are the collection or receipt, and the management, protection, accounting, investment, and disposition by the U.S. government of cash or other assets in which non-federal individuals or entities have an ownership interest that the U.S. government must uphold. Fiduciary cash and other assets are not assets of the U.S. government. We do not report these activities in our consolidated financial statements, but instead are reported in Note 25.

## AB. Related Parties and Other Entities

The primary related parties with whom we conduct business are other federal agencies, mainly through the normal lending activities of the Fiscal Service and the FFB. We disclose these activities in the consolidated financial statements. Additionally, the Secretary serves on the Federal Housing Finance Oversight Board, and consults with the Director of FHFA on matters involving Fannie Mae and Freddie Mac. This provides us with an advisory role in the FHFA's actions as the conservator for Fannie Mae and Freddie Mac. We have no transactions with FHFA, but rather transact directly with the GSEs. We also utilize the services of the FRBs to execute a variety of transactions on behalf of the Fiscal Service and the ESF. Due to the magnitude and variety of services provided, the following provides an overview of the FRBs' purpose, governance, and the various services provided on our behalf.

### Federal Reserve System

Congress, under the *Federal Reserve Act of 1913*, created the FR System. The FR System consists of the Federal Reserve Board of Governors (Board), the Federal Open Market Committee (FOMC), and the FRBs. Collectively, the FR System serves as the nation's central bank and is responsible for formulating and conducting monetary policy, issuing and distributing currency (Federal Reserve Notes), supervising and regulating financial institutions, providing nationwide payments systems (including large-dollar transfers of funds, automated clearinghouse [ACH] operations, and check collection), providing certain financial services to federal agencies and fiscal principals, and serving as the U.S. government's bank. Monetary policy includes actions undertaken by the FR System that influence the availability and cost of money and credit as a means of helping to promote national economic goals. The FR System also conducts operations in foreign markets in order to counter disorderly conditions in exchange markets or to meet other needs specified by the FOMC to carry out its central bank responsibilities. The FR System is not included in the federal budget. The FR System is considered an independent central bank, and the executive branch of the U.S. government does not ratify its decisions.

We interact with the FRBs in a variety of ways, including the following:

- The FRBs serve as our fiscal agent and depositary, executing banking and other financial transactions on our behalf (refer to Note 5). We reimburse the FRBs for these services, the cost of which is included on the Consolidated Statements of Net Costs.
- The FRBs hold Treasury and other federal securities in the FRBs' System Open Market Account (SOMA) for the purpose of conducting monetary policy (refer to Note 15).
- The FRBs hold gold certificates issued by the Department in which the certificates are collateralized by gold (refer to Note 6).
- The FRBs hold SDR certificates issued by the Department which are collateralized by SDRs (refer to Notes 5 and 7).
- The FRBs are required by Board policy to transfer their excess earnings to us on behalf of the U.S. government (refer to Notes 8 and 22).

We also consult with the FR System on matters affecting the economy and certain financial stabilization activities. We account for and disclose the above financial activities involving us in our consolidated financial statements. In accordance with SFFAC No. 2, we do not consolidate the FR Systems' assets, liabilities, and operations into our financial statements.

## Federal Reserve System Structure

The Board is an independent regulatory organization governed by seven members appointed by the President and confirmed by the Senate. The full term of a Board member is 14 years, and the appointments are staggered so that one term expires on January 31 of each even-numbered year. The Board has a number of supervisory and regulatory responsibilities for institutions including, among others, state-chartered banks that are members of the FR System, bank holding companies, and savings and loan holding companies. In addition, the Board has general supervisory responsibilities for the 12 FRBs, and issues currency (Federal Reserve Notes) to the FRBs for distribution.

The FOMC is comprised of the seven Board members and five of the 12 FRB presidents. FOMC formulates and conducts monetary policy primarily through open market operations (the purchase and sale of certain securities in the open market), the principal tool of national monetary policy. These operations affect the amount of reserve balances available to depository institutions, thereby influencing overall monetary and credit conditions. The 12 FRBs are chartered under the Federal Reserve Act, which requires each member bank to own the capital stock of its FRB. Each FRB has a board of directors that exercises supervision and control of each FRB, with three members appointed by the Board, and six board members elected by their member banks.

The FRBs participate in formulating and conducting monetary policy, distribute currency and coin, and serve as our fiscal agent, as well as the fiscal agent for other federal agencies and fiscal principals. Additionally, the FRBs provide short-term loans to depository institutions and loans to participants in programs or facilities with broad-based eligibility in unusual and crucial circumstances when approved by the Board and Secretary of the Treasury.

## Federal Reserve System Assets and Liabilities

The FRBs hold Treasury and other securities in the SOMA for the purpose of conducting monetary policy. Treasury securities held by the FRBs totaled $2.0 trillion and $1.8 trillion as of September 30, 2017 and 2016, respectively (refer to Note 15). These assets are generally subject to the same market (principally interest-rate) and credit risks as other financial instruments. In the open market, the FR System purchases and sells Treasury securities as a mechanism for controlling the money supply.

The FRBs have deposit liabilities with Treasury and depository institutions. The FRBs issue Federal Reserve Notes, the circulating currency of the U.S., which are collateralized by the Treasury securities and other assets held by the FRBs.

Financial and other information concerning the FR System, including financial statements for the Board and the FRBs, may be obtained from the FR System website.

## FRB Residual Earnings Transferred to the Department

FRBs generate income from interest earned on securities, reimbursable services provided to federal agencies, and the provision of priced services to depository institutions as specified by the *Monetary Control Act of 1980*. Although the FRBs generate earnings from carrying out open market operations, via the earnings on securities held in the SOMA account, their execution of these operations is for the purpose of accomplishing monetary policy rather than generating earnings. Each FRB is required by Board policy to transfer to us its residual (or excess) earnings after providing for the cost of operations, payment of dividends, and surplus funds not to exceed an FRB's allocated portion of an aggregate of $10 billion for all FRBs, in accordance with the provisions of *Fixing America's Surface Transportation Act* (P.L. 114-94).

FRBs' residual earnings may vary due to, among other things, changes in the SOMA balance levels that may occur in conducting monetary policy. Under P.L. 114-94, if an FRB's earnings for the year are not sufficient to provide for the cost of operations, payment of dividends, or allocated portion of the $10 billion aggregate surplus funds limitation, an FRB will suspend its payments to us until such earnings become sufficient. The FRB residual earnings of $81.3 billion and $115.7 billion for fiscal years ended September 30, 2017 and 2016, respectively, are reported as custodial revenues on our Statements of Custodial Activity. They constituted 2.3 percent and 3.3 percent of our total custodial revenues collected in FY 2017 and 2016, respectively. "*Taxes, Interest and Other Receivables, Net*" includes a receivable for FRB's residual earnings which represents the earnings due to us as of September 30, but not collected by us until after the end of the month (refer to Note 8).

# 2. FUND BALANCE

As of September 30, 2017 and 2016, Fund Balance consisted of the following:

| (in millions) | | 2017 | | 2016 |
|---|---|---|---|---|
| Appropriated Funds | $ | **422,556** | $ | 431,008 |
| Revolving Funds | | **1,743** | | 2,277 |
| Special Funds | | **985** | | 783 |
| Clearing Funds | | **554** | | 689 |
| Deposit Funds | | **67** | | 78 |
| Other Funds (principally Receipt, Suspense, and Trust Funds) | | **491** | | 411 |
| **Total Fund Balance** | $ | **426,396** | $ | 435,246 |

Appropriated funds consist of amounts appropriated annually by Congress to fund our operations.

We use revolving funds for continuing cycles of business-like activity in which the fund charges for the sale of products or services and uses the proceeds to finance its spending, usually without requirement for annual appropriations. A public enterprise revolving fund is an account that is authorized by law to be credited with offsetting collections from the public, and those monies are used to finance operations. Also included in revolving funds are the working capital fund and financing funds. The working capital fund is a fee-for-service fund established to support operations of our components. The financing funds relate to credit reform activities.

Special funds include funds designated for specific purposes. Clearing funds represent reconciling differences with our balances as reported in the U.S. government's central accounts. These fund accounts temporarily hold unidentifiable general, special, or trust fund collections that belong to the U.S. government until they are classified to the proper receipt or expenditure account by the federal entity. Deposit funds are accounts that record amounts held temporarily by the U.S. government until ownership is determined, and include seized cash and other amounts received as an advance that are not accompanied by an order.

## STATUS OF FUND BALANCE

As of September 30, 2017 and 2016, the status of the fund balance consisted of the following:

| (in millions) | | 2017 | | 2016 |
|---|---|---|---|---|
| Unobligated Balance - Available | $ | **275,698** | $ | 275,595 |
| Unobligated Balance - Not Available | | **40,750** | | 41,614 |
| Unpaid Obligations | | **71,570** | | 75,617 |
| Subtotal | | **388,018** | | 392,826 |
| Adjustment for ESF | | **(94,659)** | | (94,273) |
| Adjustment for Intra-Treasury Investments | | **(9,354)** | | (9,347) |
| Adjustment for Borrowing Authority | | **(6,600)** | | (6,520) |
| Adjustment for IMF | | **134,785** | | 138,373 |
| Adjustment for Authority Unavailable for Obligations | | **12,099** | | 12,091 |
| Other Adjustments | | **2,107** | | 2,096 |
| **Total Status of Fund Balance** | $ | **426,396** | $ | 435,246 |

Portions of the Unobligated Balance Not Available, as shown on the Combined Statement of Budgetary Resources, include amounts appropriated in prior fiscal years that are not available to fund new obligations. However, we may use such amounts for upward and downward adjustments for existing obligations in future years. The Unpaid Obligations represent amounts designated for payment of goods and services ordered but not received, or goods and services received but for which payment has not yet been made.

Since the following line items are either a component of Fund Balance or post to budgetary status accounts, the following adjustments are required to reconcile the budgetary status to the non-budgetary Fund Balance as reported on the Consolidated Balance Sheets:

- Adjustments for ESF – ESF investments in Treasury securities (which are eliminated on the Consolidated Balance Sheets), foreign investments, SDR holdings, and related balances that meet the criteria for reporting as part of budgetary resources are reported on the Combined Statements of Budgetary Resources; however, they are not a component of the Fund Balance as they represent invested funds;
- Adjustments for Intra-Treasury Investments – Budgetary resources include Treasury security investments; however, we have moved the money from the Fund Balance to Investments, which we eliminate on the Consolidated Balance Sheets;
- Adjustments for Borrowing Authority – Borrowing authority is in budgetary status reported on the Combined Statements of Budgetary Resources but not in the Fund Balance because we have not received the amounts;
- Adjustments for IMF – The funding received through appropriation warrants for IMF is reported as a component of Fund Balance; however, the IMF transactions are not reported as budgetary resources and uses on the Combined Statements of Budgetary Resources (refer to Note 7); and
- Adjustment for Authority Unavailable for Obligations – Resources unavailable for obligations reduced the budgetary resources reported on the Combined Statements of Budgetary Resources; however, they do not impact the Fund Balance.

As of September 30, 2017 and 2016, we had no budgetary authority in the Fund Balance that was specifically withheld from apportionment by the OMB. We hold balances in non-entity funds, such as certain deposit funds (e.g., seized cash), for the public or for another federal entity, such as the General Fund. Such funds have an offsetting liability equal to the Fund Balance. Refer to Note 7 regarding restrictions related to the line of credit held on the U.S. quota in the IMF.

# 3. LOANS AND INTEREST RECEIVABLE – INTRA-GOVERNMENTAL

## ENTITY INTRA-GOVERNMENTAL

Through FFB, we issue loans to federal agencies for the agencies' own use or for the agencies to loan to private sector borrowers whose loans are guaranteed by the federal agencies. FFB is a wholly-owned Government corporation that operates under the general supervision of the Secretary, and has its own broad statutory authority to finance any obligations that are issued, sold, or guaranteed by federal agencies. For agencies that have the statutory authority to borrow in the market, but not from Treasury through the Fiscal Service (refer to the Non-Entity Intra-Governmental section below), FFB uses its statutory authority to make these loans directly to federal agencies.

FFB also uses its statutory authority to finance direct or indirect federally-guaranteed obligations which, as a matter of long-standing federal credit policy, is the least expensive and most efficient method of financing these credit-risk obligations when compared to private sector lender financing. When a federal agency has to honor its guarantee because a private-sector borrower defaults, the federal agency that guaranteed the loan must obtain an appropriation or use other resources to repay FFB.

All principal and interest on FFB loans to federal agencies and private-sector borrowers are, or have a commitment to be, backed by the full faith and credit of the U.S. government. Accordingly, we have not recognized any credit-related losses on its loans, nor have we recorded an allowance for uncollectible intra-governmental loans.

As of September 30, 2017 and 2016, entity intra-governmental loans (issued by FFB) and interest receivable consisted of the following:

| (in millions) | Loans Receivable | Interest Receivable | 2017 Total | Loans Receivable | Interest Receivable | 2016 Total |
|---|---|---|---|---|---|---|
| Department of Agriculture | $ **45,080** | $ **353** | $ **45,433** | $ 43,339 | $ 25 | $ 43,364 |
| United States Postal Service[(1)] | **15,000** | **53** | **15,053** | 15,000 | 61 | 15,061 |
| Department of Energy | **14,448** | **70** | **14,518** | 15,616 | 70 | 15,686 |
| Department of Education | **1,563** | **13** | **1,576** | 1,442 | 12 | 1,454 |
| Department of Housing & Urban Development | **1,193** | **3** | **1,196** | 554 | 1 | 555 |
| Other Agencies | **4** | **-** | **4** | 3 | - | 3 |
| **Total Entity Intra-governmental** | $ **77,288** | $ **492** | $ **77,780** | $ 75,954 | $ 169 | $ 76,123 |

*(1) The United States Postal Service (USPS) experienced an operating deficit in both FY 2017 and FY 2016. We, along with Congress and other stakeholders are aware of the current and long-term financial issues of the USPS. Congress is considering legislative solutions for returning the USPS to financial stability.*

## NON-ENTITY INTRA-GOVERNMENTAL

Through the Fiscal Service, we account for and report on the principal borrowings from and repayments to the General Fund for various funds managed by other federal agencies, as well as the related interest due to the General Fund. These federal agencies are statutorily authorized to borrow from the General Fund, through the Fiscal Service, to make loans for a broad range of purposes, such as education, housing, farming, and small business support.

As of September 30, 2017 and 2016, non-entity intra-governmental loans (issued by the Fiscal Service) and interest receivable that were due to the General Fund consisted of the following:

| (in millions) | Loans Receivable | Interest Receivable | 2017 Total | Loans Receivable | Interest Receivable | 2016 Total |
|---|---|---|---|---|---|---|
| Department of Education | **$ 1,178,495 $** | **- $** | **1,178,495** $ | 1,126,370 $ | - $ | 1,126,370 |
| Department of Agriculture | **69,987** | **-** | **69,987** | 75,627 | - | 75,627 |
| Department of Homeland Security | **30,440** | **-** | **30,440** | 23,017 | - | 23,017 |
| Department of Housing and Urban Development | **28,082** | **-** | **28,082** | 30,447 | - | 30,447 |
| Export Import Bank of the U.S. | **24,645** | **-** | **24,645** | 25,022 | - | 25,022 |
| Department of Transportation | **14,298** | **-** | **14,298** | 10,868 | - | 10,868 |
| Small Business Administration | **7,693** | **-** | **7,693** | 8,020 | - | 8,020 |
| Department of Labor | **5,744** | **-** | **5,744** | 5,706 | - | 5,706 |
| Department of Energy | **5,538** | **30** | **5,568** | 5,209 | 28 | 5,237 |
| Railroad Retirement Board | **3,712** | **41** | **3,753** | 3,577 | 39 | 3,616 |
| Overseas Private Investment Corporation | **3,015** | **-** | **3,015** | 2,491 | - | 2,491 |
| Executive Office of the President/ Defense Security Cooperation Agency | **2,505** | **-** | **2,505** | 2,499 | - | 2,499 |
| Department of Defense | **1,631** | **-** | **1,631** | 1,631 | - | 1,631 |
| National Credit Union Administration | **-** | **-** | **-** | 1,000 | 1 | 1,001 |
| Other Agencies | **1,989** | **-** | **1,989** | 2,978 | 1 | 2,979 |
| **Total Non-Entity Intra-governmental** | **$ 1,377,774 $** | **71 $** | **1,377,845** $ | 1,324,462 $ | 69 $ | 1,324,531 |
| **Total Intra-governmental Loans and Interest Receivable (Entity and Non-Entity)** | **$ 1,455,062 $** | **563 $** | **1,455,625 $** | 1,400,416 $ | 238 $ | 1,400,654 |

As a result of Hurricanes Harvey, Irma, and Maria, Congress enacted the Additional Supplemental Appropriations for Disaster Relief Requirements Act of 2017 (Pub. L. 115-72) on October 26, 2017. The Act provides, among other things, debt relief for the Federal Emergency Management Agency's National Flood Insurance Program— an agency of the Department of Homeland Security—by cancelling $16.0 billion of the Program's debt to Treasury. In FY 2018, the debt forgiveness will reduce the Department of Homeland Security's non-entity intra-governmental loans receivable balance shown above.

# 4. DUE FROM THE GENERAL FUND AND DUE TO THE GENERAL FUND

The General Fund consists of assets and liabilities used to finance the daily and long-term operations of the U.S government, as a whole. It also includes accounts used in the management of the Budget of the U.S. Government.

We hold and manage General Fund assets, such as loans and interest receivable, cash, and investments in the GSEs on behalf of the U.S. government. General Fund assets constitute resources available to meet the operating needs of the U.S. government. We report these managed assets separately on the Consolidated Balance Sheets, with a corresponding amount reported as Due To the General Fund that represents a liability to reflect assets we owed to the General Fund.

General Fund liabilities, primarily federal debt and interest payable and liability for restoration of federal debt principal and interest, are obligations of the U.S. government. We report these Department-managed liabilities separately on the Consolidated Balance Sheets, with a corresponding amount reported as Due From the General Fund that represents a receivable, or future funds required of the General Fund to repay borrowings from the public and other federal agencies.

As of September 30, 2017 and 2016, the General Fund liabilities we owed exceeded the assets held on behalf of the General Fund by $18.6 trillion and $17.8 trillion, respectively. This represents the amount needed by the U.S. government, through a combination of future tax collections and/or continued borrowing from the public and federal agencies to meet its obligations.

As of September 30, 2017 and 2016, Due From the General Fund included the following non-entity liabilities:

| Liabilities Requiring Funding from the General Fund (in millions) | 2017 | 2016 |
|---|---|---|
| Federal Debt and Interest Payable - Held by the Public (Note 15) | **$ 14,699,687** | $ 14,196,734 |
| Federal Debt and Interest Payable - Intra-governmental (Note 15) | **5,637,950** | 5,466,422 |
| Liability for Restoration of Federal Debt Principal and Interest - Intra-governmental (Note 15) | **660** | - |
| Refunds Payable (Note 22) | **3,074** | 2,993 |
| Adjustment for Eliminated Liabilities | **32,406** | 33,003 |
| **Total Due From the General Fund** | **$ 20,373,777** | $ 19,699,152 |

The Adjustment for Eliminated Liabilities principally represents investments in U.S. government securities held by our reporting entities that were eliminated against Federal Debt and Interest Payable Intra-governmental.

As of September 30, 2017 and 2016, Due To the General Fund included the following non-entity assets:

| Assets to be Distributed to the General Fund (in millions) | 2017 | 2016 |
|---|---|---|
| Fund Balance | **$ 793** | $ 694 |
| Loans and Interest Receivable - Intra-governmental (Note 3) | **1,377,845** | 1,324,531 |
| Advances to Trust Funds | **9,021** | 8,558 |
| Cash Due To the General Fund (Held by the Department) (Note 5) | **153,475** | 347,077 |
| Accounts Receivable - Intra-governmental | **790** | 377 |
| Foreign Currency | **152** | 118 |
| Custodial Gold without Certificates and Silver Held by the Mint | **25** | 25 |
| Taxes and Other Non-Entity Receivables Due To the General Fund | **53,341** | 50,201 |
| Credit Reform Downward Subsidy Re-estimates | **120** | 152 |
| Loans and Interest Receivable | **8** | 8 |
| Investments in Government Sponsored Enterprises (Note 10) | **92,640** | 108,550 |
| Adjustment for Eliminated Assets | **66,847** | 66,332 |
| **Total Due To the General Fund** | **$ 1,755,057** | $ 1,906,623 |

*The assets to be distributed to the General Fund do not represent all of the non-entity assets we manage. Refer to Note 14 for all of our non-entity assets held.*

The Fund Balance reported above represents the non-entity funds we hold on behalf of the General Fund. It is used to administer programs such as the Presidential Election Campaign and payments for Legal Services Corporation and thus not available for our general use.

The Advances to Trust Funds consists of Advances to the Unemployment Trust Fund and Advances to the Federal Supplementary Medical Insurance Trust Fund. The General Fund issues advances to the DOL's Unemployment Trust Fund to disburse to states for unemployment benefits. We transfer DOL's repayment of these advances to the General Fund.

The *Bipartisan Budget Act of 2015* (P.L. 114-74) authorized a transfer from the General Fund to HHS' Federal Supplementary Medical Insurance Trust Fund to temporarily replace the reduction in Medicare Part B participants' premiums. We transfer HHS's repayment of these advances to the General Fund. Beginning in FY 2017, we commenced reporting this balance within the line item entitled "*Advances to Trust Funds*" on our Consolidated Balance Sheet, with an offsetting liability due to the General Fund.

Taxes and Other Non-Entity Receivables Due To the General Fund primarily represents IRS-related federal taxes receivable (refer to Note 8).

The Adjustment for Eliminated Assets principally represents loans and interest payable owed by our Treasury reporting entities, which were eliminated against Loans and Interest Receivable Intra-governmental held by the Fiscal Service.

# 5. CASH, FOREIGN CURRENCY, AND OTHER MONETARY ASSETS

Cash, Foreign Currency, and Other Monetary Assets held as of September 30, 2017 and 2016 were as follows:

| (in millions) | 2017 | 2016 |
|---|---|---|
| **Entity:** | | |
| Cash | $ **27** | $ 32 |
| Foreign Currency and Foreign Currency Denominated Assets | **12,651** | 11,756 |
| Other Monetary Assets: | | |
| Special Drawing Right Holdings | **51,491** | 50,057 |
| U.S. Dollars Held in Cash by the IMF | **308** | 309 |
| **Total Entity** | **64,477** | 62,154 |
| **Non-Entity:** | | |
| Operating Cash of the U.S. government | **153,323** | 346,956 |
| Foreign Currency | **152** | 118 |
| Miscellaneous Cash Held by All Treasury Reporting Entities | **878** | 870 |
| **Total Non-Entity** | **154,353** | 347,944 |
| **Total Cash, Foreign Currency, and Other Monetary Assets** | $ **218,830** | $ 410,098 |

We hold non-entity operating and other miscellaneous cash due to the General Fund which consisted of the following as of September 30, 2017 and 2016:

| (in millions) | 2017 | 2016 |
|---|---|---|
| Operating Cash - FRB Account | $ **159,322** | $ 353,312 |
| Outstanding Checks | **(5,999)** | (6,356) |
| **Total Operating Cash of the U.S. government** | **153,323** | 346,956 |
| Miscellaneous Cash | **154** | 127 |
| **Subtotal** | **153,477** | 347,083 |
| Amounts Due to the Public | **(2)** | (6) |
| **Total Cash Due to the General Fund (Note 4)** | $ **153,475** | $ 347,077 |

## ENTITY

Entity cash, foreign currency, and other monetary assets principally include foreign currency, foreign currency denominated assets (FCDAs), and SDRs. These assets are valued as of September 30, 2017 and 2016 using current exchange rates plus accrued interest.

### Foreign Currency and Foreign Currency Denominated Assets

Foreign currency and FCDAs represent foreign deposit accounts and securities with original maturities of three months or less which were valued at $12.7 billion and $11.8 billion as of September 30, 2017 and 2016, respectively.

### Special Drawing Rights

The SDR is an international reserve asset created by the IMF to supplement existing reserve assets. The IMF has allocated new SDRs on several occasions to members participating in the IMF's SDR department. The SDR derives its value as a reserve asset essentially from the commitments of participants to hold and accept SDRs and to honor various obligations connected with their proper functioning as a reserve asset. Pursuant to the *Special Drawing Rights Act of 1968*, as amended, we issued certificates to the Federal Reserve, valued at $5.2 billion which were reported as a liability on the

Consolidated Balance Sheets as of September 30, 2017 and 2016. The certificates were issued to finance the ESF's acquisition of SDRs from other countries or to provide U.S. dollar resources for financing other ESF operations.

On a daily basis, the IMF calculates the value of the SDR using the currency exchange rate in terms of the U.S. dollar from weighted amounts of each of five freely usable currencies, as defined by the IMF. These currencies are the U.S. dollar, the European euro, the Japanese yen, the British pound sterling, and the Chinese renminbi. We revalue the U.S. SDR holdings and allocations from the IMF monthly based on the SDR valuation rate calculated by the IMF.

Pursuant to the IMF Articles of Agreement, SDR holdings and allocations acquired by the U.S. are permanent resources or liabilities unless:

- cancelled by the Board of Governors pursuant to an 85.0 percent majority decision of the total voting power of IMF members;
- the SDR department of the IMF is liquidated;
- the IMF is liquidated; or
- the U.S. chooses to withdraw from the IMF or terminate its participation in the SDR department

Except for the payment of interest and charges on SDR allocations to the U.S., the payment of the U.S. commitment related to SDR allocations is conditional on events listed above, in which the U.S. has a substantial or controlling voice. The U.S. has received no SDR allocations since 2009.

As of September 30, 2017 and 2016, the total amount of SDR holdings of the U.S. was the equivalent of $51.5 billion and $50.1 billion, respectively. As of September 30, 2017 and 2016, the total value of SDR allocations to the U.S. was the equivalent of $49.9 billion and $49.3 billion, respectively.

## NON-ENTITY

We manage the non-entity cash, foreign currency, and other monetary assets which principally included Operating Cash of the U.S. government. Also included is foreign currency maintained by various U.S. disbursing offices, miscellaneous cash such as seized monetary instruments, undistributed cash, and offers in compromises which are maintained as a result of our tax collecting responsibilities. The Operating Cash of the U.S. government represents balances from tax collections, other revenues, federal debt receipts, and other receipts, net of checks outstanding, which are held in the FRBNY.

# 6. GOLD AND SILVER RESERVES, AND GOLD CERTIFICATES ISSUED TO THE FEDERAL RESERVE BANKS

Through the Mint, we are responsible for safeguarding most of the U.S. government's gold and all of the silver reserves in accordance with 31 USC 5117; a smaller portion of the gold is in the custody of the FRBs.

The gold reserves we hold are partially offset by a liability for gold certificates issued by the Secretary to the FRBs at the statutory rate, as provided in 31 USC 5117. Since 1934, Gold Certificates have been issued in non-definitive or book-entry form to the FRBs. Our liability incurred by issuing the Gold Certificates, as reported on the Consolidated Balance Sheets, is limited to the gold we hold at the statutory value. Upon issuance of Gold Certificates to the FRBs, we deposit the proceeds from the certificates into the operating cash of the U.S. government. All of our certificates issued are payable to the FRBs. The Mint also holds 100,000 fine troy ounces (FTO) ($4 million at the statutory carrying value) of gold reserves without certificates.

The gold and silver bullion reserve (deep storage and working stock) are reported on the consolidated financial statements at the values stated in 31 USC 5116 – 5117 (statutory rates) which are $42.2222 per FTO of gold and no less than $1.292929292 per FTO of silver. Accordingly, the silver is valued at $1.292929292 per FTO. The market values of the gold and silver reserves disclosed below are based on the London Gold Fixing. As of September 30, 2017 and 2016, the values of gold and silver reserves consisted of the following:

| | FTOs | Statutory Rate | 2017 Statutory Carrying Value (in millions) | Market Rate Per FTO | 2017 Market Value (in millions) |
|---|---|---|---|---|---|
| Gold | **248,046,116** | **$ 42.2222** | **$ 10,473** | **$ 1,283.10** | **$ 318,268** |
| Gold Held by Federal Reserve Banks | **13,452,811** | **$ 42.2222** | **568** | **$ 1,283.10** | **17,261** |
| **Total Gold** | **261,498,927** | | **11,041** | | **335,529** |
| Silver | **16,000,000** | **$ 1.2929** | **21** | **$ 16.86** | **270** |
| **Total Gold and Silver Reserves** | | | **$ 11,062** | | **$ 335,799** |

| | FTOs | Statutory Rate | 2016 Statutory Carrying Value (in millions) | Market Rate Per FTO | 2016 Market Value (in millions) |
|---|---|---|---|---|---|
| Gold | 248,046,116 | $ 42.2222 | $ 10,473 | $ 1,322.50 | $ 328,041 |
| Gold Held by Federal Reserve Banks | 13,452,811 | $ 42.2222 | 568 | $ 1,322.50 | 17,791 |
| **Total Gold** | 261,498,927 | | 11,041 | | 345,832 |
| Silver | 16,000,000 | $ 1.2929 | 21 | $ 19.35 | 310 |
| **Total Gold and Silver Reserves** | | | $ 11,062 | | $ 346,142 |

# 7. Reserve Position in the International Monetary Fund and Related Loans and Interest Receivable

The U.S. participates in the IMF through a quota subscription and certain borrowing arrangements that supplement IMF resources.

As a result of the *Consolidated Appropriations Act, 2016* (P.L. 114-113) we obtained appropriation warrants to cover the full amount of the commitment made to the IMF and received current indefinite authority to maintain the U.S. dollar equivalent of the SDR funding commitment levels. The IMF transactions—other than related interest earnings and cost estimates for U.S. quota and New Arrangements to Borrow (NAB) adjustments—are not reported as budgetary resources and uses on our Combined Statement of Budgetary Resources.

## Reserve Position in the International Monetary Fund

We pay quota subscriptions partly through the transfer of reserve assets, such as foreign currencies or SDRs, which are international reserve assets created by the IMF, and partly by making domestic currency available as needed through a non-interest-bearing letter of credit. This letter of credit, issued by us and maintained by the FRBNY, represents our available commitment to the IMF which may be drawn upon by the IMF.

Transfers to the IMF under the U.S. quota do not result in net budgetary outlays as they constitute an exchange of monetary assets in which the U.S. receives an equal offsetting claim on the IMF in the form of an increase in the U.S. reserve position in the IMF. Similarly, when the IMF repays dollars to the U.S., no net budgetary receipt results because the U.S. reserve position declines concurrently in an equal amount. The U.S. reserve position is an interest-bearing asset like other international reserve assets held by the U.S., and is available at any time to meet U.S. funding needs.

The U.S. quota is denominated in SDRs. As of September 30, 2017 and 2016, the U.S. quota in the IMF was SDR 83.0 billion. The equivalent U.S. dollar value of the U.S. quota consisted of the following:

| (in millions) | 2017 | 2016 |
|---|---|---|
| Letter of Credit [1] | **$ 105,627** | $ 106,116 |
| Reserve Position [2] | **11,509** | 9,570 |
| **Total U.S. Quota in the IMF** | **$ 117,136** | $ 115,686 |

*(1) Letter of Credit amounts are included as part of the "Fund Balance" as reported on the Consolidated Balance Sheets and "Appropriated Funds" as disclosed in Note 2. Amounts also include approximately 0.25 percent of the U.S. quota held in cash in an IMF account at the FRBNY.*

*(2) The Reserve Position amounts are reported as "Reserve Position in the IMF" on the Consolidated Balance Sheets.*

Fluctuations in the value of the U.S. dollar with respect to the SDR result in valuation changes in dollar terms for the U.S. quota. We periodically adjust this balance to maintain the SDR value of the U.S. quota as required by the IMF Articles of Agreement. As of September 30, 2017 and 2016, the U.S. quota reflects a net upward adjustment in value of $1.5 billion and a net downward adjustment in value of $648 million, respectively, due to the depreciation and appreciation of the U.S. dollar against the SDR, respectively.

## Loans and Interest Receivable

In addition to quota subscriptions, the IMF maintains borrowing arrangements to supplement its resources in order to forestall or cope with an impairment of the international monetary system when IMF liquidity is low. The U.S. has the authority to participate in two such arrangements – the NAB and the General Arrangements to Borrow (GAB). When the

U.S. transfers funds to the IMF under these supplemental borrowing arrangements, the U.S. receives in exchange a liquid and interest-bearing claim on the IMF. As of September 30, 2017 and 2016, the IMF had not utilized the GAB.

In accordance with P.L. 114-113, the NAB participation as of September 30, 2017 and 2016 was SDR 28.2 billion, which was equivalent to $39.9 billion and $39.4 billion respectively. As of September 30, 2017 and 2016, under the U.S. NAB arrangement with the IMF, there was $7.4 billion and $8.6 billion, respectively, of U.S. loans outstanding which were reported as "*Loans and Interest Receivable*" on the Consolidated Balance Sheets.

# 8. TAXES, INTEREST, AND OTHER RECEIVABLES, NET

As of September 30, 2017 and 2016, Taxes, Interest, and Other Receivables, Net consisted of the following:

| (in millions) | 2017 | 2016 |
|---|---|---|
| **Non-Entity** | | |
| Federal Taxes Receivable, Gross | **$ 197,188** | $ 178,181 |
| Less Allowance on Taxes Receivable | **(145,176)** | (129,165) |
| Interest Receivable on FRB Deposits of Earnings | **347** | 376 |
| Other Receivables | **1,117** | 936 |
| Less Allowance on Other Receivables | **(121)** | (118) |
| **Total Non-Entity (Note 14)** | **53,355** | 50,210 |
| | | |
| **Entity** | | |
| Miscellaneous Entity Receivables and Related Interest | **141** | 96 |
| **Total Taxes, Interest, and Other Receivables, Net** | **$ 53,496** | $ 50,306 |

Federal taxes receivable constitutes the largest portion of these receivables, with IRS-related taxes receivable representing the majority of the balance. IRS federal taxes receivable consists of tax assessments, penalties, and interest which were not paid or abated, and which were agreed to by either the taxpayer and IRS, or the courts. Federal taxes receivable is reduced by an allowance for doubtful accounts which we established to represent an estimate for uncollectible amounts. The portion of taxes receivable estimated to be collectible and the allowance for doubtful accounts are based on projections of collectability from a statistical sample of taxes receivable (refer to the section entitled *Required Supplementary Information (unaudited)* for additional discussion on IRS Federal Taxes Receivable, Net).

In addition to amounts attributed to taxes, these receivables also include accrued interest income due on funds deposited in FRBs. We do not establish an allowance for the receivable on deposits of FRB earnings.

# 9. Credit Program Receivables, Net

We administer a number of programs designed to stabilize the nation's financial system and restore the flow of credit to consumers, businesses, and homeowners. As of September 30, 2017 and 2016, Credit Program Receivables, Net consisted of the following:

| (in millions) | 2017 | 2016 |
|---|---|---|
| State and Local Housing Finance Agency Program (GSE sponsored) | **$ 4,363** | $ 5,718 |
| Other [1] | **930** | 1,340 |
| **Total** | **$ 5,293** | $ 7,058 |

*(1) Includes CDFI, SBLF, and TARP credit program receivables valued at $568 million, $269 million and $93 million, respectively, as of September 30, 2017, and $401 million, $449 million, and $490 million, respectively, as of September 30, 2016.*

## State and Local Housing Finance Agency Program (GSE sponsored)

Under the *Housing and Economic Recovery Act of 2008* (HERA), (P.L. 110-289), we, together with the FHFA, Fannie Mae, and Freddie Mac, created a program in October 2009 to provide support to HFAs. The HFA Program is comprised of the New Issue Bond Program (NIBP) that is designed to support low mortgage rates and expand resources for low- and middle-income borrowers to purchase or rent homes, making them more affordable over the long term. Under the terms of the NIBP, we purchased securities of Fannie Mae and Freddie Mac backed by new mortgage revenue bonds issued by HFAs. As of September 30, 2017 and 2016, the HFA net credit program receivable of $4.4 billion and $5.7 billion, respectively, included a positive subsidy allowance of $669 million and $791 million, respectively, which reflects our projection that the HFA program will result in a net cost to us after accounting for repayments, interest, and fees.

We performed a financial statement re-estimate of the NIBP program's cost as of September 30, 2017 and 2016. These re-estimates resulted in a downward re-estimate, or a decrease in the cost of the program, of $98 million and $38 million as of September 30, 2017 and 2016, respectively. The downward re-estimates in FY 2017 and 2016 were primarily driven by higher than estimated principal collections, and a higher prepayment curve used in the projection of future years' cash flows as a result of improved economic conditions.

## Summary Tables

The following tables provide the net composition, subsidy cost, re-estimates, a reconciliation of subsidy cost allowances, and the components of the subsidy for each of our credit programs for the fiscal years ended September 30, 2017 and 2016. The tables also include budget subsidy rates pertaining only to the cohorts for the fiscal year presented. These rates cannot be applied to the direct loans disbursed during the current reporting year to yield the subsidy expense. The subsidy expense for new loans reported in 2017 and 2016 could result from disbursements of loans from both current year cohorts and prior year(s) cohorts, and also includes modifications and re-estimates. Amounts reported in the line item "*Net Credit Program Receivables*" are not necessarily the same as the proceeds that we would expect to receive from selling these assets.

| (in millions) | | HFA | Other [2] | 2017 TOTAL |
|---|---|---|---|---|
| **Credit Program Receivables, Net:** | | | | |
| Credit Program Receivables, Gross | $ | 5,032 $ | 973 $ | 6,005 |
| Subsidy Cost Allowance | | (669) | (43) | (712) |
| **Net Credit Program Receivables** | $ | 4,363 $ | 930 $ | 5,293 |
| **New Credit Program Loans Disbursed** | $ | - $ | 176 $ | 176 |
| **Obligations for Loans Not Yet Disbursed** | $ | - $ | 866 $ | 866 |
| **Reconciliation of Subsidy Cost Allowance:** | | | | |
| Balance, Beginning | $ | 791 - | 103 - | 894 |
| Subsidy Cost for Disbursements | | - | (3) | (3) |
| Fees, Interest and Dividend Revenue Received | | 160 | 38 | 198 |
| Net Proceeds from Sales and Repurchases of Assets Less than Cost | | - | (82) | (82) |
| Loans Written Off | | - | (13) | (13) |
| Subsidy Allowance Amortized [1] | | (184) | (34) | (218) |
| Balance, Ending, Before Re-estimates | | 767 | 9 | 776 |
| Subsidy Re-estimates | | (98) | 34 | (64) |
| **Balance, Ending** | $ | 669 $ | 43 $ | 712 |
| **Re-estimates** | | | | |
| Interest on Re-estimate | $ | (25) $ | 1 $ | (24) |
| Technical/Default Re-estimate | | (73) | 33 | (40) |
| **Total Re-estimates – Increase (Decrease) in Subsidy Cost** | $ | (98) $ | 34 $ | (64) |
| **Reconciliation of Subsidy Costs:** | | | | |
| Subsidy Cost for Disbursements | $ | - $ | (3) $ | (3) |
| Subsidy Re-estimates | | (98) | 34 | (64) |
| **Total Credit Program Receivables Subsidy Costs** | $ | (98) $ | 31 $ | (67) |
| **Administrative Expense** | $ | 1 $ | 8 $ | 9 |

| (in millions) | | HFA | Other [3] | 2016 TOTAL |
|---|---|---|---|---|
| **Credit Program Receivables, Net:** | | | | |
| Credit Program Receivables, Gross | $ | 6,509 $ | 1,443 $ | 7,952 |
| Subsidy Cost Allowance | | (791) | (103) | (894) |
| **Net Credit Program Receivables** | $ | 5,718 $ | 1,340 $ | 7,058 |
| **New Credit Program Loans Disbursed** | $ | - $ | 213 $ | 213 |
| **Obligations for Loans Not Yet Disbursed** | $ | - $ | 789 $ | 789 |
| **Reconciliation of Subsidy Cost Allowance:** | | | | |
| Balance, Beginning | $ | 865 $ | 767 $ | 1,632 |
| Subsidy Cost for Disbursements | | - | (4) | (4) |
| Subsidy Cost for Modifications | | - | 25 | 25 |
| Fees, Interest, and Dividend Revenue Received | | 212 | 45 | 257 |
| Net Proceeds from Sales, Repurchases, and Repayments of Assets Less than Cost | | - | (37) | (37) |
| Subsidy Allowance Amortized [1] | | (248) | (47) | (295) |
| Other | | - | (547) | (547) |
| Balance, Ending, Before Re-estimates | | 829 | 202 | 1,031 |
| Subsidy Re-estimates | | (38) | (99) | (137) |
| **Balance, Ending** | $ | 791 $ | 103 $ | 894 |
| **Re-estimates** | | | | |
| Interest on Re-estimate | $ | (9) $ | (1) $ | (10) |
| Technical/Default Re-estimate | | (29) | (98) | (127) |
| **Total Re-estimates – Increase (Decrease) in Subsidy Cost** | $ | (38) $ | (99) $ | (137) |
| **Reconciliation of Subsidy Costs:** | | | | |
| Subsidy Cost for Disbursements | $ | - $ | (4) $ | (4) |
| Subsidy Cost for Modifications | | - | 25 | 25 |
| Subsidy Re-estimates | | (38) | (99) | (137) |
| **Total Credit Program Receivables Subsidy Costs** | $ | (38) $ | (78) $ | (116) |
| **Administrative Expense** | $ | 2 $ | 9 $ | 11 |

*(1) Amount includes net interest income (expense) on borrowings from the Fiscal Service and financing account balance.*
*(2) CDFI Financial Assistance Direct Loan Program budget subsidy rates for Interest Differential and for Defaults were 1.56% and 9.97%, respectively.*
*(3) CDFI Financial Assistance Direct Loan Program budget subsidy rates for Interest Differential and for Defaults were 1.66%, and 10.72%, respectively.*

# 10. INVESTMENTS IN GOVERNMENT SPONSORED ENTERPRISES

Congress established Fannie Mae and Freddie Mac as GSEs to support mortgage lending. A key function of the GSEs is to purchase mortgages, package those mortgages into securities, which are subsequently sold to investors, and guarantee the timely payment of principal and interest on these securities.

Leading up to the financial crisis, increasingly difficult conditions in the housing market challenged the soundness and profitability of the GSEs, thereby threatening to undermine the entire housing market. In response, Congress passed HERA (P.L. 110-289) in July 2008. This act created FHFA, with enhanced regulatory authority over the GSEs, and provided the Secretary with certain authorities intended to ensure the financial stability of the GSEs, if necessary. In September 2008, FHFA placed the GSEs under conservatorship, and we invested in the GSEs by entering into a SPSPA with each GSE. We took these actions to preserve the GSEs' assets, ensure a sound and solvent financial condition, and mitigate systemic risks that contributed to market instability. The purpose of such actions is to maintain the solvency of the GSEs so they can continue to fulfill their vital roles in the home mortgage market while the Administration and Congress determine what structural changes should be made to the housing finance system. Draws under the SPSPAs result in an increased investment in the GSEs as further discussed below.

Under the SPSPAs, we initially received from each GSE: *(i)* 1,000,000 shares of non-voting variable liquidation preference senior preferred stock with a liquidation preference value of $1,000 per share, and *(ii)* a non-transferable warrant for the purchase, at a nominal cost, of 79.9 percent of common stock on a fully-diluted basis. The warrants expire on September 7, 2028. Under the amended SPSPAs, the quarterly dividend payment changed from a 10.0 percent per annum fixed rate dividend on the total liquidation preference (as discussed below) to an amount equivalent to the GSEs' positive net worth above a capital reserve amount. The capital reserve amount, which was initially set at $3.0 billion for calendar year 2013, declines by $600 million at the beginning of each calendar year thereafter until it reaches zero by calendar year 2018. On January 1, 2017 and 2016, the capital reserve amount had declined to $600 million and $1.2 billion for calendar years 2017 and 2016, respectively. The GSEs will not pay a quarterly dividend if their positive net worth is below their required capital reserve threshold. We received cash dividends of $25.3 billion and $11.5 billion during fiscal years ended September 30, 2017 and 2016, respectively.

The SPSPAs, which have no expiration date, provide for us to disburse funds to the GSEs if, at the end of any quarter, the FHFA determines that the liabilities of either GSE exceed its assets. Draws from the Department under the SPSPAs are designed to ensure that the GSEs maintain positive net worth, with a fixed maximum amount available to each GSE under this agreement, established as of December 31, 2012 (refer to the "*Contingent Liability to GSEs*" section below). Draws against the funding commitment of the SPSPAs do not result in the issuance of additional shares of senior preferred stock; instead, it increases the liquidation preference of the initial 1,000,000 shares by the amount of the draw. The combined cumulative liquidation preference totaled $189 billion as of September 30, 2017 and 2016. There were no payments to the GSEs for the fiscal years ended September 30, 2017 and 2016.

## ACCOUNTING TREATMENT

*Entity Transactions*— If we estimate a probable contingent liability to the GSEs, we will accrue and report this liability on our Consolidated Balance Sheets, and fund the liability through our direct appropriations. We will report the liability accrual, if any, at its gross amount as an "entity" cost on our Consolidated Statements of Net Cost, and within the line item, "*Cumulative Results of Operations*" on our Consolidated Balance Sheets, without considering the increase in senior preferred stock liquidation preference/fair value adjustments, and future dividend receipts from the GSEs.

*Non-Entity Transactions*— If we make actual payments to the GSEs, they will result in increases to the U.S. government's liquidation preference in the GSEs' senior preferred stock, and thus represent General Fund exchange revenue reported on our Consolidated Statements of Net Cost as "*GSEs Non-Entity Revenue, Net*." Changes in the fair valuation of the GSE preferred stock and common stock warrants, and related dividends received, are General Fund-related costs and revenues which we report as "*GSEs Non-Entity Revenue, Net*."

## INVESTMENTS IN GSEs

As of September 30, 2017 and 2016, our investments in the GSEs consisted of the following:

| GSEs Investments (in millions) | Gross Investments As of 9/30/17 | Cumulative Valuation Gain/(Loss) | 9/30/2017 Fair Value |
|---|---|---|---|
| Fannie Mae Senior Preferred Stock | **$ 116,989** | **$ (74,489)** | **$ 42,500** |
| Freddie Mac Senior Preferred Stock | **72,160** | **(41,060)** | **31,100** |
| Fannie Mae Warrants Common Stock | **3,104** | **9,256** | **12,360** |
| Freddie Mac Warrants Common Stock | **2,264** | **4,416** | **6,680** |
| **Total GSEs Investments** | **$ 194,517** | **$ (101,877)** | **$ 92,640** |

| GSEs Investments (in millions) | Gross Investments As of 9/30/16 | Cumulative Valuation Gain/(Loss) | 9/30/2016 Fair Value |
|---|---|---|---|
| Fannie Mae Senior Preferred Stock | $ 116,989 | $ (58,889) | $ 58,100 |
| Freddie Mac Senior Preferred Stock | 72,160 | (32,560) | 39,600 |
| Fannie Mae Warrants Common Stock | 3,104 | 4,016 | 7,120 |
| Freddie Mac Warrants Common Stock | 2,264 | 1,466 | 3,730 |
| **Total GSEs Investments** | $ 194,517 | $ (85,967) | $ 108,550 |

## SENIOR PREFERRED STOCK AND WARRANTS FOR COMMON STOCK

In determining the fair value of the senior preferred stock and warrants for common stock, we relied on the GSEs' public filings and press releases concerning their financial statements, as well as non-public, long-term financial forecasts, monthly summaries, quarterly credit supplements, independent research regarding preferred stock trading, independent research regarding the GSEs' common stock trading on the OTC Bulletin Board, discussions with each of the GSEs and FHFA, and other information pertinent to the valuations. Because the instruments are not publicly traded, there is no comparable trading information available. The fair valuations rely on significant unobservable inputs that reflect assumptions about the expectations that market participants would use in pricing.

The fair value of the senior preferred stock considers the amount of forecasted dividend payments. The fair valuations assume that a hypothetical buyer would acquire the discounted dividend stream as of the transaction date. The fair value of the senior preferred stock decreased as of September 30, 2017 when compared to September 30, 2016, primarily reflecting a higher discount rate which was driven by a higher long-term Treasury rate (or risk-free rate), as well as an increase in the market value of the GSEs' other equity securities that comprise their total equity (refer to Note 1V).

Factors impacting the fair value of the warrants include the nominal exercise price and the large number of potential exercise shares, the market trading of the common stock that underlies the warrants as of September 30, the principal market, and the market participants. Other factors impacting the fair value include, among other things, the holding period risk related directly to the assumption of the amount of time that it will take to sell the exercised shares without depressing the market. The fair value of the warrants increased at the end of FY 2017, when compared to 2016, primarily due to increases in the market price of the underlying common stock of each GSE.

## CONTINGENT LIABILITY TO GSEs

As part of the annual process undertaken by the Department, we prepare a series of long-term financial forecasts to assess, as of September 30, the likelihood and magnitude of future draws to be required by the GSEs under the SPSPAs within the forecast time horizon. We used 25-year financial forecasts prepared through years 2042 and 2041 in assessing if a contingent liability was required as of September 30, 2017 and 2016, respectively. If future payments under the SPSPAs are deemed to be probable within the forecast horizon, we will estimate and accrue a contingent liability to the GSEs to reflect the forecasted equity deficits of the GSEs. We will not discount this accrued contingent liability, nor will we take into account any of the offsetting dividends that we could receive, as the dividends, if any, would be owed directly to the General Fund. We will adjust such recorded accruals in subsequent years as new information develops or circumstances change.

Based on our annual assessment, we estimated there was no probable future funding draws as of September 30, 2017 and 2016, and thereby accrued no contingent liability. However, as of September 30, 2017, it is reasonably possible that market volatility or non-recurring events—for instance, changes to accounting policies that impact credit loss calculations or tax laws that affect the value of the GSEs' deferred tax assets—could potentially cause the GSEs to generate quarterly losses and, therefore, result in future funding draws against our funding commitment. Due to challenges quantifying future market volatility or the timing, magnitude, and likelihood of non-recurring events, we could not estimate the total amount of this reasonably possible future funding liability as of September 30, 2017. At September 30, 2017 and 2016, the maximum remaining contractual commitment to the GSEs for the remaining life of the SPSPAs was $258.1 billion.

In assessing the need for an estimated contingent liability, we rely on the GSEs' public filings and press releases concerning their financial statements, monthly summaries, and quarterly credit supplements, as well as non-public, long-term financial forecasts, the FHFA House Price Index, discussions with each of the GSEs and FHFA, and other information pertinent to the liability estimates. The forecasts prepared in assessing the need for an estimated contingent liability as of September 30, 2017 include three potential wind-down scenarios, with varying assumptions regarding the timing as to when the GSEs would cease issuing new guaranteed mortgage-backed securities. The forecasts also assume a continued gradual wind-down of the retained portfolios (and corresponding net interest income) through 2018, as directed under the amended SPSPAs for each GSE to reduce the maximum balance of its retained mortgage portfolio by 15.0 percent per annum beginning December 31, 2013. The maximum balance of the GSEs' retained mortgage portfolio was initially set at $650 billion as of December 31, 2012, and the amended SPSPAs requires that we reduce this maximum balance to $250 billion by December 31, 2018.

## ESTIMATION FACTORS

Our forecasts concerning the GSEs may differ from actual experience. Estimated senior preferred values and future draw amounts will depend on numerous factors that are difficult to predict including, but not limited to, changes in government policy with respect to the GSEs, the business cycle, inflation, home prices, unemployment rates, interest rates, changes in housing preferences, home financing alternatives, availability of debt financing, market rates of guarantee fees, outcomes of loan refinancings and modifications, new housing programs, and other applicable factors.

## FINANCIAL PERFORMANCE OF THE GSEs

The summarized unaudited aggregated financial condition of the GSEs as of September 30, 2017 and 2016, along with their summarized unaudited aggregated financial operating results for the nine months ended September 30, 2017 and 2016 were as follows:

| (in millions) | | 2017 | | 2016 |
|---|---|---|---|---|
| Combined Assets | | | | |
| Investment Securities | $ | **129,997** | $ | 165,805 |
| Mortgage Loans | | **4,997,651** | | 4,831,397 |
| Other | | **233,767** | | 274,002 |
| Total Combined Assets | | **5,361,415** | | 5,271,204 |
| Combined Liabilities | | | | |
| Long-Term Debt | | **5,214,940** | | 5,103,417 |
| Other | | **137,577** | | 160,101 |
| Total Combined Liabilities | | **5,352,517** | | 5,263,518 |
| Combined Net Equity | $ | **8,898** | $ | 7,686 |
| **For the Nine Months Ended September 30** | | | | |
| Combined Net Interest Income | $ | **26,285** | $ | 25,984 |
| Combined Benefit for Loan Losses | | **1,303** | | 4,587 |
| Combined Net Interest Income After Benefit for Loan Losses | $ | **27,588** | $ | 30,571 |
| Combined Net Income | $ | **17,542** | $ | 10,246 |

*We obtained this financial information from the GSEs' quarterly financial reports filed with the Securities and Exchange Commission. The financial information above excludes certain financial guarantees not directly reflected on the GSEs' balance sheets.*

## GSEs NON-ENTITY REVENUE

For the fiscal years ended September 30, 2017 and 2016, GSEs Non-Entity Revenue, Net consisted of the following:

| Summary of GSEs Non-Entity Revenue (in millions) | | 2017 | | 2016 |
|---|---|---|---|---|
| Fair Value Loss/(Gain) on GSEs Warrants/Preferred Stock | $ | **15,910** | $ | (2,280) |
| GSEs Preferred Stock Dividends | | **(25,349)** | | (11,522) |
| Total GSEs Non-Entity Revenue, Net | $ | **(9,439)** | $ | (13,802) |

## REGULATORY ENVIRONMENT

To date, Congress has not approved a plan to address the future of the GSEs, thus the GSEs continue to operate under the direction of their conservator, the FHFA, whose stated strategic goals for the GSEs are to: *(i)* maintain foreclosure prevention activities and credit availability to foster liquid, efficient, competitive, and resilient national housing finance markets; *(ii)* reduce taxpayer risk through increasing the role of private capital in the mortgage market; and *(iii)* build a new single-family securitization infrastructure.

The *Temporary Payroll Tax Cut Continuation Act of 2011* (P.L. 112-78) was funded by an increase of ten basis points in the GSEs' guarantee fees (referred to as "the incremental fees") which began in April 2012, and is effective through October 1, 2021. The incremental fees are remitted to us and not retained by the GSEs and, thus, do not affect the profitability of the GSEs. For FY 2017 and 2016, the GSEs remitted to us the incremental fees totaling $3.2 billion and $2.8 billion, respectively, which are reported within the line item entitled "*Fines, Penalties, Interest and Other Revenue*" on our Statements of Custodial Activity.

# 11. Investments in Multilateral Development Banks

As of September 30, 2017 and 2016, Investments in Multilateral Development Banks consisted of the following:

| (in millions) | | 2017 | | 2016 |
|---|---|---|---|---|
| International Bank for Reconstruction and Development | $ | **2,850** | $ | 2,844 |
| Inter-American Development Bank [(1)] | | **2,023** | | 2,001 |
| Asian Development Bank | | **991** | | 991 |
| European Bank for Reconstruction and Development | | **636** | | 636 |
| International Finance Corporation | | **569** | | 569 |
| African Development Bank | | **369** | | 337 |
| North American Development Bank | | **225** | | 225 |
| Multilateral Investment Guarantee Agency | | **45** | | 45 |
| Total | $ | **7,708** | $ | 7,648 |

*Refer to Note 26 for a description of the additional commitments related to these institutions.*
*(1) Includes Inter-American Investment Corporation*

# 12. Other Investments and Related Interest

Other investments and related interest include foreign currency holdings that we typically invest in interest-bearing securities issued or held through foreign governments or monetary authorities (refer to Note 5). ESF holds most of our foreign currency investments. Of the total $8.5 billion fair value of foreign investments (excluding interest receivable) held at September 30, 2017, $1.8 billion will mature within one year, $4.8 billion will mature after one year but before five years, and $1.9 billion will mature after five years but before ten years.

As of September 30, 2017 and 2016, Other Investments and Related Interest consisted of the following:

| Type of Investment (in millions) | | Cost/ Acquisition Value | Unamortized (Premium)/ Discount | Interest Receivable | 9/30/17 Net Investment | Unrealized Gain/(Loss) | 9/30/17 Fair Value |
|---|---|---|---|---|---|---|---|
| Foreign Investments: | | | | | | | |
| Euro Bonds & Notes | **$** | **5,879 $** | **481 $** | **69 $** | **6,429 $** | **299 $** | **6,728** |
| Japanese Government Bonds | | **1,754** | **2** | **1** | **1,757** | **56** | **1,813** |
| Other Investments | | **29** | **(1)** | **-** | **28** | **(10)** | **18** |
| **Total Non-Federal** | **$** | **7,662 $** | **482 $** | **70 $** | **8,214 $** | **345 $** | **8,559** |

| Type of Investment (in millions) | | Cost/ Acquisition Value | Unamortized (Premium)/ Discount | Interest Receivable | 9/30/16 Net Investment | Unrealized Gain/(Loss) | 9/30/16 Fair Value |
|---|---|---|---|---|---|---|---|
| Foreign Investments: | | | | | | | |
| Euro Bonds & Notes | $ | 5,223 $ | 217 $ | 60 $ | 5,500 $ | (207) $ | 5,293 |
| Japanese Government Bonds | | 3,959 | 6 | 2 | 3,967 | 582 | 4,549 |
| Other Investments | | 30 | (2) | - | 28 | (10) | 18 |
| **Total Non-Federal** | $ | 9,212 $ | 221 $ | 62 $ | 9,495 $ | 365 $ | 9,860 |

# 13. PROPERTY, PLANT, AND EQUIPMENT, NET

As of September 30, 2017 and 2016, Property, Plant, and Equipment, Net consisted of the following:

| (in millions) | Depreciation Method | Service Life | | Cost | | Accumulated Depreciation | | 2017 Net Book Value |
|---|---|---|---|---|---|---|---|---|
| **Buildings, Structures and Facilities** | **S/L** | **3 - 50 years** | **$** | **766** | **$** | **(459)** | **$** | **307** |
| **Furniture, Fixtures and Equipment** | **S/L** | **2 - 20 years** | | **2,831** | | **(2,051)** | | **780** |
| **Construction-in-Progress** | **N/A** | **N/A** | | **103** | | **-** | | **103** |
| **Land and Land Improvements** | **N/A** | **N/A** | | **18** | | **(2)** | | **16** |
| **Internal-Use Software in Use** | **S/L** | **2 - 15 years** | | **3,574** | | **(2,076)** | | **1,498** |
| **Internal-Use Software in Development** | **N/A** | **N/A** | | **181** | | **-** | | **181** |
| **Assets Under Capital Lease** | **S/L** | **2 - 25 years** | | **21** | | **(12)** | | **9** |
| **Leasehold Improvements** | **S/L** | **2 - 25 years** | | **415** | | **(249)** | | **166** |
| **Total** | | | **$** | **7,909** | **$** | **(4,849)** | **$** | **3,060** |

| (in millions) | Depreciation Method | Service Life | | Cost | | Accumulated Depreciation | | 2016 Net Book Value |
|---|---|---|---|---|---|---|---|---|
| Buildings, Structures and Facilities | S/L | 3 - 50 years | $ | 766 | $ | (446) | $ | 320 |
| Furniture, Fixtures and Equipment | S/L | 2 - 20 years | | 2,787 | | (2,023) | | 764 |
| Construction-in-Progress | N/A | N/A | | 61 | | - | | 61 |
| Land and Land Improvements | N/A | N/A | | 18 | | (2) | | 16 |
| Internal-Use Software in Use | S/L | 2 - 15 years | | 3,108 | | (1,789) | | 1,319 |
| Internal-Use Software in Development | N/A | N/A | | 336 | | - | | 336 |
| Assets Under Capital Lease | S/L | 2 - 25 years | | 14 | | (10) | | 4 |
| Leasehold Improvements | S/L | 2 - 25 years | | 413 | | (228) | | 185 |
| Total | | | $ | 7,503 | $ | (4,498) | $ | 3,005 |

*The service life ranges vary significantly due to the diverse nature of PP&E we hold.*

## HERITAGE ASSETS

We have 15 heritage assets, of which five are considered multi-use, for FY 2017 and 2016. The Treasury Complex (Main Treasury Building and Annex), declared a national historical landmark in 1972, is treated as a multi-use heritage asset and is expected to be preserved indefinitely. The buildings that house the Mint in Denver, San Francisco, Fort Knox, and West Point are also multi-use heritage assets and included on the National Register of Historic Places. Additionally, the Mint maintains heritage assets consisting of four coin collections and six historical artifacts.

# 14. NON-ENTITY VS. ENTITY ASSETS

Non-entity assets are those that we hold and manage on behalf of the General Fund but are not available for our use. The table below shows our total assets, segregated between non-entity and entity, as of September 30, 2017 and 2016:

| | 2017 | | |
|---|---|---|---|
| **(in millions)** | **Non-Entity** | **Entity** | **Total** |
| **Intra-governmental Assets:** | | | |
| Fund Balance [a] | **$ 1,668** | **$ 424,728** | **$ 426,396** |
| Loans and Interest Receivable (Note 3) | **1,377,845** | **77,780** | **1,455,625** |
| Advances to Trust Funds (Note 4) | **9,021** | **-** | **9,021** |
| Due From the General Fund (Note 4) | **20,373,777** | **-** | **20,373,777** |
| Other Intra-governmental Assets | **789** | **29** | **818** |
| **Total Intra-governmental Assets** | **21,763,100** | **502,537** | **22,265,637** |
| Cash, Foreign Currency, and Other Monetary Assets (Note 5) [b] | **154,353** | **64,477** | **218,830** |
| Gold and Silver Reserves (Note 6) [c] | **11,062** | **-** | **11,062** |
| Taxes, Interest, and Other Receivables, Net (Note 8) | **53,355** | **141** | **53,496** |
| Investments in GSEs (Note 10) | **92,640** | **-** | **92,640** |
| Other Assets [d] | **8** | **44,487** | **44,495** |
| **Total Assets** | **$ 22,074,518** | **$ 611,642** | **$ 22,686,160** |

(a) *$793 million of the non-entity balance represents assets held on behalf of the General Fund (refer to Note 4).*
(b) *$153.6 billion of the non-entity balance represents assets held on behalf of the General Fund (refer to Note 4).*
(c) *$25 million of the non-entity balance represents assets held on behalf of the General Fund (refer to Note 4).*
(d) *Other Assets (Entity) include loans and interest receivable, other investments and related interest, reserve position in the IMF, and other various assets on the Consolidated Balance Sheets not separately presented in this table.*

| | 2016 | | |
|---|---|---|---|
| **(in millions)** | **Non-Entity** | **Entity** | **Total** |
| **Intra-governmental Assets:** | | | |
| Fund Balance [e] | $ 2,228 | $ 433,018 | $ 435,246 |
| Loans and Interest Receivable (Note 3) | 1,324,531 | 76,123 | 1,400,654 |
| Advances to Trust Funds (Note 4) | 8,558 | - | 8,558 |
| Due From the General Fund (Note 4) | 19,699,152 | - | 19,699,152 |
| Other Intra-governmental Assets | 377 | 78 | 455 |
| **Total Intra-governmental Assets** | 21,034,846 | 509,219 | 21,544,065 |
| Cash, Foreign Currency, and Other Monetary Assets (Note 5) [f] | 347,944 | 62,154 | 410,098 |
| Gold and Silver Reserves (Note 6) [g] | 11,062 | - | 11,062 |
| Taxes, Interest, and Other Receivables, Net (Note 8) | 50,210 | 96 | 50,306 |
| Investments in GSEs (Note 10) | 108,550 | - | 108,550 |
| Other Assets [h] | 8 | 46,819 | 46,827 |
| **Total Assets** | $ 21,552,620 | $ 618,288 | $ 22,170,908 |

(e) *$694 million of the non-entity balance represents assets held on behalf of the General Fund (refer to Note 4).*
(f) *$347.2 billion of the non-entity balance represents assets held on behalf of the General Fund (refer to Note 4).*
(g) *$25 million of the non-entity balance represents assets held on behalf of the General Fund (refer to Note 4).*
(h) *Other Assets (Entity) include loans and interest receivable, other investments and related interest, reserve position in the IMF, and other various assets on the Consolidated Balance Sheets not separately presented in this table.*

# 15. FEDERAL DEBT AND INTEREST PAYABLE AND RELATED LIABILITIES

Treasury is responsible for administering the federal debt on behalf of the U.S. government. The federal debt includes borrowings from the public as well as borrowings from federal agencies. The federal debt does not include debt issued by other governmental agencies, such as the Tennessee Valley Authority or Department of Housing and Urban Development.

Debt held by the public primarily represents the amount the U.S. government has borrowed to finance cumulative cash deficits. In contrast, debt held by other federal agencies, primarily trust funds, represents balances of Treasury securities held by individual federal agencies with either the authority or the requirement to invest excess receipts in Treasury securities, with the principal and interest guaranteed by the full faith and credit of the U.S. government.

Federal Debt and Interest Payable as of September 30, 2017 and 2016 was as follows:

| Held by Other Federal Agencies (Intra-governmental) (in millions) | 2017 | 2016 |
|---|---|---|
| Beginning Balance | $ **5,354,167** | $ 4,980,598 |
| New Borrowings/(Repayments) - Net | **173,554** | 373,569 |
| Subtotal at Par Value | **5,527,721** | 5,354,167 |
| Premium/(Discount) | **72,073** | 72,598 |
| Debt Principal Not Covered by Budgetary Resources (Note 18) | **5,599,794** | 5,426,765 |
| Interest Payable Covered by Budgetary Resources | **38,156** | 39,657 |
| **Total** | $ **5,637,950** | $ 5,466,422 |

| Held by the Public (in millions) | 2017 | 2016 |
|---|---|---|
| Beginning Balance | $ **14,173,424** | $ 13,123,847 |
| New Borrowings - Net of Repayments | **500,005** | 1,049,577 |
| Subtotal at Par Value | **14,673,429** | 14,173,424 |
| Premium/(Discount) | **(39,204)** | (33,800) |
| Debt Principal Not Covered by Budgetary Resources (Note 18) | **14,634,225** | 14,139,624 |
| Interest Payable Covered by Budgetary Resources | **65,462** | 57,110 |
| **Total** | $ **14,699,687** | $ 14,196,734 |

## FEDERAL DEBT HELD BY OTHER FEDERAL AGENCIES

Certain federal agencies are allowed to invest excess funds in debt securities we issue on behalf of the U.S. government. The terms and the conditions of debt securities issued allow the U.S. government to meet its cash needs. The vast majority of debt securities are non-marketable securities issued at par value, but others are issued at market prices and interest rates that reflect market terms. The average intra-governmental interest rate for debt held by the federal entities, excluding Treasury Inflation-Protected Securities (TIPS) and Floating Rate Notes (FRNs), for both FY 2017 and 2016 was 2.8 percent. The average intra-governmental interest rate on TIPS for both FY 2017 and 2016 was 1.3 percent. The average interest rate represents the original issue weighted effective yield on securities outstanding at the end of the fiscal year.

The federal debt also includes intra-governmental marketable debt securities that certain agencies are permitted to buy and sell on the open market. The debt held by federal agencies at par value (not including premium/discount or interest payable) as of September 30, 2017 and 2016 was as follows:

| (in millions) | | 2017 | | 2016 |
|---|---|---|---|---|
| Social Security Administration | $ | **2,889,869** | $ | 2,842,592 |
| Office of Personnel Management | | **1,014,837** | | 994,528 |
| Department of Defense Agencies | | **898,480** | | 815,608 |
| Department of Health and Human Services | | **273,197** | | 259,742 |
| All Other Federal Entities — Consolidated | | **451,338** | | 441,697 |
| **Total Federal Debt Held by Other Federal Agencies** | $ | **5,527,721** | $ | 5,354,167 |

*These amounts do not include Intra-departmental debt and related interest that are eliminated from our financial statements.*

## FEDERAL DEBT HELD BY THE PUBLIC

Federal Debt Held by the Public at par value (not including premium/discount or interest payable) as of September 30, 2017 and 2016 consisted of the following:

| *(at par value in millions)* | Term | Average Interest Rates | | 2017 |
|---|---|---|---|---|
| **Marketable:** | | | | |
| Treasury Bills | **1 Year or Less** | **1.1%** | **$** | **1,799,570** |
| Treasury Notes | **Over 1 Year - 10 Years** | **1.8%** | | **8,798,940** |
| Treasury Bonds | **Over 10 Years** | **4.2%** | | **1,948,414** |
| Treasury Inflation-Protected Securities (TIPS) | **5 Years or More** | **0.8%** | | **1,286,123** |
| Treasury Floating Rate Notes (FRN) | **2 Years** | **1.2%** | | **342,630** |
| **Total Marketable** | | | | **14,175,677** |
| Non-Marketable | **On Demand to Over 40 Years** | **2.3%** | | **497,752** |
| **Total Federal Debt Held by the Public** | | | **$** | **14,673,429** |

| *(at par value in millions)* | Term | Average Interest Rates | | 2016 |
|---|---|---|---|---|
| **Marketable:** | | | | |
| Treasury Bills | 1 Year or Less | 0.4% | $ | 1,644,759 |
| Treasury Notes | Over 1 Year - 10 Years | 1.8% | | 8,624,253 |
| Treasury Bonds | Over 10 Years | 4.4% | | 1,825,339 |
| Treasury Inflation-Protected Securities (TIPS) | 5 Years or More | 0.8% | | 1,209,814 |
| Treasury Floating Rate Notes (FRN) | 2 Years | 0.4% | | 334,139 |
| **Total Marketable** | | | | 13,638,304 |
| Non-Marketable | On Demand to Over 40 Years | 2.0% | | 535,120 |
| **Total Federal Debt Held by the Public** | | | $ | 14,173,424 |

We generally issue Treasury bills, notes, bonds, and TIPS to meet the borrowing needs of the U.S. government. We issue marketable bills at a discount or at par, and pay the par amount of the security upon maturity. The average interest rate on Treasury bills represents the original issue effective yield on securities outstanding at year end.

We issue marketable notes and bonds as long-term securities that pay semi-annual interest based on the securities' stated interest rates. We issue these securities at either par value or at an amount that reflects a discount or premium. The average interest rate on marketable notes and bonds represents the stated interest rate adjusted by any discount or premium on securities outstanding at year-end. We also issue TIPS that have interest and redemption payments tied to the CPI for all Urban Consumers, a widely used measurement of inflation. We adjust the principal for TIPS daily over the life of the security based on the CPI for all Urban Consumers. At maturity, TIPS are redeemed at the inflation-adjusted principal amount, or the original par value, whichever is greater. TIPS pay a semi-annual fixed rate of interest applied to the inflation-adjusted principal. The average interest rate on TIPS represents the stated interest rate on principal plus inflation, adjusted by any discount or premium on securities outstanding as of the end of the fiscal year. The inflation-adjusted TIPS principal balance of federal debt held by the public included inflation of $103.7 billion and $90.8 billion as of September 30, 2017 and 2016, respectively.

We also issue marketable FRNs which pay interest quarterly based on the interest rate at the time of payment. The interest rate of FRNs can change over time and is indexed to the highest acceptable discount rate of the most recent 13-week marketable bill auction. Similar to marketable notes and bonds, we issue these securities at either par value or at an amount that reflects a discount or premium. The average interest rate on marketable FRNs represents the highest accepted discount rate of the most recent 13-week marketable auction as of September 30, adjusted by any discount or premium on securities outstanding as of that date.

Federal Debt Held by the Public includes federal debt held outside of the U.S. government by individuals, corporations, FRBs, state and local governments, foreign governments, and central banks. As of September 30, 2017, the FRBs had total holdings of $2.0 trillion which: *(i)* excluded $502.0 billion in Treasury securities used in overnight reverse repurchase transactions, and *(ii)* included a net of $1.3 billion in Treasury securities held by the FRB as collateral for securities lending activities. As of September 30, 2016, the FRBs had total holdings of $1.8 trillion which: *(i)* excluded $713.9 billion in Treasury securities used in overnight reverse repurchase transactions, and *(ii)* included a net of $0.7 billion in Treasury securities held by the FRB as collateral for securities lending activities. The FRB holds Treasury securities in the FRB SOMA for the purpose of conducting monetary policy.

## STATUTORY DEBT LIMIT

Congress has provided us with statutory authority to take certain extraordinary measures in the event that the public debt nears the statutory debt limit and a delay in raising the statutory debt limit occurs. These measures authorize us to deviate from our normal debt management operations—which include the investment (or non-investment) of trust fund balances in Treasury securities—to avoid exceeding the statutory debt limit.

During the period of the delay in raising the statutory debt limit, we may undertake the following extraordinary measures: *(i)* suspend new issuances of Treasury securities to the Government Securities Investment Fund (G Fund) of the FERS TSP, the Civil Service Retirement and Disability Fund (Civil Service Fund), the Postal Service Retiree Health Benefits Fund (Postal Benefits Fund), and the ESF; *(ii)* redeem early a certain amount of Treasury securities held by the Civil Service Fund and Postal Benefit Fund; (*iii*) suspend new issuances of State and Local Government Series (SLGS) securities; *(iv)* utilize FFB to exchange outstanding Treasury securities held by the Civil Service Fund for non-Treasury securities (refer to Note 16); and (*v*) issue cash management bills to manage short-term financing needs.

When the period of delay in raising the statutory debt limit ends, we discontinue our use of extraordinary measures and resume our normal debt management operations. Furthermore, we are required by the relevant statutes, to issue to the G Fund, along with the OPM-administered Civil Service Fund and Postal Benefits Fund (the OPM funds), Treasury securities that bears such interest rates and maturity dates necessary to replicate the investments the funds would have held had the delay not occurred (the unissued securities). In addition, relevant statutes require us to pay these funds the related lost interest (foregone interest) on the unissued securities. While we may restore the ESF, relevant statutes do not permit us to pay the ESF interest lost during a period of delay.

A delay in raising the statutory debt limit occurred from March 16, 2015 until Friday, October 30, 2015. On Monday, November 2, 2015, Congress enacted the *Bipartisan Budget Act of 2015* (P.L. 114-74) which temporarily suspended the debt limit through March 15, 2017. Another delay in raising the debt limit occurred from March 16, 2017 until September 7, 2017. On September 8, 2017, Congress enacted the *Continuing Appropriations Act, 2018 and Supplemental Appropriations for Disaster Relief Requirements Act, 2017* (P.L. 115-56) which temporarily suspended the debt limit through December 8, 2017.

During the period March 16, 2015 through October 30, 2015, we undertook the extraordinary measures as described above. On November 2, 2015, when Congress temporarily suspended the debt limit, we resumed normal debt management operations. On this date, we restored unissued securities totaling $352.6 billion, of which $204.8 billion was restored to the G Fund and $147.8 billion was restored to the two OPM funds. We also restored foregone interest totaling $2.7 billion, of which $1.7 billion was restored to the G Fund on the next interest payment date of November 3, 2015 and $971 million was restored to the two OPM funds on the next semi-annual interest payment date of December 31, 2015. In addition, we restored the ESF and resumed issuance of SLGS securities.

Of the $2.7 billion of foregone interest paid in FY 2016, $635 million was reported in FY 2016 as a current year, non-entity expense within the line item, "*Restoration of Foregone Federal Debt Interest*." In FY 2016, we reversed the $2.1 billion of accrued foregone interest as part of other financing sources on the Consolidated Statement of Changes in Net Position in connection with the actual payment of interest.

During the period March 16, 2017 through September 7, 2017, we again departed from our normal debt management operations and undertook extraordinary measures to avoid exceeding the statutory debt limit. On September 8, 2017, when Congress temporarily suspended the debt limit, we discontinued the use of extraordinary measures and resumed normal debt management operations. On this date, we restored unissued securities totaling $294.9 billion, of which $192.6 billion was restored to the G Fund and $102.3 billion was restored to the two OPM funds. We also restored foregone interest of $1.6 billion to the G Fund on the next interest payment date of September 11, 2017. Foregone interest related to the unissued securities during the period of March 16, 2017 through September 7, 2017 for the two OPM funds, which totaled $660 million through September 30, 2017, will be restored on the next semi-annual interest payable date of December 31, 2017.

The liability for the interest related to the unissued securities for the OPM funds as of September 30, 2017 totaling $660 million was reported on our Consolidated Balance Sheets in the line item "*Liability for Restoration of Federal Debt Principal and Interest*." A corresponding amount was reported in the "*Due From the General Fund*" on the Consolidated Balance Sheets (refer to Note 4). Additionally, the accrued foregone interest expense totaling $660 million was reported as a non-entity expense within the line item, "*Accrued Restoration of Foregone Federal Debt Interest*," on Consolidated Statements of Net Cost, with an offsetting amount reported within the line item, "*Accrued Interest on Restoration of Federal Debt Principal*," as part of other financing sources on the Consolidated Statements of Changes in Net Position.

# 16. Other Debt and Interest Payable

Through FFB, we have outstanding borrowings and related accrued interest owed to the Civil Service Fund. At September 30, 2017 and 2016, FFB had outstanding borrowings of $11.5 billion and $13.1 billion, inclusive of $86 million and $101 million of accrued interest payable, respectively. During FY 2017 and 2016, FFB paid $1.6 billion and $2.0 billion in principal, respectively. The outstanding borrowings at September 30, 2017 had stated interest rates that ranged from 2.25 percent to 4.63 percent per annum, and an effective interest rate of 2.97 percent. The outstanding borrowings at September 30, 2016 had stated interest rates that ranged from 2.25 percent to 4.63 percent per annum, and an effective interest rate of 3.08 percent. Maturity dates ranged from June 30, 2018 to June 30, 2029 for outstanding borrowings at September 30, 2017, and from June 30, 2017 to June 30, 2029 for outstanding borrowings at September 30, 2016.

# 17. D.C. Federal Pension and Judicial Retirement Actuarial Liability

Title XI of the *Balanced Budget Act of 1997*, as amended intended to relieve the D.C. government of the burden of unfunded pension liabilities transferred to the District by the U.S. government in 1979. To fulfill our responsibility, we manage two funds — the D.C. Teachers', Police Officers', and Firefighters' Federal Pension Fund (the D.C. Federal Pension Fund) and the District of Columbia Judicial Retirement and Survivors' Annuity Fund (the Judicial Retirement Fund). We are required to make annual amortized payments from the General Fund to the D.C. Federal Pension Fund and the Judicial Retirement Fund. The D.C. Federal Pension Fund benefit payments relate to creditable service performed on or before June 30, 1997, while the Judicial Retirement Fund benefit payments relate to all creditable service.

A reconciliation of the combined actuarial pension liability for the D.C. Federal Pension Fund and the Judicial Retirement Fund as of September 30, 2017 and 2016 is as follows:

| (in millions) | 2017 | 2016 |
|---|---|---|
| **Beginning Liability Balance** | **$ 8,836** | $ 8,849 |
| **Pension Expense:** | | |
| Normal Cost | **6** | 6 |
| Interest on Pension Liability During the Year | **102** | 136 |
| **Actuarial (Gains) Losses During the Year:** | | |
| From Experience | **26** | (94) |
| From Discount Rate Assumption Change | **428** | 385 |
| From Other Assumption Changes | **(164)** | 107 |
| Total Pension Expense | **398** | 540 |
| Less Amounts Paid | **(552)** | (553) |
| **Ending Liability Balance** | **$ 8,682** | $ 8,836 |

| Additional Information ($ in millions): | | D.C. Federal Pension Fund | Judicial Retirement Fund | 2017 Total |
|---|---|---|---|---|
| Amount Received from the General Fund | $ | **452 $** | **16 $** | **468** |
| Annual Rate of Investment Return Assumption | | **0.71% - 4.03%** | **0.71% - 4.03%** | |
| Future Annual Rate of Inflation and Cost-Of-Living Adjustment: | | | | |
| Police Officers | | **1.82%** | **N/A** | |
| Firefighters | | **1.82%** | **N/A** | |
| Teachers | | **1.86%** | **N/A** | |
| Judicial | | **N/A** | **1.69%** | |
| Future Annual Rate of Salary Increases: | | | | |
| Police Officers | | **1.80%** | **N/A** | |
| Firefighters | | **2.20%** | **N/A** | |
| Teachers | | **3.00%** | **N/A** | |
| Judicial | | **N/A** | **1.08%** | |

| Additional Information ($ in millions): | | D.C. Federal Pension Fund | Judicial Retirement Fund | 2016 Total |
|---|---|---|---|---|
| Amount Received from the General Fund | $ | 461 $ | 14 $ | 475 |
| Annual Rate of Investment Return Assumption | | 1.12% - 4.17% | 1.12% - 4.17% | |
| Future Annual Rate of Inflation and Cost-Of-Living Adjustment: | | | | |
| Police Officers | | 1.87% | N/A | |
| Firefighters | | 1.87% | N/A | |
| Teachers | | 1.90% | N/A | |
| Judicial | | N/A | 1.99% | |
| Future Annual Rate of Salary Increases: | | | | |
| Police Officers | | 2.00% | N/A | |
| Firefighters | | 2.20% | N/A | |
| Teachers | | 3.00% | N/A | |
| Judicial | | N/A | 1.15% | |

# 18. LIABILITIES

## LIABILITIES NOT COVERED BY BUDGETARY AND OTHER RESOURCES

As of September 30, 2017 and 2016, liabilities not covered by budgetary and other resources consisted of the following:

| (in millions) | 2017 | 2016 |
|---|---|---|
| **Intra-governmental Liabilities Not Covered by Budgetary and Other Resources** | | |
| Federal Debt Principal, Premium/Discount (Note 15) | **$ 5,599,794** | $ 5,426,765 |
| Liability for Restoration of Federal Debt Principal and Interest (Note 15) | **660** | - |
| Other Intra-governmental Liabilities | **130** | 114 |
| **Total Intra-governmental Liabilities Not Covered by Budgetary and Other Resources** | **5,600,584** | 5,426,879 |
| Federal Debt Principal, Premium/Discount (Note 15) | **14,634,225** | 14,139,624 |
| Gold and Silver Reserves (Note 6) | **11,062** | 11,062 |
| D.C. Federal Pension and Judicial Retirement - Actuarial Liability (Unfunded) | **4,841** | 5,002 |
| Other Liabilities | **1,041** | 1,052 |
| **Total Liabilities Not Covered by Budgetary and Other Resources** | **20,251,753** | 19,583,619 |
| **Total Liabilities Covered by Budgetary and Other Resources** | **1,937,082** | 2,083,375 |
| **Total Liabilities** | **$ 22,188,835** | $ 21,666,994 |

## OTHER LIABILITIES

Total "*Other Liabilities*" displayed on the Consolidated Balance Sheets consists of both liabilities that are covered and not covered by budgetary resources. "*Other Liabilities*" at September 30, 2017 and 2016, consisted of the following:

| (in millions) | Current | Non-Current | 2017 Total | Current | Non-Current | 2016 Total |
|---|---|---|---|---|---|---|
| **Intra-governmental** | | | | | | |
| Accounts Payable | **$ 77** | **$ -** | **$ 77** | $ 130 | $ - | $ 130 |
| Unfunded Federal Workers Compensation Program Liability (FECA) | **43** | **52** | **95** | 44 | 54 | 98 |
| Other Accrued Liabilities | **440** | **1** | **441** | 233 | 1 | 234 |
| **Total Intra-governmental** | **$ 560** | **$ 53** | **$ 613** | $ 407 | $ 55 | $ 462 |
| | | | | | | |
| **With the Public** | | | | | | |
| Liability for Deposit Funds (Held by the U.S. government for Others) and Suspense Accounts | **$ 1,156** | **$ -** | **$ 1,156** | $ 1,236 | $ - | $ 1,236 |
| Actuarial Federal Workers Compensation Program Liability (FECA) | **-** | **592** | **592** | - | 597 | 597 |
| Accrued Funded Payroll and Benefits | **420** | **-** | **420** | 413 | - | 413 |
| Accounts Payable and Other Accrued Liabilities | **3,170** | **82** | **3,252** | 3,943 | 79 | 4,022 |
| **Total With the Public** | **$ 4,746** | **$ 674** | **$ 5,420** | $ 5,592 | $ 676 | $ 6,268 |

# 19. NET POSITION

Cumulative Results of Operations represents the net results of operations since inception, and includes cumulative amounts related to investments in capitalized assets and donations and transfers of assets in and out without reimbursement. Also included as a reduction in Cumulative Results of Operations are accruals for which the related expenses require funding from future appropriations and assessments. These future funding requirements include, among others: (a) accumulated annual leave earned but not taken; (b) accrued FECA; (c) credit reform cost re-estimates; (d) unfunded D.C. Federal pension; and (e) expenses for contingent liabilities.

Unexpended Appropriations represents the amount of spending authorized as of year-end that is unliquidated or unobligated and has not lapsed, been rescinded, or withdrawn. No-year appropriations remain available for obligation until expended. Annual appropriations remain available for upward or downward adjustment of obligations until canceled. We report adjustments related to unexpended appropriations, such as cancellations of expired funds or rescissions, as "*Other Adjustments*" on the Consolidated Statements of Changes in Net Position.

## APPROPRIATIONS RECEIVED

Congress appropriates the amount reported as "*Appropriations Received*" from the General Fund receipts, such as income taxes, that are not dedicated by law for a specific purpose. This amount will not necessarily agree with the "*appropriations (discretionary and mandatory)*" amount reported on the Combined Statements of Budgetary Resources because of differences between proprietary and budgetary accounting concepts and reporting requirements. For example, certain dedicated receipts are recorded as "*appropriations (discretionary and mandatory)*" on the Combined Statements of Budgetary Resources, but are recognized as exchange or non-exchange revenue (i.e., typically in revolving, special, and non-revolving trust funds) and reported on the Consolidated Statements of Changes in Net Position in accordance with SFFAS No. 7.

## TRANSFERS TO THE GENERAL FUND AND OTHER

The amount reported as "*Transfers to the General Fund and Other*" on the Consolidated Statements of Changes in Net Position under "*Other Financing Sources*" includes the following for the years ended September 30, 2017 and 2016:

| (in millions) | 2017 | 2016 |
|---|---|---|
| **Categories of Transfers to the General Fund and Other** | | |
| Interest Revenue | **$ 44,304** | $ 44,636 |
| Increase in Liquidation Preference of GSEs Preferred Stock, GSEs Preferred Stock Dividends and Valuation Changes (Note 10) | **9,439** | 13,802 |
| Other | **1,482** | 6,511 |
| **Total** | **$ 55,225** | $ 64,949 |

Included in "*Transfers to the General Fund and Other*" is the annual valuation adjustment on the GSE Senior Preferred Stock investments and related dividends. These transfers also include distribution of interest revenue to the General Fund. We accrue interest revenue on inter-agency loans held on behalf of the U.S. government. We report a corresponding amount on the Consolidated Statements of Net Cost under "*Non-Entity Costs: Less Interest Revenue from Loans*." Eliminations between our bureaus reduce the amount reported on the Consolidated Statements of Net Cost.

The "*Other"* line generally includes collections from other federal agencies for reimbursement of costs we incurred for our administration of trust funds established within the Social Security Act. We execute these administrative services as directed by statute. The FY 2016 activity also includes a $3.8 billion transfer of forfeited assets to a Fiscal Service-managed miscellaneous receipt account. Seigniorage and numismatic profits also are included in the "*Other*" line. Seigniorage is the face value of newly minted circulating coins less the cost of production. Numismatic profit is any profit on the sale of proof coins, uncirculated coins, commemorative coins, and related products and accessories. The Mint is required to distribute seigniorage and numismatic profits in excess of operating expenses to the General Fund (refer to Note 21). In any given year, the amount recognized as seigniorage may differ from the amount distributed to the General Fund by an insignificant amount due to timing differences. The "*Other*" line also includes the credit reform downward re-estimate subsidies transferred to the General Fund resulting from a change in forecasts of future cash flows.

# 20. CONSOLIDATED STATEMENTS OF NET COST AND NET COSTS OF TREASURY SUB-ORGANIZATIONS

Our Consolidated Statements of Net Cost display information on a consolidated basis. We consist of DO and seven operating bureaus that we provide supporting schedules for Net Cost in the notes to the financial statements (refer to Note 1). These supporting schedules provide consolidating information, which fully displays the costs, revenues, and net cost of DO and each operating bureau.

The classification of sub-organizations has been determined in accordance with SFFAS No. 4, *Managerial Cost Accounting Standards and Concepts*, which states that the predominant factor is the reporting entity's organization structure and existing responsibility components, such as bureaus, administrations, offices, and divisions within a department.

Each sub-organization is responsible for accumulating costs. The assignment of the costs to Department-wide programs is the result of using the following cost assignment methods: (1) direct costs; (2) cause and effect; and (3) cost allocation.

## INTRA-DEPARTMENTAL COSTS/REVENUES

We report intra-departmental costs/revenues resulting from the provision of goods and/or services on a reimbursable basis among our sub-organizations as costs by providing sub-organizations and as revenues by receiving sub-organizations. We recognized intra-departmental imputed costs on the Consolidated Statements of Net Cost of $695 million and $646 million during FY 2017 and 2016, respectively. Accordingly, we eliminated such costs or revenues in the consolidation process.

## INTRA-GOVERNMENTAL COSTS

Intra-governmental costs relate to the source of goods and services we purchased and not to the classification of the related intra-governmental revenue.

In certain cases, other federal agencies incur costs that are directly identifiable to our operations. In accordance with SFFAS No. 30, *Inter-Entity Cost Implementation Amending SFFAS No. 4, Managerial Cost Accounting Standards and Concepts*, we recognize identified costs paid on our behalf by other agencies. The imputed inter-departmental financing sources we currently recognize include the actual cost of future benefits for the federal pension plans that other federal entities pay, the Federal Employees Health Benefits Program, and any un-reimbursed contract dispute payments made from the Treasury Judgment Fund on our behalf. We reflect the funding for these costs as costs on the Consolidated Statements of Net Cost,

and as imputed financing sources on the Consolidated Statements of Changes in Net Position. Costs paid by other agencies on our behalf were $552 million and $681 million for the fiscal years ended September 30, 2017 and 2016, respectively.

## CONSOLIDATED STATEMENTS OF NET COST PRESENTATION

OMB Circular No. A-136, *Financial Reporting Requirements*, as revised, requires that the presentation of the Consolidated Statements of Net Cost align directly with the goals and outcomes identified in Treasury's Strategic Plan. Accordingly, we have presented the gross costs and earned revenues by our major program categories as defined by the strategic goals reported in our FY 2014 – 2017 Strategic Plan. The majority of our bureaus' and reporting entities' net cost information falls within a single program category in the Consolidated Statements of Net Cost. DO and TTB allocate costs and related revenues to multiple programs using a net cost percentage calculation. All of our management offices coordinate, on a Treasury-wide basis, their efforts to achieve the Management program-related strategic goals. For financial statement presentation purposes, we combine the net costs associated with our Management program-related goals with the net costs associated with our Financial program-related strategic goals.

Our Consolidated Statements of Net Cost also present interest expense on the federal debt and other federal costs incurred on behalf of the U.S. government. We do not reflect these costs as program costs related to our strategic plan missions. We eliminate these costs in the consolidation process to the extent that they involve transactions with our sub-organizations.

Non-entity other federal costs shown on the Consolidated Statements of Net Cost for the fiscal years ended September 30, 2017 and 2016 consisted of the following:

| (in millions) | 2017 | 2016 |
|---|---|---|
| Credit Reform Interest on Uninvested Funds (Intra-governmental) | $ **8,322** | $ 7,349 |
| Judgment Claims and Contract Disputes | **2,705** | 3,563 |
| Resolution Funding Corporation | **2,628** | 2,628 |
| Corporation for Public Broadcasting | **495** | 485 |
| All Other Payments | **575** | 529 |
| **Total** | **$ 14,725** | $ 14,554 |

# 20. CONSOLIDATED STATEMENT OF NET COST AND NET COSTS OF TREASURY SUB-ORGANIZATIONS (IN MILLIONS)

For Fiscal Year Ended September 30, 2017

| Program Costs | Bureau of Engraving & Printing | Bureau of the Fiscal Service | Departmental Office[(a)] | Financial Crimes Enforcement Network | Internal Revenue Service | U.S. Mint |
|---|---|---|---|---|---|---|
| **FINANCIAL PROGRAM** | | | | | | |
| Intra-governmental Gross Costs | $ - | $ 443 | $ 2,314 | $ - | $ 4,270 | $ - |
| Less Earned Revenue | - | (209) | (3,071) | - | (152) | - |
| Intra-governmental Net Costs | - | 234 | (757) | - | 4,118 | - |
| Gross Costs with the Public | - | 1,735 | 949 | - | 8,449 | - |
| Less Earned Revenue | - | (152) | (176) | - | (415) | - |
| Net Costs with the Public | - | 1,583 | 773 | - | 8,034 | - |
| Net Cost: Financial Program | - | 1,817 | 16 | - | 12,152 | - |
| **ECONOMIC PROGRAM** | | | | | | |
| Intra-governmental Gross Costs | 107 | - | 374 | - | - | 77 |
| Less Earned Revenue | (4) | - | (241) | - | - | - |
| Intra-governmental Net Costs | 103 | - | 133 | - | - | 77 |
| Gross Costs with the Public | 598 | - | 15,020 | - | - | 2,185 |
| Less Earned Revenue | (703) | - | (7,582) | - | - | (2,236) |
| Net Costs with the Public | (105) | - | 7,438 | - | - | (51) |
| Net Cost (Revenue): Economic Program | (2) | - | 7,571 | - | - | 26 |
| **SECURITY PROGRAM** | | | | | | |
| Intra-governmental Gross Costs | - | - | 209 | 26 | - | - |
| Less Earned Revenue | - | - | (28) | (2) | - | - |
| Intra-governmental Net Costs | - | - | 181 | 24 | - | - |
| Gross Costs with the Public | - | - | 177 | 92 | - | - |
| Less Earned Revenue | - | - | - | - | - | - |
| Net Costs with the Public | - | - | 177 | 92 | - | - |
| Net Cost: Security Program | - | - | 358 | 116 | - | - |
| **Total Net Program Cost (Revenue) Before Changes in Actuarial Assumptions** | (2) | 1,817 | 7,945 | 116 | 12,152 | 26 |
| (Gain)/Loss on Pension, ORB, or OPEB Assumption Changes | - | - | 264 | - | - | - |
| **Total Net Cost of (Revenue From) Treasury Operations** | $ (2) | $ 1,817 | $ 8,209 | $ 116 | $ 12,152 | $ 26 |

*(a) Of the total $7.6 billion of net cost reported by Departmental Offices (DO) for the Economic Program, Treasury International Assistance Programs, OFS, and DO Policy Offices contributed $1.7 billion, $4.1 billion, and $1.2 billion respectively. Other net costs were spread throughout other DO programs or offices.*

# 20. CONSOLIDATED STATEMENT OF NET COST AND NET COSTS OF TREASURY SUB-ORGANIZATIONS (IN MILLIONS) (CON'T):

For Fiscal Year Ended September 30, 2017

| Program Costs | Office of the Comptroller of the Currency | Alcohol and Tobacco Tax and Trade Bureau | Combined Total | Eliminations | 2017 Consolidated |
|---|---|---|---|---|---|
| **FINANCIAL PROGRAM** | | | | | |
| Intra-governmental Gross Costs | $ - | $ 14 | $ 7,041 | $ 2,872 | $ 4,169 |
| Less Earned Revenue | - | (2) | (3,434) | (765) | (2,669) |
| Intra-governmental Net Costs | - | 12 | 3,607 | 2,107 | 1,500 |
| Gross Costs with the Public | - | 41 | 11,174 | - | 11,174 |
| Less Earned Revenue | - | (3) | (746) | - | (746) |
| Net Costs with the Public | - | 38 | 10,428 | - | 10,428 |
| Net Cost: Financial Program | - | 50 | 14,035 | 2,107 | 11,928 |
| **ECONOMIC PROGRAM** | | | | | |
| Intra-governmental Gross Costs | 157 | 16 | 731 | 342 | 389 |
| Less Earned Revenue | (36) | - | (281) | (222) | (59) |
| Intra-governmental Net Costs | 121 | 16 | 450 | 120 | 330 |
| Gross Costs with the Public | 979 | 46 | 18,828 | - | 18,828 |
| Less Earned Revenue | (1,169) | (1) | (11,691) | - | (11,691) |
| Net Costs with the Public | (190) | 45 | 7,137 | - | 7,137 |
| Net Cost (Revenue): Economic Program | (69) | 61 | 7,587 | 120 | 7,467 |
| **SECURITY PROGRAM** | | | | | |
| Intra-governmental Gross Costs | - | - | 235 | 68 | 167 |
| Less Earned Revenue | - | - | (30) | (25) | (5) |
| Intra-governmental Net Costs | - | - | 205 | 43 | 162 |
| Gross Costs with the Public | - | - | 269 | - | 269 |
| Less Earned Revenue | - | - | - | - | - |
| Net Costs with the Public | - | - | 269 | - | 269 |
| Net Cost: Security Program | - | - | 474 | 43 | 431 |
| **Total Net Program Cost (Revenue) Before Changes in Actuarial Assumptions** | (69) | 111 | 22,096 | 2,270 | 19,826 |
| (Gain)/Loss on Pension, ORB, or OPEB Assumption Changes | - | - | 264 | - | 264 |
| **Total Net Cost of (Revenue From) Treasury Operations** | $ (69) | $ 111 | $ 22,360 | $ 2,270 | $ 20,090 |

# 20. CONSOLIDATED STATEMENT OF NET COST AND NET COSTS OF TREASURY SUB-ORGANIZATIONS (IN MILLIONS) (CON'T):

For Fiscal Year Ended September 30, 2016

| Program Costs | Bureau of Engraving & Printing | Bureau of the Fiscal Service | Depart-mental Office[(a)] | Financial Crimes Enforcement Network | Internal Revenue Service | U.S. Mint |
|---|---|---|---|---|---|---|
| **FINANCIAL PROGRAM** | | | | | | |
| Intra-governmental Gross Costs | $ - | $ 452 | $ 2,704 | $ - | $ 4,342 | $ - |
| Less Earned Revenue | - | (211) | (2,899) | - | (99) | - |
| Intra-governmental Net Costs | - | 241 | (195) | - | 4,243 | - |
| Gross Costs with the Public | - | 1,635 | 819 | - | 8,139 | - |
| Less Earned Revenue | - | (139) | (145) | - | (405) | - |
| Net Costs with the Public | - | 1,496 | 674 | - | 7,734 | - |
| Net Cost: Financial Program | - | 1,737 | 479 | - | 11,977 | - |
| **ECONOMIC PROGRAM** | | | | | | |
| Intra-governmental Gross Costs | 104 | - | 463 | - | - | 79 |
| Less Earned Revenue | (6) | - | (128) | - | - | (3) |
| Intra-governmental Net Costs | 98 | - | 335 | - | - | 76 |
| Gross Costs with the Public | 613 | - | 7,139 | - | - | 2,900 |
| Less Earned Revenue | (675) | - | (2,235) | - | - | (2,995) |
| Net Costs with the Public | (62) | - | 4,904 | - | - | (95) |
| Net Cost (Revenue): Economic Program | 36 | - | 5,239 | - | - | (19) |
| **SECURITY PROGRAM** | | | | | | |
| Intra-governmental Gross Costs | - | - | 211 | 25 | - | - |
| Less Earned Revenue | - | - | (41) | - | - | - |
| Intra-governmental Net Costs | - | - | 170 | 25 | - | - |
| Gross Costs with the Public | - | - | 171 | 95 | - | - |
| Less Earned Revenue | - | - | - | - | - | - |
| Net Costs with the Public | - | - | 171 | 95 | - | - |
| Net Cost: Security Program | - | - | 341 | 120 | - | - |
| **Total Net Program Cost (Revenue) Before Changes in Actuarial Assumptions** | 36 | 1,737 | 6,059 | 120 | 11,977 | (19) |
| (Gain)/Loss on Pension, ORB, or OPEB Assumption Changes | - | - | 492 | - | - | - |
| **Total Net Cost of (Revenue From) Treasury Operations** | $ 36 | $ 1,737 | $ 6,551 | $ 120 | $ 11,977 | $ (19) |

(a) *Of the total $5.2 billion of net cost reported by Departmental Offices (DO) for the Economic Program, Treasury International Assistance Programs and OFS contributed $2.0 billion and $4.1 billion respectively, partially offset by ESF which contributed net income of $1.6 billion. Other net costs were spread throughout other DO programs or offices.*

# 20. Consolidated Statement of Net Cost and Net Costs of Treasury Sub-Organizations (in millions) (con't):

For Fiscal Year Ended September 30, 2016

| Program Costs | Office of the Comptroller of the Currency | Alcohol and Tobacco Tax and Trade Bureau | Combined Total | Eliminations | 2016 Consolidated |
|---|---|---|---|---|---|
| **FINANCIAL PROGRAM** | | | | | |
| Intra-governmental Gross Costs | $ - | $ 15 | $ 7,513 | $ 3,181 | $ 4,332 |
| Less Earned Revenue | - | (3) | (3,212) | (774) | (2,438) |
| Intra-governmental Net Costs | - | 12 | 4,301 | 2,407 | 1,894 |
| Gross Costs with the Public | - | 44 | 10,637 | - | 10,637 |
| Less Earned Revenue | - | (2) | (691) | - | (691) |
| Net Costs with the Public | - | 42 | 9,946 | - | 9,946 |
| Net Cost: Financial Program | - | 54 | 14,247 | 2,407 | 11,840 |
| **ECONOMIC PROGRAM** | | | | | |
| Intra-governmental Gross Costs | 161 | 15 | 822 | 421 | 401 |
| Less Earned Revenue | (35) | (1) | (173) | (130) | (43) |
| Intra-governmental Net Costs | 126 | 14 | 649 | 291 | 358 |
| Gross Costs with the Public | 948 | 44 | 11,644 | - | 11,644 |
| Less Earned Revenue | (1,129) | (1) | (7,035) | - | (7,035) |
| Net Costs with the Public | (181) | 43 | 4,609 | - | 4,609 |
| Net Cost (Revenue): Economic Program | (55) | 57 | 5,258 | 291 | 4,967 |
| **SECURITY PROGRAM** | | | | | |
| Intra-governmental Gross Costs | - | - | 236 | 90 | 146 |
| Less Earned Revenue | - | - | (41) | (38) | (3) |
| Intra-governmental Net Costs | - | - | 195 | 52 | 143 |
| Gross Costs with the Public | - | - | 266 | - | 266 |
| Less Earned Revenue | - | - | - | - | - |
| Net Costs with the Public | - | - | 266 | - | 266 |
| Net Cost: Security Program | - | - | 461 | 52 | 409 |
| **Total Net Program Cost (Revenue) Before Changes in Actuarial Assumptions** | (55) | 111 | 19,966 | 2,750 | 17,216 |
| (Gain)/Loss on Pension, ORB, or OPEB Assumption Changes | 9 | - | 501 | - | 501 |
| **Total Net Cost of (Revenue From) Treasury Operations** | $ (46) | $ 111 | $ 20,467 | $ 2,750 | $ 17,717 |

# 21. Additional Information Related to the Combined Statements of Budgetary Resources

## Undelivered Orders

Undelivered orders represent goods and services ordered and obligated which have not been received. This includes any orders for which we have paid in advance, but for which delivery or performance has not yet occurred. Undelivered orders as of September 30, 2017 and 2016 consisted of the following:

| (in millions) | | 2017 | 2016 |
|---|---|---|---|
| Paid | $ | **11** $ | 10 |
| Unpaid | | **14,334** | 18,443 |
| **Undelivered orders at the end of the year** | **$** | **14,345** $ | 18,453 |

## Contributed Capital

Contributed capital represents the current year authority and prior year balances of amounts actually transferred through non-expenditure transfers to miscellaneous receipt accounts of the General Fund to repay a portion of a capital investment or transfer seigniorage and numismatic profits (refer to Note 19). Contributed capital for the fiscal years ended September 30, 2017 and 2016 was $117 million and $195 million, respectively.

## Apportionment Categories of New Obligations and Upward Adjustments

Apportionment categories are determined in accordance with the guidance provided in OMB Circular No. A-11, *Preparation, Submission and Execution of the Budget*. Apportionment Category A represents resources apportioned for calendar quarters. Apportionment Category B represents resources apportioned for other time periods for activities, projects or objectives, or for any combination thereof. New obligations and upward adjustments for direct and reimbursable obligations by apportionment category for the fiscal years ended September 30, 2017 and 2016 consisted of the following:

| (in millions) | | 2017 | 2016 |
|---|---|---|---|
| Direct - Category A | **$** | **35** $ | 106 |
| Direct - Category B | | **27,925** | 31,768 |
| Direct - Exempt from Apportionment | | **467,038** | 441,961 |
| **Total Direct** | | **494,998** | 473,835 |
| | | | |
| Reimbursable - Category B | | **5,728** | 4,954 |
| Reimbursable - Exempt from Apportionment | | **1,343** | 1,301 |
| **Total Reimbursable** | | **7,071** | 6,255 |
| **Total Direct and Reimbursable** | **$** | **502,069** $ | 480,090 |

## Terms of Borrowing Authority Used

Several of our programs have authority to borrow under the FCRA, as amended. The FCRA provides indefinite borrowing authority to financing accounts to fund the unsubsidized portion of direct loans and to satisfy obligations in the event the financing account's resources are insufficient. OMB Circular No. A-11 defines repayment requirements. Interest expense due is calculated based on the beginning balance of borrowings outstanding and the borrowings/repayments activity that occurred during the fiscal year. Undisbursed Departmental borrowings earn interest at the same rate as the financing account pays on its debt owed to the Fiscal Service. In the event that principal and interest collections exceed the interest expense due, we receive the excess payment. If principal and interest do not exceed interest expense due, we will borrow the

difference. We make periodic principal repayments based on the analysis of cash balances and future disbursement needs. All interest on borrowings is due on September 30. Interest rates on FCRA borrowings range from 1.92 percent to 6.36 percent.

## AVAILABLE BORROWING

The available borrowing authority and related changes in available borrowing authority as of and for the fiscal years ended September 30, 2017 and 2016 are shown below:

| (in millions) | 2017 | 2016 |
|---|---|---|
| Beginning Balance | **$ 6,520** | $ 93,963 |
| Current Authority | **268** | 365 |
| Borrowing Authority Withdrawn [1] | **-** | (87,501) |
| Borrowing Authority Converted to Cash | **(188)** | (307) |
| **Ending Balance** | **$ 6,600** | $ 6,520 |

*(1) In FY 2016, Congress passed the Consolidated Appropriations Act of 2016 (P.L. 114-113) which ended the application of FCRA in connection with IMF programs. The decrease in this activity for FY 2017 is a result of the FY 2016 withdrawal of borrowing authority and obtaining an appropriation warrant to cover the full amount of the commitment made to the IMF.*

## RECONCILIATION OF THE PRESIDENT'S BUDGET

The Budget of the United States (also known as the President's Budget), with actual numbers for FY 2017, was not published at the time that these financial statements were issued. The FY 2019 President's Budget is expected to be published in February 2018, will be located on the OMB website, and will be available from the U.S. Government Publishing Office. The following chart displays the differences between the Combined Statement of Budgetary Resources (SBR) in the FY 2016 AFR and the actual FY 2016 balances included in the FY 2018 President's Budget.

## Reconciliation of FY 2016 Combined Statement of Budgetary Resources to the FY 2018 President's Budget

| (in millions) | Budgetary Resources | Obligations and Upward Adjustments | Outlays (net of offsetting collections) | Distributed Offsetting Receipts | Net Outlays |
|---|---|---|---|---|---|
| **Combined Statement of Budgetary Resources (SBR) Amounts** | $ 797,299 | $ 480,090 | $ 462,822 | $ (62,565) | $ 400,257 |
| IRS non-entity tax credit payments and other outlays not in SBR [(1)] | 127,101 | 127,101 | 121,821 | - | 121,821 |
| Tax and Trade Bureau (TTB) non-entity collections for Puerto Rico not in SBR | 417 | 417 | 417 | - | 417 |
| Expired funds in SBR | (700) | - | - | - | - |
| Non-Treasury offsetting receipts | - | - | - | (857) | (857) |
| Other | (51) | (47) | (53) | - | (53) |
| **President's Budget Amounts** | **$ 924,066** | **$ 607,561** | **$ 585,007** | **$ (63,422)** | **$ 521,585** |

[(1)] *These are primarily refundable Earned Income Tax Credit, Refundable Premium Tax Credit and Child Tax Credit, reported with refunds as custodial activities in our financial statements and thus are not reported as budgetary resources.*

## LEGAL ARRANGEMENTS AFFECTING USE OF UNOBLIGATED BALANCES

The use of unobligated balances is restricted based on annual legislation requirements or enabling authorities. Funds are presumed to be available for only one fiscal year unless otherwise noted in the annual appropriation language. Unobligated balances in unexpired Treasury account fund symbols are available in the next fiscal year for new obligations unless some restrictions have been placed on those funds by law. In those situations, the restricted funding will be temporarily unavailable until such time as the reasons for the restriction have been satisfied or legislation has been enacted to remove the restriction.

Amounts in expired Treasury account fund symbols are not available for new obligations, but may be used to make adjustments to reflect, and make disbursements to liquidate, obligations that were created before the budgetary authority expired.

# 22. Sources and Disposition of Custodial Revenue

We collect the majority of federal revenue from income and excise taxes. The table below shows collection activity, by revenue type and tax year, for the fiscal years ended September 30, 2017 and 2016:

| | Tax Year | | | | |
|---|---|---|---|---|---|
| (in millions) | 2017 | 2016 | 2015 | Pre-2015 | 2017 Collections |
| Individual Income and FICA Taxes | $ 1,929,988 | $ 988,750 | $ 32,331 | $ 25,375 | $ 2,976,444 |
| Corporate Income Taxes | 218,569 | 108,883 | 1,773 | 9,304 | 338,529 |
| Estate and Gift Taxes | 162 | 20,873 | 1,050 | 1,695 | 23,780 |
| Excise Taxes | 62,684 | 22,455 | 40 | 154 | 85,333 |
| Railroad Retirement Taxes | 4,592 | 1,363 | - | 2 | 5,957 |
| Unemployment Taxes | 4,433 | 3,706 | 32 | 113 | 8,284 |
| Fines, Penalties, Interest & Other Revenue - Tax Related | 218 | 1 | - | 1 | 220 |
| **Tax Related Revenue Received** | 2,220,646 | 1,146,031 | 35,226 | 36,644 | 3,438,547 |
| Deposit of Earnings, Federal Reserve System | 61,837 | 19,450 | - | - | 81,287 |
| Fines, Penalties, Interest & Other Revenue - Non-Tax Related | 3,952 | 868 | - | - | 4,820 |
| **Non-Tax Related Revenue Received** | 65,789 | 20,318 | - | - | 86,107 |
| **Total Revenue Received** | $ 2,286,435 | $ 1,166,349 | $ 35,226 | $ 36,644 | $ 3,524,654 |
| Less Amounts Collected for Non-Federal Entities | | | | | 370 |
| **Total** | | | | | $ 3,524,284 |

| | Tax Year | | | | |
|---|---|---|---|---|---|
| (in millions) | 2016 | 2015 | 2014 | Pre-2014 | 2016 Collections |
| Individual Income and FICA Taxes | $ 1,833,546 | $ 982,879 | $ 32,757 | $ 25,695 | $ 2,874,877 |
| Corporate Income Taxes | 228,219 | 107,207 | 2,426 | 7,700 | 345,552 |
| Estate and Gift Taxes | 18 | 8,006 | 906 | 13,407 | 22,337 |
| Excise Taxes | 74,711 | 23,011 | 67 | 142 | 97,931 |
| Railroad Retirement Taxes | 4,527 | 1,411 | 1 | 2 | 5,941 |
| Unemployment Taxes | 4,311 | 3,974 | 50 | 105 | 8,440 |
| Fines, Penalties, Interest & Other Revenue - Tax Related | 470 | - | 1 | 1 | 472 |
| **Tax Related Revenue Received** | 2,145,802 | 1,126,488 | 36,208 | 47,052 | 3,355,550 |
| Deposit of Earnings, Federal Reserve System | 72,244 | 43,428 | - | - | 115,672 |
| Fines, Penalties, Interest & Other Revenue - Non-Tax Related | 3,069 | 848 | - | - | 3,917 |
| **Non-Tax Related Revenue Received** | 75,313 | 44,276 | - | - | 119,589 |
| **Total Revenue Received** | $ 2,221,115 | $ 1,170,764 | $ 36,208 | $ 47,052 | $ 3,475,139 |
| Less Amounts Collected for Non-Federal Entities | | | | | 425 |
| **Total** | | | | | $ 3,474,714 |

## Amounts Provided to Fund the U.S. Government

For the fiscal years ended September 30, 2017 and 2016, collections of custodial revenue transferred to other federal entities were as follows:

| (in millions) | | 2017 | 2016 |
|---|---|---|---|
| Department of the Interior | $ | **760** $ | 749 |
| General Fund | | **3,086,201** | 3,047,484 |
| **Total** | $ | **3,086,961** $ | 3,048,233 |

## Federal Tax Refunds and Other Payments

Federal tax refunds and other payments include amounts paid to taxpayers who have paid more than the actual taxes they owe, as well as payments for various refundable tax credits. Refunds and other payments, by revenue type and tax year, were as follows for the years ended September 30, 2017 and 2016:

| | Tax Year | | | | |
|---|---|---|---|---|---|
| (in millions) | 2017 | 2016 | 2015 | Pre-2015 | 2017 Refunds / Payments |
| Individual Income and FICA Taxes | **$ 46,278 $** | **306,351 $** | **27,804 $** | **8,734 $** | **389,167** |
| Corporate Income Taxes | **5,167** | **14,447** | **7,758** | **17,523** | **44,895** |
| Estate and Gift Taxes | **-** | **188** | **381** | **478** | **1,047** |
| Excise Taxes | **411** | **956** | **224** | **462** | **2,053** |
| Railroad Retirement Taxes | **-** | **3** | **-** | **(1)** | **2** |
| Unemployment Taxes | **1** | **114** | **15** | **29** | **159** |
| **Total** | **$ 51,857 $** | **322,059 $** | **36,182 $** | **27,225 $** | **437,323** |

| | Tax Year | | | | |
|---|---|---|---|---|---|
| (in millions) | 2016 | 2015 | 2014 | Pre-2014 | 2016 Refunds / Payments |
| Individual Income and FICA Taxes | $ 37,029 $ | 300,721 $ | 26,529 $ | 8,030 $ | 372,309 |
| Corporate Income Taxes | 6,511 | 19,143 | 7,345 | 18,283 | 51,282 |
| Estate and Gift Taxes | 357 | 529 | 130 | 285 | 1,301 |
| Excise Taxes | 157 | 611 | 379 | 243 | 1,390 |
| Railroad Retirement Taxes | - | 3 | - | - | 3 |
| Unemployment Taxes | 1 | 155 | 18 | 22 | 196 |
| Total | $ 44,055 $ | 321,162 $ | 34,401 $ | 26,863 $ | 426,481 |

## Federal Tax Refunds and Other Amounts Payable

As of September 30, 2017 and 2016, refunds and other amounts payable consisted of the following:

| (in millions) | | 2017 | 2016 |
|---|---|---|---|
| Internal Revenue Service | $ | **3,062** $ | 2,974 |
| Alcohol and Tobacco Tax and Trade Bureau | | **12** | 19 |
| **Total** | $ | **3,074** $ | 2,993 |

# 23. FUNDS FROM DEDICATED COLLECTIONS

ESF represents the majority of our FDC activities. In addition, such funds managed by BEP, Mint, and OCC (our non-appropriated bureaus) and certain funds managed by the IRS are public enterprise (or revolving) funds and receive no appropriations from the Congress. Fiscal Service, DO, IRS, OFR, TFF, and the CDFI Fund manage other miscellaneous FDCs.

The following is a list of FDCs and a brief description of the purpose, accounting, and uses of these funds.

| Bureau | Fund Code | Fund Title/Description |
|---|---|---|
| **Exchange Stabilization Fund (ESF)** | | |
| ESF | 020X4444 | Exchange Stabilization Fund |
| | | |
| **Public Enterprise/Revolving Funds** | | |
| BEP | 020X4502 | Bureau of Engraving and Printing Fund |
| Mint | 020X4159 | Public Enterprise Fund |
| OCC | 020X8413 | Assessment Funds |
| IRS | 020X4413 | Federal Tax Lien Revolving Fund |
| | | |
| **Other FDC Funds** | | |
| Fiscal Service | 020X5080 | Gifts to Reduce Public Debt |
| Fiscal Service | 020X5081 | Presidential Election Campaign |
| Fiscal Service | 020X8625 | Gulf Coast Restoration Trust Fund |
| Fiscal Service | 020X8902 | Esther Cattell Schmitt Gift Fund |
| Fiscal Service | 5805585 | Travel Promotion Fund, Corp for Travel Promotion |
| Fiscal Service | 580X5585 | Travel Promotion Fund, Corp for Travel Promotion |
| Fiscal Service | 020X5581 | HOPE Reserve Fund |
| Fiscal Service | 0205445002 | Debt Collection Special Fund |
| Fiscal Service | 0205445003 | Debt Collection Special Fund |
| Fiscal Service | 0201/25445 | Debt Collection Special Fund |
| Fiscal Service | 0202/35445 | Debt Collection Special Fund |
| Fiscal Service | 0203/45445 | Debt Collection Special Fund |
| Fiscal Service | 0204/55445 | Debt Collection Special Fund |
| Fiscal Service | 0205/65445 | Debt Collection Special Fund |
| Fiscal Service | 0206/75445 | Debt Collection Special Fund |
| Fiscal Service | 0207/85445 | Debt Collection Special Fund |
| DO | 020X8790 | Gifts and Bequests Trust Fund |
| IRS | 020X5510 | Private Collection Agency Program |
| IRS | 020X5433 | Informant Reimbursement |
| IRS | 020X5622 | Special Compliance Personnel Program Account |
| OFR | 020X5590 | Financial Research Fund |
| TFF | 020X5697 | Treasury Forfeiture Fund |
| CDFI | 020X8524 | Capital Magnet Fund |

Pursuant to the legal authority found in Section 10 of the *Gold Reserve Act of 1934*, as amended, the ESF may purchase or sell foreign currencies, hold U.S. foreign exchange and SDR assets, and may provide financing to foreign governments and foreign entities. The ESF accounts for and reports its holdings to the Fiscal Service on the Standard Form 224, "*Statement of Transactions*," and provides other reports to Congress. Interest on SDRs in the IMF, investments in Treasury securities, and investments in foreign currency assets are ESF's primary sources of revenue. The ESF's earnings and realized gains on foreign currency assets represent inflows of resources to the government, and the interest revenues earned from U.S. Securities are the result of intra-departmental flows.

The BEP, Mint, OCC, and IRS operate "public enterprise/revolving funds" to account for all or some of their respective revenues and expenses. 31 USC 5142 established the Bureau of Engraving and Printing Fund for BEP to account for revenue and expenses related to the currency printing activities. P.L. 104-52 (31 USC 5136) established the Public Enterprise Fund for the Mint to account for all revenue and expenses related to the production and sale of numismatic products and circulating coinage. Revenues and other financing sources at the Mint are mainly from the sale of numismatic and bullion products and the sale of circulating coins to the FRB system. These revenues represent inflows of resources to the government. 12 USC 481 established the Assessment Funds for OCC. Revenue and financing sources are from the bank examinations and assessments for the oversight of the national banks, savings associations, and savings and loan holding companies. These non-appropriated funds contribute to the inflows of resources to the government to specifically fund these entities' operations. 26 USC 7810 established the Federal Tax Lien Revolving Fund to account for revenue and expenses from the sale of property foreclosed upon by a holder of a lien. Such revenue represents inflows of resources to the federal government. There are minimal transactions with other government agencies.

There are other FDCs at several of our bureaus, such as donations to the Presidential Election Campaign Fund, gifts to reduce the public debt, and other enforcement related activities. Public laws and the U.S. Code established and authorized the use of these funds. Sources of revenues and other financing sources include contributions, cash and property forfeited in enforcement activities, public donations, and other allocations, all which represent inflows to the government.

## INTRA-GOVERNMENTAL INVESTMENTS IN TREASURY SECURITIES

The U.S. government does not set aside assets to pay future benefits or other expenditures associated with FDCs. Our bureaus and other federal agencies invest some of the funds that they collect from the public, if they have the statutory authority to do so, in Treasury securities. The Fiscal Service collects cash and makes deposits in the General Fund, which is then available for general government purposes.

When our bureaus or other federal agencies redeem these securities to make expenditures, the government finances those redemptions out of accumulated cash balances, by collecting taxes or other receipts, by borrowing from the public, or by curtailing expenditures. This is the same way that the government finances all other expenditures.

The securities are an asset to our bureaus and other federal agencies and a liability of the General Fund. Because our bureaus and other federal agencies are parts of the U.S. government, these assets and liabilities offset each other from the standpoint of the government as a whole. For this reason, they do not represent an asset or a liability in the U.S. government-wide financial statements.

Our financial statements do not display the balances related to the investments made by our bureaus because the bureaus are subcomponents of the Department. However, the General Fund remains liable to the Fiscal Service for the invested balances and the Fiscal Service remains liable to the investing bureaus (refer to Note 4).

## Summary Information for Funds from Dedicated Collections as of and for the Fiscal Year Ended September 30, 2017

| (in millions) | Exchange Stabilization Fund | Public Enterprise/ Revolving Funds | Other FDC Funds | Combined FDC Funds |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Fund Balance | $ - | $ 1,048 | $ 1,060 | $ 2,108 |
| Investments and Related Interest - Intra-governmental | 22,091 | 1,793 | 3,606 | 27,490 |
| Cash, Foreign Currency and Other Monetary Assets | 64,142 | - | 12 | 64,154 |
| Investments and Related Interest | 8,541 | - | - | 8,541 |
| Other Assets | - | 1,591 | 228 | 1,819 |
| **Total Assets** | $ 94,774 | $ 4,432 | $ 4,906 | $ 104,112 |
| **LIABILITIES** | | | | |
| Intra-governmental Liabilities | $ - | $ 29 | $ 1,075 | $ 1,104 |
| Certificates Issued to the Federal Reserve | 5,200 | - | - | 5,200 |
| Allocation of Special Drawing Rights | 49,912 | - | - | 49,912 |
| Other Liabilities | 46 | 686 | 113 | 845 |
| **Total Liabilities** | 55,158 | 715 | 1,188 | 57,061 |
| **Net Position** | | | | |
| Unexpended Appropriations | 200 | - | - | 200 |
| Cumulative Results of Operations | 39,416 | 3,717 | 3,718 | 46,851 |
| **Total Liabilities and Net Position** | $ 94,774 | $ 4,432 | $ 4,906 | $ 104,112 |
| **Statement of Net Cost** | | | | |
| Gross Cost | $ 7,655 | $ 4,103 | $ 698 | $ 12,456 |
| Less: Earned Revenue | (7,434) | (4,148) | (322) | (11,904) |
| **Total Net Cost of (Revenue From) Operations** | $ 221 | $ (45) | $ 376 | $ 552 |
| **Statement of Changes in Net Position** | | | | |
| **Cumulative Results of Operations:** | | | | |
| Beginning Balance | $ 39,637 | $ 3,492 | $ 3,981 | $ 47,110 |
| Budgetary Financing Sources | - | (19) | (168) | (187) |
| Other Financing Sources | - | 199 | 281 | 480 |
| **Total Financing Sources** | - | 180 | 113 | 293 |
| Revenue From (Net Cost of) Operations | (221) | 45 | (376) | (552) |
| Change in Net Position | (221) | 225 | (263) | (259) |
| **Ending Balance** | $ 39,416 | $ 3,717 | $ 3,718 | $ 46,851 |

## Summary Information for Funds from Dedicated Collections as of and for the Fiscal Year Ended September 30, 2016

| (in millions) | Exchange Stabilization Fund | Public Enterprise/ Revolving Funds | Other FDC Funds | Combined FDC Funds |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Fund Balance | $ - | $ 944 | $ 935 | $ 1,879 |
| Investments and Related Interest - Intra-governmental | 22,680 | 1,662 | 3,733 | 28,075 |
| Cash, Foreign Currency and Other Monetary Assets | 61,813 | - | 17 | 61,830 |
| Investments and Related Interest | 9,842 | - | - | 9,842 |
| Other Assets | - | 1,686 | 241 | 1,927 |
| **Total Assets** | $ 94,335 | $ 4,292 | $ 4,926 | $ 103,553 |
| **LIABILITIES** | | | | |
| Intra-governmental Liabilities | $ - | $ 32 | $ 763 | $ 795 |
| Certificates Issued to the Federal Reserve | 5,200 | - | - | 5,200 |
| Allocation of Special Drawing Rights | 49,294 | - | - | 49,294 |
| Other Liabilities | 4 | 768 | 182 | 954 |
| **Total Liabilities** | 54,498 | 800 | 945 | 56,243 |
| **Net Position** | | | | |
| Unexpended Appropriations | 200 | - | - | 200 |
| Cumulative Results of Operations | 39,637 | 3,492 | 3,981 | 47,110 |
| **Total Liabilities and Net Position** | $ 94,335 | $ 4,292 | $ 4,926 | $ 103,553 |
| **Statement of Net Cost** | | | | |
| Gross Cost | $ 317 | $ 4,804 | $ 576 | $ 5,697 |
| Less: Earned Revenue | (1,925) | (4,841) | (309) | (7,075) |
| Gains/Losses on Pension, ORB, or OPEB Assumption Changes | - | 9 | - | 9 |
| **Total Net Cost of (Revenue From) Operations** | $ (1,608) | $ (28) | $ 267 | $ (1,369) |
| **Statement of Changes in Net Position** | | | | |
| **Cumulative Results of Operations:** | | | | |
| Beginning Balance | $ 38,029 | $ 3,415 | $ 7,202 | $ 48,646 |
| Budgetary Financing Sources | - | (61) | (3,339) | (3,400) |
| Other Financing Sources | - | 110 | 385 | 495 |
| **Total Financing Sources** | - | 49 | (2,954) | (2,905) |
| Revenue From (Net Cost of) Operations | 1,608 | 28 | (267) | 1,369 |
| Change in Net Position | 1,608 | 77 | (3,221) | (1,536) |
| **Ending Balance** | $ 39,637 | $ 3,492 | $ 3,981 | $ 47,110 |

# 24. RECONCILIATION OF NET COST OF TREASURY OPERATIONS AND NON-ENTITY COSTS TO BUDGET

The Reconciliation of Net Cost of Operations to Budget explains the difference between the budgetary net obligations and the proprietary net cost of Treasury operations and non-entity costs. For the fiscal years ended September 30, 2017 and 2016, the Reconciliation of Net Cost of Operations to Budget consisted of the following:

| (in millions) | 2017 | 2016 |
|---|---|---|
| **RESOURCES USED TO FINANCE ACTIVITIES** | | |
| **Budgetary Resources Obligated:** | | |
| New Obligations and Upward Adjustments (Note 21) | **$ 502,069** | $ 480,090 |
| Less: Actual Offsetting Collections and Recoveries of Prior Year Unpaid Obligations, Net of Change in Uncollected Payments | **(10,508)** | (114,447) |
| New Obligations and Upward Adjustments Net of Offsetting Collections and Recoveries | **491,561** | 365,643 |
| Less: Distributed Offsetting Receipts | **(75,089)** | (62,565) |
| **Net Obligations** | **416,472** | 303,078 |
| **Other Resources:** | | |
| Donations and Forfeiture of Property | **106** | 158 |
| Financing Sources for Accrued Interest and Discount on Debt | **11,266** | 3,456 |
| Financing Sources for Accrued Interest on Restoration of Federal Debt Principal (Note 15) | **660** | (2,052) |
| Transfers In/Out Without Reimbursement | **-** | (3) |
| Imputed Financing Sources from Cost Absorbed by Others | **552** | 681 |
| Transfers to the General Fund and Other (Note 19) | **(55,225)** | (64,949) |
| Net Other Resources Used to Finance Activities | **(42,641)** | (62,709) |
| **Total Resources Used to Finance Activities** | **373,831** | 240,369 |
| **RESOURCES USED TO FINANCE ITEMS NOT PART OF THE NET COST OF TREASURY OPERATIONS AND NON-ENTITY COSTS** | | |
| Change in Budgetary Resources Obligated for Goods, Services, and Benefits Ordered but not yet Provided | **(3,934)** | (97,256) |
| Resources that Fund Expenses Recognized in Prior Periods | **(77)** | 115 |
| Budgetary Offsetting Collections & Receipts that do not affect Net Cost of Treasury Operations and Non-Entity Costs | **(73,724)** | (60,595) |
| Adjustment to Accrued Interest and Discount on Debt | **13,839** | 5,810 |
| Resources that Finance the Acquisition of Assets or Liquidation of Liabilities | **(551)** | (7,444) |
| Other Resources or Adjustments to Net Obligated Resources that do not Affect Net Cost of Treasury Operations and Non-Entity Costs | **436** | (4,209) |
| Total Resources Used to Finance Items Not Part of the Net Cost of Treasury Operations and Non-Entity Costs | **(64,011)** | (163,579) |
| **Total Resources Used to Finance the Net Cost of Treasury Operations and Non-Entity Costs** | **437,842** | 403,948 |
| Total Components of Net Cost of Treasury Operations and Non-Entity Costs That Will Require or Generate Resources in Future Periods | **(26)** | (290) |
| Total Components of Net Cost of Treasury Operations and Non-Entity Costs That Will Not Require or Generate Resources [(a)] | **832** | (34) |
| **Total Components of Net Cost of Treasury Operations and Non-Entity Costs That Will Not Require or Generate Resources in the Current Period** | **806** | (324) |
| **Net Cost of Treasury Operations and Non-Entity Costs** | **$ 438,648** | $ 403,624 |

[(a)] *The Components not requiring or generating resources primarily include depreciation and amortization and revaluation of assets or liabilities.*

# 25. Schedule of Fiduciary Activity

We have identified the following funds as meeting the criteria for fiduciary activity. Details of the funds are provided below.

| Bureau | Fund Code | Authority | Fund Title/Description |
|---|---|---|---|
| Fiscal Service | 020X6133 | 31 USC 1322 | Payment of Unclaimed Monies |
| BEP | 020X6513.013 | 31 USC 5119 | Mutilated Currency Claims Funds |
| Fiscal Service | 020X6045 | 31 USC 3328 | Proceeds, Payments of Unpaid Checks |
| Fiscal Service | 020X6048 | 31 USC 3329, 3330 | Proceeds of Withheld Foreign Checks |
| Fiscal Service | 020015X6078 | 50 APP. USC 2012 | War Claims Fund, Foreign Claims Settlement Commission |
| Fiscal Service | 020X6092 | 31 USC 1321 | Debt Management Operations |
| Fiscal Service | 020X6104 | 22 USC 1627 | Albanian Claims Fund, Treasury |
| Fiscal Service | 020X6210 | 22 USC 1623 | Iraq Claims Settlement Fund |
| Fiscal Service | 020X6309 | 22 USC 1627(a) | Libyan Claims Settlement Fund |
| Fiscal Service | 020X6310 | 22 USC 1627(a) | Libyan Claims Settlement Fund |
| Fiscal Service | 020X6312 | 22 USC 1627 | Iranian Claims Settlement Fund |
| Fiscal Service | 020X6314 | 22 USC 1644g | German Democrat Settlement Fund |
| Fiscal Service | 020X6315 | 22 USC 1645h | Vietnam Claims Settlement Fund |
| Fiscal Service | 020X6501.018 | 31 USC 3513 | Small Escrow Amounts |
| Fiscal Service | 020X6720 | 31 USC 3513 | Small Difference Account for Deposit and Check Adjustments |
| Fiscal Service | 020X6830 | 104 Stat. 1061 | Net Interest Payments to/from State |
| Fiscal Service | 020X6999 | 31 USC 3513 | Accounts Payable, Check Issue Underdrafts |
| IRS | 020X6737 | 90 Stat. 269-270 | Internal Revenue Collections for Northern Mariana Island |
| IRS | 020X6738 | 31 USC 3513 | Coverover Withholdings-U.S. Virgin Islands |
| IRS | 020X6740 | 31 USC 3515 | Coverover Withholdings-Guam |
| IRS | 020X6741 | 31 USC 3513 | Coverover Withholdings-American Samoa |
| OAS | 020X6317.001 | 22 USC 2431 | Belize Escrow, Debt Reduction |

"Payment of Unclaimed Monies" is a fund authorized by 31 USC 1322, permitting the Fiscal Service to collect unclaimed monies on behalf of the public. Our other fiduciary activities as listed above are included in All Other Fiduciary Funds.

## Schedule of Fiduciary Activity

| | 2017 | | | 2016 | | |
|---|---|---|---|---|---|---|
| (in millions) | Payment of Unclaimed Monies Fund | All Other Fiduciary Funds | Total Fiduciary Funds | Payment of Unclaimed Monies Fund | All Other Fiduciary Funds | Total Fiduciary Funds |
| **Fiduciary Net Assets, Beginning of the Year** | **$ 647** | **$ 132** | **$ 779** | $ 608 | $ 133 | $ 741 |
| Increases: | | | | | | |
| Contributions to Fiduciary Net Assets | **51** | **382** | **433** | 39 | 342 | 381 |
| Investment earnings | **-** | **-** | **-** | - | 1 | 1 |
| **Total Increases** | **51** | **382** | **433** | 39 | 343 | 382 |
| Decreases: | | | | | | |
| Disbursements to and on behalf of beneficiaries | **(2)** | **(416)** | **(418)** | - | (344) | (344) |
| **Total Decreases** | **(2)** | **(416)** | **(418)** | - | (344) | (344) |
| Net Increase (Decrease) in Fiduciary Assets | **49** | **(34)** | **15** | 39 | (1) | 38 |
| **Fiduciary Net Assets, End of Year** | **$ 696** | **$ 98** | **$ 794** | $ 647 | $ 132 | $ 779 |

### Schedule of Fiduciary Net Assets

| (in millions) | 2017 Payment of Unclaimed Monies Fund | 2017 All Other Fiduciary Funds | 2017 Total Fiduciary Funds | 2016 Payment of Unclaimed Monies Fund | 2016 All Other Fiduciary Funds | 2016 Total Fiduciary Funds |
|---|---|---|---|---|---|---|
| **Fiduciary Net Assets** | | | | | | |
| Cash and Cash Equivalents | **$ 696** | **$ 42** | **$ 738** | $ 647 | $ 69 | $ 716 |
| Investments | **-** | **61** | **61** | - | 67 | 67 |
| Other Assets | **-** | **-** | **-** | - | 1 | 1 |
| **Total Fiduciary Assets** | **696** | **103** | **799** | 647 | 137 | 784 |
| Less: Fiduciary Liabilities | **-** | **(5)** | **(5)** | - | (5) | (5) |
| **Total Fiduciary Net Assets** | **$ 696** | **$ 98** | **$ 794** | $ 647 | $ 132 | $ 779 |

# 26. COMMITMENTS AND CONTINGENCIES

## LEGAL CONTINGENCIES

We are a party in various administrative proceedings, legal actions, and claims, which may ultimately result in settlements or decisions adverse to the U.S. government. These contingent liabilities arise in the normal course of operations and their ultimate disposition is unknown. We disclose contingent liabilities where the conditions for liability recognition have not been met and the likelihood of unfavorable outcome is more than remote. We do not accrue for possible losses related to cases where we cannot estimate the potential loss or the likelihood of an unfavorable outcome is less than probable.

In some cases, a portion of any loss that may occur may be paid by our Judgment Fund, which is separate from our operating resources. For cases related to the *Contract Disputes Act of 1978* (P.L. 95-563) and awards under federal anti-discrimination and whistle-blower protection acts, we must reimburse the Judgment Fund from future appropriations.

In the opinion of our management and legal counsel, based on information available as of the date of this report, the expected outcome of other legal actions, individually or in the aggregate, will not have a materially adverse effect on our consolidated financial statements, except for the pending legal actions described below which may have a materially adverse impact on our consolidated financial statements depending on the outcomes of the cases.

### Pending Legal Actions

- *Tribal Trust Fund Cases:* Native American tribes have filed numerous cases in the U.S. District Courts seeking a declaration that the U.S. has not provided the tribes with a full and complete accounting of their trust funds, and also seeking an order requiring the U.S. government to provide such an accounting. In addition, there are a number of other related cases seeking damages in the U.S. Court of Federal Claims, which do not name us as a defendant. The U.S. government is currently in discussion with counsel representing most of the remaining plaintiff tribes with tribal trust fund cases pending against the U. S. about the feasibility of an out-of-court settlement. Plaintiff tribes in several of the pending cases have chosen to pursue active litigation, rather than settlement discussion, and the U.S. government is litigating those cases vigorously. We are unable to determine the likelihood of an unfavorable outcome or an estimate of potential loss at this time.
- *GSE Related Cases:* A number of cases were filed in the U.S. Court of Federal Claims and U.S. District Courts in which the plaintiffs allege, among other things, that the U.S. government took their property and contractual rights as

preferred and common stockholders when the third amendments to the SPSPAs between us and each GSE were executed in August 2012 (refer to Note 10). One case also alleges that the U.S. government took plaintiffs' property and contractual rights when the GSEs were placed into conservatorship and entered into the SPSPAs with us in September 2008. In the U.S. Court of Federal Claims, the plaintiffs seek just compensation (damages) from the U.S. government. In the U.S. District Courts, the plaintiffs seek to set aside the third amendments to the SPSPAs as well as damages, and in some cases a declaration that the FHFA's structure violates the separation of powers. The U.S. District Court for the District of Columbia (D.C.) granted the defendants' motions to dismiss four cases pending in that court. On February 21, 2017, the U.S. Court of Appeals for the D.C. Circuit affirmed dismissal of all claims against the Department. On October 16, 2017, the plaintiff petitioned the Supreme Court for a writ of certiorari. An additional case in the U.S. District Court for the D.C. was dismissed and not appealed. Cases in the U.S. District Court for the Northern District of Illinois, the U.S. District Court for the Northern District of Iowa, the U.S. District Court for the Eastern District of Kentucky, and the U.S. District Court for the Southern District of Texas have been dismissed by the District Courts and appeals are pending. We are unable to determine the likelihood of an unfavorable outcome or an estimate of potential loss in these cases at this time.

- *Starr International Co., Inc. v. United States:* The plaintiff, an American International Group, Inc. (AIG) shareholder, brought suit on behalf of two classes of shareholders. The suit alleges that the U.S. government violated the Fifth Amendment to the U. S. Constitution by illegally exacting or taking property without just compensation. One class, the Credit Agreement Shareholder Class, claimed the U.S. government violated the Fifth Amendment when it conveyed a majority share of AIG's equity and voting rights in connection with an $85 billion loan to AIG during the 2008 financial crisis. Starr also asserted a Fifth Amendment violation on behalf of the second class, the Reverse Stock Split Shareholder Class, alleging that a June 2009 reverse stock split constituted a taking of the common stockholders' asserted right to a shareholder vote on whether to approve a reverse split of AIG's common stock. The U.S. Court of Federal Claims held that the Credit Agreement Shareholder Class prevails on liability, but recovers no damages, and that the Reverse Stock Split Shareholder Class does not prevail on liability or damages. Upon appeal, the U.S. Court of Appeals for the Federal Circuit overturned the lower court's finding with respect to the Credit Agreement Shareholder Class and held that the plaintiff did not have standing to bring the illegal exaction claim, since equity-acquisition claims belong exclusively to AIG and not to its shareholders. (AIG's board of directors declined to pursue any claims against the U.S. government in a unanimous vote in January 2013.) The U.S. Court of Appeals for the Federal Circuit also affirmed the trial court's ruling on the reverse stock split claim. On October 6, 2017, the plaintiff petitioned the Supreme Court for a writ of certiorari. We are unable to determine the likelihood of an unfavorable outcome or make an estimate of potential loss at this time.
- *Unredeemed Savings Bonds Related Cases:* A number of plaintiffs filed claims in the U.S. Court of Federal Claims requesting that we redeem matured savings bonds not possessed by the applicable states, but which have registered owners with last known addresses in those states. We informed the applicable states we would not redeem these savings bonds since those states were not the registered owners of the bonds. On August 20, 2015, the U.S. Court of Federal Claims partially dismissed one claim and denied the U.S. government's motion to dismiss with respect to other claims. On August 8, 2017, the court ruled in favor of two states, and the U.S. government has appealed. We are unable to determine the likelihood of an unfavorable outcome or an estimate of potential loss at this time.
- *Adam Steele, Brittany Montrois, and Joseph Henchman v. United States:* The plaintiffs filed a class claim in the U.S. District Court for the District of Columbia seeking refunds of all user fees paid, plus interest, to obtain a preparer tax identification number (PTIN). Additionally, the plaintiffs seek to force us to cease charging a user fee to obtain a PTIN and asking for more information than is necessary to issue a PTIN. On June 1, 2017, the U.S. District Court for the D.C. found for the plaintiffs in the previously mentioned matters. On October 24, 2017, a motion for stay was filled and is

awaiting a ruling as the U.S. government considers whether or not to appeal. We are unable to determine the likelihood of an unfavorable outcome or an estimate of potential loss at this time.

- *Anonymous Whistleblower Cases:* A number of whistleblower cases were filed in the U.S. Tax Court under seal, appealing the denial of an award by the IRS Whistleblower Office. The anonymous claimants allegedly provided confidential information about tax fraud committed by multiple taxpayers to the IRS. The U.S. Tax Court is currently holding these cases in abeyance until it determines the scope and standard of review it will follow. We are unable to determine the likelihood of an unfavorable outcome or an estimate of potential loss at this time.
- *American Recovery and Reinvestment Tax Act of 2009 (ARRA) Related Cases:* A number of cases were filed in the U.S. Court of Federal Claims alleging that the U.S. government violated statutory and regulatory mandates to make proper payments to plaintiffs under ARRA, Section 1603, for having placed certain energy properties into service. We have determined there is a reasonably possible likelihood of an unfavorable outcome in some of the cases. On October 28, 2016, the U.S. Court of Federal Claims entered judgment against the U. S. in the amount of $207 million in one of the cases. The U.S. government appealed the judgment and the case remains in litigation. Additional related cases with alleged damages of approximately $49 million have been filed. Another unrelated case with alleged damages of $47 million remains in litigation.
- *Other Legal Actions:* We are also involved in employment related legal actions (e.g., matters alleging discrimination and other claims before federal courts, the Equal Employment Opportunity Commission, and the Merit Systems Protection Board) for which an unfavorable outcome is reasonably possible, but for which an estimate of potential loss cannot be determined at this time. We do not expect that these cases will have a material adverse effect on our consolidated financial position or results.

## OTHER COMMITMENTS AND CONTINGENCIES

### Loan Commitments

Through the FFB, we make loan commitments with federal agencies, or private sector borrowers with loans guaranteed by federal agencies, to extend them credit for their own use (refer to Notes 1L and 3). As of September 30, 2017 and 2016, we had loan commitments totaling $12.7 billion and $12.5 billion, respectively.

### Multilateral Development Banks

On behalf of the U. S., we have subscribed to capital for certain MDBs, portions of which are callable under certain limited circumstances to meet the obligations of the respective MDB. There has never been, nor is there anticipated, a call on the U.S. commitment for these subscriptions. As of September 30, 2017 and 2016, U.S. callable capital in MDBs was as follows:

| (in millions) | 2017 | 2016 |
|---|---|---|
| Inter-American Development Bank | **$ 49,181** | $ 49,181 |
| International Bank for Reconstruction and Development | **43,521** | 43,427 |
| Asian Development Bank | **18,702** | 18,701 |
| African Development Bank | **4,592** | 4,085 |
| European Bank for Reconstruction and Development | **3,055** | 3,055 |
| North American Development Bank | **1,275** | 1,275 |
| Multilateral Investment Guarantee Agency[(1)] | **315** | 315 |
| **Total** | **$ 120,641** | $ 120,039 |

*(1) Both FY 2017 and 2016 include commitments of $22 million for the undisbursed portion of the subscription to paid-in capital investments.*

## Terrorism Risk Insurance Program

Congress originally enacted the *Terrorism Risk Insurance Act* in November 2002, to address market disruptions resulting from terrorist attacks on September 11, 2001. Most recently, the *Terrorism Risk Insurance Program Reauthorization Act of 2015* (P.L. 114-1) extended the Terrorism Risk Insurance Program (TRIP) until December 31, 2020. The TRIP helps to ensure available and affordable commercial property and casualty insurance for terrorism risk, and simultaneously allows private markets to stabilize. The authority to pay claims under the TRIP is activated when the Secretary (in consultation with the Secretary of the Department of Homeland Security and the Attorney General of the United States) certifies an "act of terrorism." In the event of certification of an "act of terrorism," insurers may be eligible to receive reimbursement from the U.S. government for associated insured losses – assuming an aggregate insured loss threshold ("program trigger") has been reached – once a particular insurer has satisfied its designated deductible amount. For calendar years 2017 and 2016, the program trigger amount was $140 million and $120 million, respectively. This amount will increase by $20 million annually through calendar year 2020. Insured losses above insurer deductibles will be shared between insurance companies and the U.S. government. The TRIP includes both mandatory and discretionary authority for Treasury to recoup federal payments made under the TRIP through policyholder surcharges under certain circumstances, and contains provisions designed to manage litigation arising from or relating to a certified act of terrorism. There were no claims under the TRIP as of September 30, 2017 or 2016.

## Exchange Stabilization Agreement

The North American Framework Agreement (NAFA), which we signed in 1994, includes the Exchange Stabilization Agreement (ESA) with Mexico. Through the ESF, we have a swap line for $3.0 billion with Mexico under the NAFA and its implementing ESA. The amounts and terms (including the assured source of repayment) of any borrowing under NAFA and ESA will have to be negotiated and agreed to before any actual drawing can occur. The ESA does provide sample clauses that state that transactions shall be exchange rate neutral for the ESF, and bear an interest rate based on that comparable to Treasury bills. There were no drawings outstanding on the ESF swap line as of September 30, 2017 and 2016.

## IMF Commitments

The U.S. participates in the IMF through a quota subscription and the NAB which is a borrowing arrangement that supplements IMF resources. As of September 30, 2017 and 2016, the U. S. financial commitment under the U.S. quota was SDR 83.0 billion, which was equivalent to $117.1 billion and $115.7 billion, respectively. Its financial commitment under the NAB arrangement was SDR 28.2 billion as of September 30, 2017 and 2016, which was equivalent to $39.9 billion and $39.4 billion, respectively. Refer to Note 7 for further information.

## Housing Programs Under TARP

We design housing programs under TARP to provide stability for both the housing market and homeowners. These programs assist homeowners who are experiencing financial hardships to remain in their homes until their financial position improves or they relocate to a more sustainable living situation, and to obtain other assistance designed to prevent foreclosures. As of September 30, 2017 and 2016, we had committed up to $37.4 billion and $37.5 billion, respectively, for these programs. Outstanding commitments totaled $10.8 billion and $15.0 billion as of September 30, 2017 and 2016, respectively. For FY 2017 and 2016, payments made on behalf of the housing programs under TARP totaled $4.1 billion and $4.3 billion, respectively, reported within the Economic Program on our Consolidated Statements of Net Cost.

## Commitment to GSEs

The SPSPAs between us and each GSE, which have no expiration date, provide for us to disburse funds to the GSEs if, at the end of any quarter, the FHFA determines that the liabilities exceed the GSE's assets. At September 30, 2017 and 2016, our maximum remaining potential commitment to the GSEs was $258.1 billion. Refer to Note 10 for further information.

# REQUIRED SUPPLEMENTARY INFORMATION (UNAUDITED – SEE ACCOMPANYING AUDITORS' REPORT)

## INTRODUCTION

This section provides the Required Supplementary Information as prescribed by accounting standards.

## OTHER CLAIMS FOR REFUNDS

We estimated that $10.4 billion and $7.1 billion as of September 30, 2017 and 2016, respectively, may be payable as other claims for tax refunds. This estimate represents amounts (principal and interest) that we may pay for claims pending judicial review by the federal courts or internally, by Appeals. In FY 2017, the total estimated payout (including principal and interest) for claims pending judicial review by the federal courts and appeals courts is $8.2 billion and $2.2 billion, respectively. In FY 2016, the total estimated payout (including principal and interest) for claims pending judicial review by the federal courts and appeals courts was $4.8 billion and $2.3 billion, respectively. To the extent judgments against the government in these cases prompt other similarly situated taxpayers to file similar refund claims, these amounts could become significantly greater.

## IRS FEDERAL TAXES RECEIVABLE, NET

In accordance with SFFAS No. 7, some unpaid tax assessments do not meet the criteria for financial statement recognition. Internal Revenue Code 6201 authorizes and requires us to make inquiries, determinations, and assessments of all taxes which taxpayers have not duly paid (including interest, additions to the tax, and assessable penalties) under the law. Unpaid assessments result from taxpayers filing returns without sufficient payment, as well as from tax compliance programs such as examination, under-reporter, substitute for return, and combined annual wage reporting. We also have authority to abate the paid or unpaid portion of an assessed tax, interest, and penalty. Abatements occur for a number of reasons and are a normal part of the tax administration process. Abatements may result in claims for refunds or a reduction of the unpaid assessed amount.

Under federal accounting standards, we consider unpaid assessments which require taxpayer or court agreement federal taxes receivable. We consider assessments not agreed to by taxpayers or the courts compliance assessments and not federal taxes receivable. Due to the lack of agreement, these compliance assessments are less likely to have future collection potential than those unpaid assessments that we consider federal taxes receivable.

We call assessments with little or no future collection potential write-offs. Write-offs principally consist of amounts owed by deceased, bankrupt, or defunct taxpayers, including many failed financial institutions liquidated by the Federal Deposit Insurance Corporation and the former Resolution Trust Corporation. Write-offs have little or no future collection potential, but statutory provisions require that we maintain these assessments until the statute for collection expires.

Although we do not consider compliance assessments and write-offs receivables under federal accounting standards, they represent legally enforceable claims of the U.S. government.

The components of the total unpaid assessments at September 30, 2017 and 2016, were as follows:

| (in millions) | | 2017 | 2016 |
|---|---|---|---|
| Total Unpaid Assessments | $ | **382,000** $ | 391,000 |
| Less Compliance Assessments | | **(74,000)** | (74,000) |
| Write Offs | | **(111,000)** | (139,000) |
| Gross Federal Taxes Receivable | | **197,000** | 178,000 |
| Less Allowance for Doubtful Accounts | | **(145,000)** | (129,000) |
| Federal Taxes Receivables, Net | $ | **52,000** $ | 49,000 |

To eliminate double counting, the compliance assessments reported above exclude trust fund recovery penalties assessed against officers and directors of businesses involved in the non-remittance of federal taxes withheld from their employees. The penalties totaled $1 billion as of September 30, 2017 and 2016, respectively. We report the related unpaid assessments of those businesses as taxes receivable or write-offs, but we may also recover portions of those businesses' unpaid assessments from any and all individual officers and directors against whom we assess a trust fund recovery penalty.

## Alcohol and Tobacco Tax and Trade Bureau

As an agent of the U.S. government and as authorized by 26 USC, the TTB collects excise taxes from alcohol, tobacco, firearms, and ammunition industries. In addition, the TTB collects special occupational taxes from certain tobacco businesses. During FY 2017 and 2016, TTB collected approximately $21.8 billion and $22.1 billion in taxes, interest, and other revenues, respectively. TTB also collects Federal excise taxes on certain articles produced in Puerto Rico and the Virgin Islands, and imported into the U.S. In accordance with 26 USC 7652, such taxes collected on rum imported into the U.S. are "covered over" or paid into the treasuries of Puerto Rico and the Virgin Islands.

TTB remits substantially all of the taxes collected, net of related refund disbursements, to the General Fund. We further distribute this revenue to Federal agencies in accordance with various laws and regulations. The firearms and ammunition excise taxes are an exception. TTB remits those revenues to the Fish and Wildlife Restoration Fund under provisions of the *Pittman-Robertson Act of 1937*.

## Deferred Maintenance and Repairs

In FY 2017 and 2016, we had no material amounts of deferred maintenance and repair costs to report on vehicles, buildings, and structures we owned.

Deferred maintenance and repairs applies to owned PP&E. Deferred maintenance and repairs are maintenance and repair activity that we had not performed when it should have been, or scheduled to be, and put off or delayed for a future period. We define maintenance and repairs as the act of keeping capitalized assets in an "acceptable condition" to serve their required mission. It includes preventive maintenance, normal repairs, replacement of parts and structural components, and other activities needed to preserve the asset so that it continues to provide acceptable services and achieves its expected useful life. Deferred maintenance and repairs excludes activities aimed at expanding the capacity or significantly upgrading the assets to a different form than it was originally intended (i.e., activities related to capitalized improvements, modernization, and/or restoration).

Logistic personnel use condition assessment surveys and/or the total life-cycle cost methods to determine if there are any deferred maintenance and repairs needed to keep an asset in acceptable operating condition. We use periodic condition assessments, physical inspections, and review of manufacturing and engineering specifications, work orders, and building and other structure logistics reports under these methodologies.

## STATEMENT OF BUDGETARY RESOURCES DISAGGREGATED BY TREASURY REPORTING ENTITY

The following tables provide the Statement of Budgetary Resources for the fiscal years ended September 30, 2017 and 2016 disaggregated by Treasury reporting entity rather than by Treasury major budget account, since we manage our budget at the reporting entity level.

## Fiscal Year 2017 Combining Statement of Budgetary Resources Disaggregated by Sub-organization Accounts

| (in millions): | | Bureau of Engraving & Printing | Bureau of the Fiscal Service | Departmental Offices (a) | Fin. Crimes Enforcement Network | Internal Revenue Service |
|---|---|---|---|---|---|---|
| **BUDGETARY RESOURCES** | | | | | | |
| Unobligated balance brought forward, October 1 | $ | 134 $ | 1,379 $ | 312,864 $ | 50 $ | 948 |
| Recoveries of unpaid prior year obligations | | 12 | 90 | 167 | 3 | 100 |
| Other changes in unobligated balance | | - | (60) | (1,189) | (1) | (43) |
| Unobligated balance from prior year budget authority, net | | 146 | 1,409 | 311,842 | 52 | 1,005 |
| Appropriations (discretionary and mandatory) | | - | 476,362 | 5,207 | 115 | 11,631 |
| Borrowing authority (discretionary and mandatory) | | - | - | 268 | - | - |
| Spending authority from offsetting collections (discretionary and mandatory) | | 706 | 243 | 3,804 | 3 | 165 |
| **Total Budgetary Resources** | $ | 852 $ | 478,014 $ | 321,121 $ | 170 $ | 12,801 |
| **STATUS OF BUDGETARY RESOURCES** | | | | | | |
| New obligations and upward adjustments | $ | 779 $ | 476,598 $ | 9,399 $ | 120 $ | 11,745 |
| Unobligated balance, end of year: | | | | | | |
| Apportioned, unexpired accounts | | 74 | 1,291 | 271,524 | 44 | 528 |
| Exempt from apportionment, unexpired accounts | | - | 9 | 90 | - | 7 |
| Unapportioned, unexpired accounts | | - | 88 | 39,892 | - | 236 |
| Unexpired unobligated balance, end of year | | 74 | 1,388 | 311,506 | 44 | 771 |
| Expired unobligated balance, end of year | | (1) | 28 | 216 | 6 | 285 |
| Unobligated balance, end of year | | 73 | 1,416 | 311,722 | 50 | 1,056 |
| **Total Status of Budgetary Resources** | $ | 852 $ | 478,014 $ | 321,121 $ | 170 $ | 12,801 |
| **CHANGE IN OBLIGATED BALANCE** | | | | | | |
| **Unpaid Obligations:** | | | | | | |
| Unpaid obligations, brought forward, October 1 | $ | 115 $ | 1,177 $ | 72,224 $ | 46 $ | 1,665 |
| New obligations and upward adjustments | | 779 | 476,598 | 9,399 | 120 | 11,745 |
| Outlays (gross) | | (700) | (476,726) | (12,989) | (117) | (11,734) |
| Recoveries of prior year unpaid obligations | | (12) | (90) | (167) | (3) | (100) |
| Unpaid obligations, end of year | | 182 | 959 | 68,467 | 46 | 1,576 |
| **Uncollected Payments:** | | | | | | |
| Uncollected payments, Federal sources, brought forward, October 1 | | (52) | (38) | (68) | (1) | (28) |
| Change in uncollected payments, Federal sources | | 12 | 24 | (9) | - | 1 |
| Uncollected payments, Federal sources, end of year | | (40) | (14) | (77) | (1) | (27) |
| **Obligated Balance, End of Year** | $ | 142 $ | 945 $ | 68,390 $ | 45 $ | 1,549 |
| **Obligated Balance, Start of Year** | $ | 63 $ | 1,139 $ | 72,156 $ | 45 $ | 1,637 |
| **BUDGET AUTHORITY AND OUTLAYS, NET** | | | | | | |
| Budget authority, gross (discretionary and mandatory) | $ | 706 $ | 476,605 $ | 9,279 $ | 118 $ | 11,796 |
| Actual offsetting collections (discretionary and mandatory) | | (718) | (270) | (5,314) | (2) | (227) |
| Change in uncollected payments, Federal sources (discretionary and mandatory) | | 12 | 24 | (9) | - | 1 |
| Recoveries of prior year paid obligations (discretionary and mandatory) | | - | 2 | 3 | - | 62 |
| **Budget Authority, Net (Discretionary and Mandatory)** | $ | - $ | 476,361 $ | 3,959 $ | 116 $ | 11,632 |
| Outlays, gross (discretionary and mandatory) | $ | 700 $ | 476,726 $ | 12,989 $ | 117 $ | 11,734 |
| Actual offsetting collections (discretionary and mandatory) | | (718) | (270) | (5,314) | (2) | (227) |
| Outlays, net (discretionary and mandatory) | | (18) | 476,456 | 7,675 | 115 | 11,507 |
| Distributed offsetting receipts | | - | (45,128) | (29,550) | - | (411) |
| **Agency Outlays, Net (Discretionary and Mandatory)** | $ | (18)$ | 431,328 $ | (21,875)$ | 115 $ | 11,096 |

*(a) Of the $321 billion of Total Budgetary Resources for DO, GSE, ESF, and OAS had $259 billion, $40 billion, and $14 billion, respectively. The remainder is spread throughout other offices.*

## Fiscal Year 2017 Combining Statement of Budgetary Resources Disaggregated by Sub-organization Accounts

| (in millions): | U. S. Mint | Office of the Comptroller of the Currency | Alcohol and Tobacco Tax and Trade Bureau | Budgetary | Non-Budgetary |
|---|---|---|---|---|---|
| **BUDGETARY RESOURCES** | | | | | |
| Unobligated balance brought forward, October 1 | $ 433 | $ 1,399 | $ 2 | $ 316,775 | $ 434 |
| Recoveries of unpaid prior year obligations | 19 | 4 | 1 | 396 | - |
| Other changes in unobligated balance | (19) | - | (1) | (574) | (739) |
| Unobligated balance from prior year budget authority, net | 433 | 1,403 | 2 | 316,597 | (305) |
| Appropriations (discretionary and mandatory) | - | - | 111 | 493,425 | 1 |
| Borrowing authority (discretionary and mandatory) | - | - | - | - | 268 |
| Spending authority from offsetting collections (discretionary and mandatory) | 2,387 | 1,217 | 6 | 7,569 | 962 |
| **Total Budgetary Resources** | $ 2,820 | $ 2,620 | $ 119 | $ 817,591 | $ 926 |
| **STATUS OF BUDGETARY RESOURCES** | | | | | |
| New obligations and upward adjustments | $ 2,205 | $ 1,110 | $ 113 | $ 501,405 | $ 664 |
| Unobligated balance, end of year: | | | | | |
| Apportioned, unexpired accounts | 616 | - | 5 | 274,033 | 49 |
| Exempt from apportionment, unexpired accounts | - | 1,510 | - | 1,616 | - |
| Unapportioned, unexpired accounts | - | - | - | 40,003 | 213 |
| Unexpired unobligated balance, end of year | 616 | 1,510 | 5 | 315,652 | 262 |
| Expired unobligated balance, end of year | (1) | - | 1 | 534 | - |
| Unobligated balance, end of year | 615 | 1,510 | 6 | 316,186 | 262 |
| **Total Status of Budgetary Resources** | $ 2,820 | $ 2,620 | $ 119 | $ 817,591 | $ 926 |
| **CHANGE IN OBLIGATED BALANCE** | | | | | |
| **Unpaid Obligations:** | | | | | |
| Unpaid obligations, brought forward, October 1 | $ 293 | $ 268 | $ 25 | $ 75,010 | $ 803 |
| New obligations and upward adjustments | 2,205 | 1,110 | 113 | 501,405 | 664 |
| Outlays (gross) | (2,277) | (1,091) | (114) | (505,166) | (582) |
| Recoveries of prior year unpaid obligations | (19) | (4) | (1) | (396) | - |
| Unpaid obligations, end of year | 202 | 283 | 23 | 70,853 | 885 |
| **Uncollected Payments:** | | | | | |
| Uncollected payments, Federal sources, brought forward, October 1 | - | (7) | (2) | (197) | 1 |
| Change in uncollected payments, Federal sources | - | - | - | 29 | (1) |
| Uncollected payments, Federal sources, end of year | - | (7) | (2) | (168) | - |
| **Obligated Balance, End of Year** | $ 202 | $ 276 | $ 21 | $ 70,685 | $ 885 |
| **Obligated Balance, Start of Year** | $ 293 | $ 261 | $ 23 | $ 74,813 | $ 804 |
| **BUDGET AUTHORITY AND OUTLAYS, NET** | | | | | |
| Budget authority, gross (discretionary and mandatory) | $ 2,387 | $ 1,217 | $ 117 | $ 500,994 | $ 1,231 |
| Actual offsetting collections (discretionary and mandatory) | (2,387) | (1,217) | (5) | (7,869) | (2,271) |
| Change in uncollected payments, Federal sources (discretionary and mandatory) | - | - | - | 29 | (1) |
| Recoveries of prior year paid obligations (discretionary and mandatory) | - | - | - | 67 | - |
| **Budget Authority, Net (Discretionary and Mandatory)** | $ - | $ - | $ 112 | $ 493,221 | $ (1,041) |
| Outlays, gross (discretionary and mandatory) | $ 2,277 | $ 1,091 | $ 114 | $ 505,166 | $ 582 |
| Actual offsetting collections (discretionary and mandatory) | (2,387) | (1,217) | (5) | (7,869) | (2,271) |
| Outlays, net (discretionary and mandatory) | (110) | (126) | 109 | 497,297 | (1,689) |
| Distributed offsetting receipts | - | - | - | (75,089) | - |
| **Agency Outlays, Net (Discretionary and Mandatory)** | $ (110) | $ (126) | $ 109 | $ 422,208 | $ (1,689) |

## Fiscal Year 2016 Combining Statement of Budgetary Resources Disaggregated by Sub-organization Accounts

| (in millions): | | Bureau of Engraving & Printing | Bureau of the Fiscal Service | Departmental Offices (a) | Fin. Crimes Enforcement Network | Internal Revenue Service |
|---|---|---|---|---|---|---|
| **BUDGETARY RESOURCES** | | | | | | |
| Unobligated balance brought forward, October 1 | $ | 101 $ | 1,227 $ | 319,343 $ | 47 $ | 1,015 |
| Recoveries of unpaid prior year obligations | | - | 56 | 96,249 | 3 | 114 |
| Other changes in unobligated balance | | - | (5) | (97,739) | (1) | (58) |
| Unobligated balance from prior year budget authority, net | | 101 | 1,278 | 317,853 | 49 | 1,071 |
| Appropriations (discretionary and mandatory) | | - | 450,673 | 2,839 | 113 | 11,615 |
| Borrowing authority (discretionary and mandatory) | | - | - | 365 | - | - |
| Spending authority from offsetting collections (discretionary and mandatory) | | 681 | 257 | 3,970 | 2 | 122 |
| **Total Budgetary Resources** | $ | 782 $ | 452,208 $ | 325,027 $ | 164 $ | 12,808 |
| **STATUS OF BUDGETARY RESOURCES** | | | | | | |
| New obligations and upward adjustments | $ | 648 $ | 450,829 $ | 12,163 $ | 114 $ | 11,860 |
| Unobligated balance, end of year: | | | | | | |
| Apportioned, unexpired accounts | | 134 | 1,310 | 271,813 | 45 | 470 |
| Exempt from apportionment, unexpired accounts | | - | 3 | 95 | - | 7 |
| Unapportioned, unexpired accounts | | - | 31 | 40,689 | - | 146 |
| Unexpired unobligated balance, end of year | | 134 | 1,344 | 312,597 | 45 | 623 |
| Expired unobligated balance, end of year | | - | 35 | 267 | 5 | 325 |
| Unobligated balance, end of year | | 134 | 1,379 | 312,864 | 50 | 948 |
| **Total Status of Budgetary Resources** | $ | 782 $ | 452,208 $ | 325,027 $ | 164 $ | 12,808 |
| **CHANGE IN OBLIGATED BALANCE** | | | | | | |
| **Unpaid Obligations:** | | | | | | |
| Unpaid obligations, brought forward, October 1 | $ | 110 $ | 651 $ | 170,648 $ | 45 $ | 1,380 |
| New obligations and upward adjustments | | 648 | 450,829 | 12,163 | 114 | 11,860 |
| Outlays (gross) | | (643) | (450,247) | (14,338) | (110) | (11,461) |
| Recoveries of prior year unpaid obligations | | - | (56) | (96,249) | (3) | (114) |
| Unpaid obligations, end of year | | 115 | 1,177 | 72,224 | 46 | 1,665 |
| **Uncollected Payments:** | | | | | | |
| Uncollected payments, Federal sources, brought forward, October 1 | | (43) | (25) | (505) | - | (23) |
| Change in uncollected payments, Federal sources | | (9) | (13) | 437 | (1) | (5) |
| Uncollected payments, Federal sources, end of year | | (52) | (38) | (68) | (1) | (28) |
| **Obligated Balance, End of Year** | $ | 63 $ | 1,139 $ | 72,156 $ | 45 $ | 1,637 |
| **Obligated Balance, Start of Year** | $ | 67 $ | 626 $ | 170,143 $ | 45 $ | 1,357 |
| **BUDGET AUTHORITY AND OUTLAYS, NET** | | | | | | |
| Budget authority, gross (discretionary and mandatory) | $ | 681 $ | 450,930 $ | 7,174 $ | 115 $ | 11,737 |
| Actual offsetting collections (discretionary and mandatory) | | (672) | (246) | (13,102) | - | (155) |
| Change in uncollected payments, Federal sources (discretionary and mandatory) | | (9) | (13) | 437 | (1) | (5) |
| Recoveries of prior year paid obligations (discretionary and mandatory) | | - | 2 | 67 | - | 38 |
| **Budget Authority, Net (Discretionary and Mandatory)** | $ | - $ | 450,673 $ | (5,424)$ | 114 $ | 11,615 |
| Outlays, gross (discretionary and mandatory) | $ | 643 $ | 450,247 $ | 14,338 $ | 110 $ | 11,461 |
| Actual offsetting collections (discretionary and mandatory) | | (672) | (246) | (13,102) | - | (155) |
| Outlays, net (discretionary and mandatory) | | (29) | 450,001 | 1,236 | 110 | 11,306 |
| Distributed offsetting receipts | | - | (45,505) | (15,990) | - | (1,070) |
| **Agency Outlays, Net (Discretionary and Mandatory)** | $ | (29)$ | 404,496 $ | (14,754)$ | 110 $ | 10,236 |

*(a) Of the $325 billion of Total Budgetary Resources for DO, GSE, ESF, and OAS had $259 billion and $40 billion, and $15 billion, respectively. The remainder is spread throughout other offices.*

## Fiscal Year 2016 Combining Statement of Budgetary Resources Disaggregated by Sub-organization Accounts

| (in millions): | U. S. Mint | Office of the Comptroller of the Currency | Alcohol and Tobacco Tax and Trade Bureau | Budgetary | Non-Budgetary |
|---|---|---|---|---|---|
| **BUDGETARY RESOURCES** | | | | | |
| Unobligated balance brought forward, October 1 | $ 703 | $ 1,301 | $ 5 | $ 323,170 | $ 572 |
| Recoveries of unpaid prior year obligations | 17 | 18 | 1 | 7,034 | 89,424 |
| Other changes in unobligated balance | (58) | - | (2) | (8,355) | (89,508) |
| Unobligated balance from prior year budget authority, net | 662 | 1,319 | 4 | 321,849 | 488 |
| Appropriations (discretionary and mandatory) | - | - | 106 | 465,346 | - |
| Borrowing authority (discretionary and mandatory) | - | - | - | - | 365 |
| Spending authority from offsetting collections (discretionary and mandatory) | 3,043 | 1,170 | 6 | 8,144 | 1,107 |
| **Total Budgetary Resources** | $ 3,705 | $ 2,489 | $ 116 | $ 795,339 | $ 1,960 |
| **STATUS OF BUDGETARY RESOURCES** | | | | | |
| New obligations and upward adjustments | $ 3,272 | $ 1,090 | $ 114 | $ 478,564 | $ 1,526 |
| Unobligated balance, end of year: | | | | | |
| Apportioned, unexpired accounts | 318 | - | - | 274,048 | 42 |
| Exempt from apportionment, unexpired accounts | - | 1,400 | - | 1,505 | - |
| Unapportioned, unexpired accounts | 117 | - | - | 40,591 | 392 |
| Unexpired unobligated balance, end of year | 435 | 1,400 | - | 316,144 | 434 |
| Expired unobligated balance, end of year | (2) | (1) | 2 | 631 | - |
| Unobligated balance, end of year | 433 | 1,399 | 2 | 316,775 | 434 |
| **Total Status of Budgetary Resources** | $ 3,705 | $ 2,489 | $ 116 | $ 795,339 | $ 1,960 |
| **CHANGE IN OBLIGATED BALANCE** | | | | | |
| **Unpaid Obligations:** | | | | | |
| Unpaid obligations, brought forward, October 1 | $ 304 | $ 238 | $ 23 | $ 83,228 | $ 90,171 |
| New obligations and upward adjustments | 3,272 | 1,090 | 114 | 478,564 | 1,526 |
| Outlays (gross) | (3,266) | (1,042) | (111) | (479,748) | (1,470) |
| Recoveries of prior year unpaid obligations | (17) | (18) | (1) | (7,034) | (89,424) |
| Unpaid obligations, end of year | 293 | 268 | 25 | 75,010 | 803 |
| **Uncollected Payments:** | | | | | |
| Uncollected payments, Federal sources, brought forward, October 1 | - | (4) | (3) | (196) | (407) |
| Change in uncollected payments, Federal sources | - | (3) | 1 | (1) | 408 |
| Uncollected payments, Federal sources, end of year | - | (7) | (2) | (197) | 1 |
| **Obligated Balance, End of Year** | $ 293 | $ 261 | $ 23 | $ 74,813 | $ 804 |
| **Obligated Balance, Start of Year** | $ 304 | $ 234 | $ 20 | $ 83,032 | $ 89,764 |
| **BUDGET AUTHORITY AND OUTLAYS, NET** | | | | | |
| Budget authority, gross (discretionary and mandatory) | $ 3,043 | $ 1,170 | $ 112 | $ 473,490 | $ 1,472 |
| Actual offsetting collections (discretionary and mandatory) | (3,047) | (1,168) | (6) | (8,563) | (9,833) |
| Change in uncollected payments, Federal sources (discretionary and mandatory) | - | (3) | 1 | (1) | 408 |
| Recoveries of prior year paid obligations (discretionary and mandatory) | 3 | - | - | 110 | - |
| **Budget Authority, Net (Discretionary and Mandatory)** | $ (1) | $ (1) | $ 107 | $ 465,036 | $ (7,953) |
| Outlays, gross (discretionary and mandatory) | $ 3,266 | $ 1,042 | $ 111 | $ 479,748 | $ 1,470 |
| Actual offsetting collections (discretionary and mandatory) | (3,047) | (1,168) | (6) | (8,563) | (9,833) |
| Outlays, net (discretionary and mandatory) | 219 | (126) | 105 | 471,185 | (8,363) |
| Distributed offsetting receipts | - | - | - | (62,565) | - |
| **Agency Outlays, Net (Discretionary and Mandatory)** | $ 219 | $ (126) | $ 105 | $ 408,620 | $ (8,363) |

DEPARTMENT OF THE TREASURY

# PART 3:

# Other Information

## (Unaudited)

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THE TREASURY DEPARTMENT

# SECTION A: TAX GAP AND TAX BURDEN

## TAX GAP

The tax gap is the difference between the amount of tax imposed by law and what taxpayers actually pay on time. The tax gap provides an estimate of the level of overall noncompliance and voluntary compliance during the relevant tax periods and under the Internal Revenue Code (IRC) provisions in effect at the time. Tax gap estimates provide the Internal Revenue Service (IRS) with periodic appraisals about the nature and extent of noncompliance for use in formulating tax administration strategies.

Individual refundable income tax credits feature eligibility rules that are often complex because they must address complicated family relationships and residency arrangements. Compliance with these rules is difficult for the IRS to verify due to the lack of available third-party data. The relatively high over claim rates for these credits are, in part, a result of this complexity.

Measuring and reporting on taxpayer compliance related to various tax provisions is inherently complex and challenging. To measure overall compliance with the current tax system, the IRS develops estimates of the tax gap. The IRS also undertakes analyses of compliance behavior with respect to specific tax provisions, such as refundable and non-refundable tax credits. The IRS enforcement strategies and the Administration's legislative proposals are influenced by its National Research Program (NRP) that involves conducting detailed audits of a statistically representative sample of taxpayers to estimate compliance with individual income tax provisions, and provides data on misreporting on voluntarily filed returns. Misreporting can be in favor of the taxpayer or the government, although estimates indicate that taxpayers overall underreport tax. This can manifest as either underpayments of the liability due at the time the return is filed, claiming and receiving an excessive refund, or a combination of the scenarios.

### Tax Gap Estimates

The gross tax gap is the amount of tax liability that is not paid voluntarily and on time. The estimated annual average gross tax gap for the Tax Year (TY) 2008 – 2010 timeframe is $458 billion. The net tax gap is the gross tax gap less tax that will be subsequently collected, through voluntary payments or as the result of IRS administrative and enforcement activities. It is the portion of the gross tax gap that will not be paid. It is estimated that $52 billion of the gross tax gap will eventually be collected, resulting in a net tax gap of $406 billion.

The IRS estimates the tax gap on a periodic basis. The most recent estimates covering the TY 2008 – 2010 timeframe were released in Fiscal Year (FY) 2016. A summary of those estimates was included in the FY 2016 Agency Financial Report (AFR). The IRS expects to release tax gap estimates covering the TY 2011 – 2013 timeframe in FY 2019.

More details on the tax gap can be found in documents on the IRS website at www.IRS.gov:

- Description of the Tax Gap (https://www.irs.gov/uac/the-tax-gap); and
- Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2008 – 2010 (https://www.irs.gov/pub/irs-soi/p1415.pdf).

The tax gap structure separates noncompliance into components by the type of tax and source of noncompliance. The three primary sources of noncompliance that result in payment of less than the tax owed are: (1) the non-filing tax gap (the tax not paid on time by those who do not file required returns on time); (2) the underreporting tax gap (the net understatement of tax on timely filed returns); and (3) the underpayment tax gap (the amount of tax reported on timely filed returns that is not paid on time). The estimated gross tax gap for each of these components are $32 billion, $387 billion, and $39 billion, respectively. The gross tax gap estimates can also be grouped by type of tax. The estimated gross tax gap for individual income tax is $319 billion, for corporation income tax is $44 billion, for employment tax is $91 billion, and for estate and excise tax combined is $4 billion.

Total tax credits account for the second largest share (15 percent) of the individual income tax underreporting tax gap. Earned Income Tax Credit (EITC) accounts for 10 percent of the individual income tax underreporting tax gap, followed by the refundable and non-refundable child tax credit (three percent), and the refundable and non-refundable education credits (two percent). With limited resources, the IRS must make prudent resource-allocation decisions to address noncompliance.

### INDIVIDUAL INCOME TAX UNDERREPORTING TAX GAP ESTIMATES FOR CREDITS: TY 2008 – 2010 ($ IN BILLIONS) (1)

| Tax Return Line Items | Tax Gap | Share of Individual Income Tax Underreporting Tax Gap | Share of Gross Tax Gap |
|---|---|---|---|
| Gross Tax Gap | $458 | N/A | 100% |
| Individual Income Tax Underreporting Tax Gap | $264 | 100% | 58% |
| Total Credits | $ 40 | 15% | 9% |
| Child Tax Credit and Additional Child Tax Credit | $ 7 | 3% | 2% |
| EITC | $ 27 | 10% | 6% |
| Education Credits | $ 4 | 2% | 1% |
| All Other Credits | $ 2 | 1% | (2) |

(1) The estimates are the annual averages for the TY 2008 – 2010 timeframe.

(2) Less than 0.5 percent

Note: Components might not sum to totals because of rounding.

## Tax Gap Estimation Methodology

Estimating the tax gap is inherently challenging and requires assessing alternative methods, assumptions, and data sources. There is no single approach for estimating all the components of the tax gap. Each approach to estimating the tax gap is subject to non-sampling error. The uncertainty of the estimates is not readily captured by standard errors that typically accompany estimates based on sample data. For that reason, standard errors, confidence intervals, and statistical comparisons across years are not reported.

Unlike prior tax gap estimates that pertain to a single tax year, these estimates reflect an estimated average compliance rate and associated average annual tax gap for the TY 2008 – 2010 timeframe. The tax gap is estimated using pooled individual income tax compliance data from several tax years because the aggregated data provides more information upon which to base estimates of individual income tax underreporting, categorized by sources of noncompliance. The individual income tax NRP reporting compliance studies are the foundation for the individual income tax underreporting tax gap estimates. The methodology incorporates additional data and analytical techniques designed to account for income that is not detected by the NRP audits.

## COMPLIANCE WITH INDIVIDUAL INCOME TAX CREDITS

### Compliance Estimates

The IRS is responsible for administering 21 refundable and non-refundable individual income tax credits. These credits generally have many different eligibility rules, often relating to personal family and living arrangements, which determine eligibility. Complexity in the form of many differing rules is a contributor to tax credit errors. Additionally, these credits are difficult for the IRS to verify due to the lack of available relevant third-party data.

The IRS conducted an in-depth analysis of Child Tax Credit (CTC) compliance during the past fiscal year, highlights of which are summarized below. The IRS also completed an analysis of compliance with the EITC in FY 2014, and plans to analyze compliance with the American Opportunity Tax Credit (AOTC) and other education credits in FY 2018. Compliance with the *Patient Protection and Affordable Care Act* (ACA) Premium Tax Credit (PTC) will be reported once data become available (expected late calendar year 2018).

### Compliance Estimates for the Child Tax Credit

The IRS recently completed an analysis of taxpayer compliance behavior regarding the refundable and non-refundable components of the CTC. The refundable portion of the credit is referred to as the Additional Child Tax Credit (ACTC). The non-refundable portion of the credit is often referred to as the CTC, including on the Form 1040. For purposes of this analysis, CTC refers to the combined amount of the refundable and non-refundable parts of the credit.

The analysis is based on data from the IRS NRP individual income tax reporting study. The total number of tax returns claiming the CTC was 31 million in TY 2006 and 35 million in TY 2011. The aggregate dollar amount of CTC claims was $46 billion in TY 2006 and $55 billion in TY 2011. The increase in claims for the CTC occurred primarily in TY 2008 and TY 2009, due to the expansion of eligibility for the ACTC associated with lowering the earned income threshold in those two years. Total dollars of overclaims averaged $6.2 billion annually in TY 2006 – 2008 and $10.5 billion annually in TY 2009 – 2011. The dollar overclaim percentage for the CTC averaged 13 percent in TY 2006 – 2008 and 20 percent in TY 2009 – 2011. Qualifying child errors were the most frequent type of known error leading to a CTC overclaim. The percent of children claimed for the CTC who were disallowed for the credit was 13 percent in TY 2006 – 2008 and 19 percent in TY 2009 – 2011. During both time periods, qualifying child errors accounted for approximately 80 percent of overclaimed dollars, where the reason for the error was known.

### Relationship of Tax Compliance Estimation to Improper Payments

The *Improper Payment Elimination and Recovery Act of 2010* (IPERA) requires certain reporting for payment programs determined to be susceptible to significant improper payments. The focus of IPERA, and its subsequent amendments, and guidance documents, is on implementing internal controls to prevent and detect improper payments. IPERA does not take into consideration all aspects of administering tax provisions in a system that relies heavily on voluntary reporting. In keeping with IPERA requirements, the IRS has historically reported risk assessments for refundable credits, as well as improper payment estimates for the EITC in Part 3, Section E of this report.

The IRS has followed this practice largely because refundable credits may result in a payment to the taxpayer in excess of tax liability. However, the distinction between the portion of a credit that offsets tax liability and the portion that is refundable is governed by multiple variables, including other return elements and information provided by the taxpayer, some of which are unrelated to the refundable credit in question. Evaluating only the refunded portion of a credit offers little insight into where tax compliance occurs or how the IRS should address compliance problems. In improper payment reporting, the IRS reports on the EITC in its entirety without regard to whether errors are the result of complexity in the tax code, taxpayer behavior, or the IRS's processes, and despite the fact that amounts of tax offset by the credit are currently considered negative revenue receipts.

The same features of the tax system and taxpayer behaviors that create the compliance problems with refundable credits also create the risk of noncompliance with other tax provisions. Treasury and IRS analyses, as well as audits by the Government Accountability Office (GAO) and Treasury Inspector General for Tax Administration (TIGTA), have consistently found that payment errors for EITC and other tax credit programs are largely attributable to the statutory design and complexity of the credits within the tax system, and not rooted in internal control weaknesses, financial management or financial reporting deficiencies. Several credits passed into law by Congress to assist certain individuals and businesses to promote social and economic objectives have eligibility rules that are often complex and lead to high overclaim rates.

Tax refunds, which constitute a transfer of cash from the federal government to a taxpayer, are an integral part of the tax system as a whole. The IRS tax gap estimation measures compliance with the current tax system and always includes noncompliance with refundable and non-refundable credits. Whether a tax credit results in a refund instead of a reduction in tax liability depends on all of the taxpayers' characteristics, such as income, deductions, and other credits claimed, and is not simply driven by the credit itself.

## Refundable Credits and the Challenges of Compliance

Eligibility rules for refundable tax credits contribute to the compliance burden for taxpayers and administrative costs for the IRS. These rules differ by credit and are often complex because they must address complicated family relationships and residency arrangements to determine eligibility. The relatively high overclaim error rates for these credits are a result, in part, of this complexity. Additionally, the lack of third-party data to verify eligibility requirements for these refundable credits also complicates the ability of the IRS to administer these credits. Such data may not exist, may be unreliable or inaccurate, or may be reported to the IRS too late to be useful during tax return processing. The IRS also has limited authority to correct mismatches at filing and must use more burdensome audits to correct errors. The IRS continually looks for complete and accurate data sources to verify eligibility for claimed refundable credits without placing an undue burden on taxpayers.

The *Protecting Americans from Tax Hikes* (PATH) Act accelerated the due date for employers to submit Forms W-2 and Forms 1099 for non-employee compensation. The PATH Act also included a provision that required the IRS to hold refunds for filers claiming the EITC and the refundable portion of the CTC until February 15. The IRS integrated the Form W-2 information into its databases, leveraged pre-refund filtering processes for identity theft prevention, and employed refund fraud systems to screen all returns. This provided the IRS additional time to perform income verification for the EITC and ACTC returns.

Faced with the complexities of claiming certain refundable credits, many potential credit recipients seek help filing their tax returns from paid preparers. Over 50 percent of taxpayers claiming refundable credits use paid preparers. Although these preparers provide a service that relieves taxpayers of costs associated with their own time, resources, and anxiety about the accuracy of their returns, these services carry their own burden for taxpayers. For example, taxpayers must absorb the cost of preparer fees and must still face the risk of errors on their returns. Unenrolled paid preparers, who prepare most EITC returns, are not subject to the IRS's regulation and have higher error rates for EITC returns than taxpayers who prepare their own returns or who hire enrolled paid preparers.

The nature of refundable credits also attracts identity theft fraud. The fraudsters create a burden to taxpayers who must navigate identity theft procedures to successfully file their own returns. This includes use of an identity theft personal identification number and filing of affidavits with the IRS to prove identity theft.

The IRS has a responsibility to detect and address errors and misreporting on tax returns, including those claiming the refundable credits. Filters and other detection tools are constantly being enhanced to improve accuracy and reduce taxpayer burden, but in some instances, enforcement activities must take place. The IRS rejects millions of electronically filed returns claiming refundable credits for a variety of reasons, such as missing forms, incorrect Social Security Numbers (SSNs), or if another taxpayer has claimed the same child. Most taxpayers can correct their electronic returns and successfully re-file with little burden. In some cases, a taxpayer must print and send in their paper return, resulting in refund delays and possible audits with the associated costs. Despite the compliance burden and costs associated with these refundable tax credits, the burden to taxpayers may be lower than with other payment or benefit programs. For example, tax credit recipients can self-certify; they do not need to meet with caseworkers, nor submit upfront documentation as is required with some direct service anti-poverty programs, such as Supplemental Security Income (SSI) or Temporary Assistance for Needy Families (TANF).

The IRS may initiate a correspondence audit if it identifies, through its scoring and selection process, potential noncompliance with eligibility requirements. Most refundable credit audits are conducted pre-refund, meaning the IRS holds the credit refund until the taxpayer proves eligibility. The IRS sends a letter to the taxpayer requesting documentation showing that the taxpayer meets credit eligibility requirements. In addition to the refund delay, taxpayers face the burden of gathering and sending in the requested information. In FY 2017, the IRS conducted over 327,000 EITC exams, the majority through correspondence audits.

Sustained annual budget reductions at the IRS have heightened the importance of determining how best to allocate finite, declining resources to ensure the IRS can still meet agency-wide strategic goals of increasing taxpayer compliance, using resources more efficiently, and minimizing taxpayer burden.

## TAX BURDEN

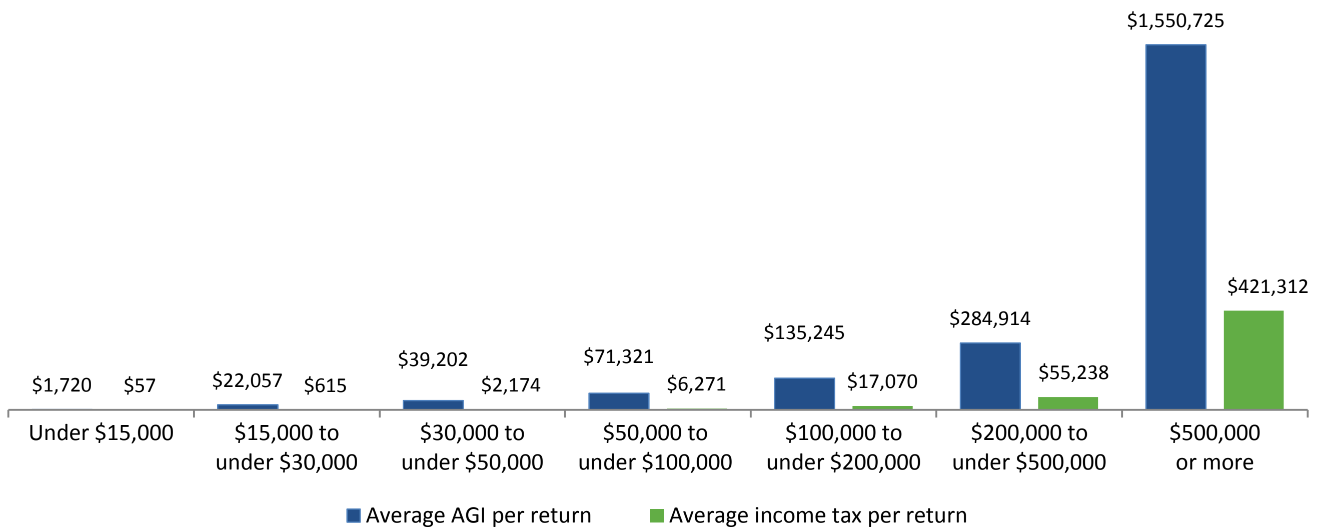
The IRC creates the basis for a progressive tax system that applies higher rates of taxation to progressively higher levels of income. For TY 2016, individual income tax rates ranged from 10.0 percent for the lowest income filers to 39.6 percent for the highest income brackets. The amount of taxable income can be adjusted through the application of exemptions and deductions, which will influence the amount of taxes owed. In addition, many taxpayers qualify for one or more refundable tax credits, which collectively have a significant impact on tax administration and federal tax revenues and refund payments.

The IRS measures tax liability by income level for individuals and by revenue and assets for corporations. Using these data, it is possible to illustrate how tax liability rises with increases in Adjusted Gross Income (AGI) for individuals

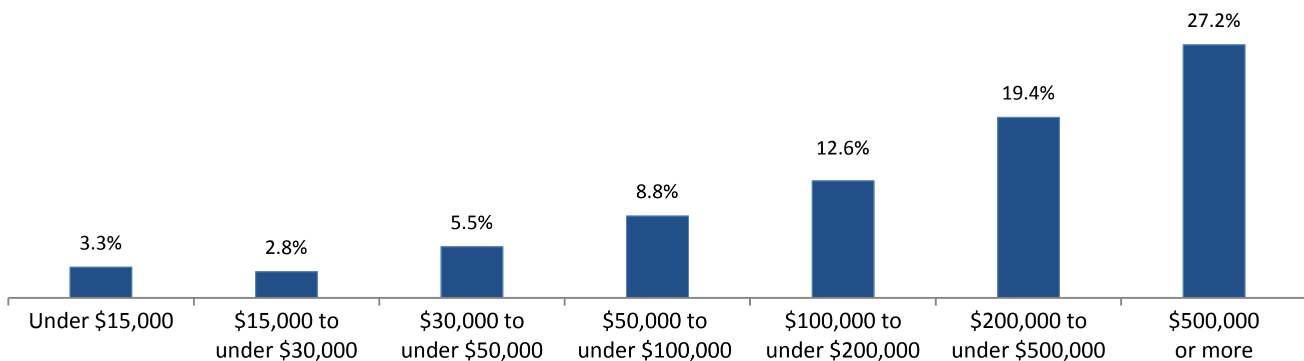
(Figures 1.1 and 1.2 and Table 1). Similar data for corporations shows the tax burden based on the percentage of taxable income (Figure 2 and Table 2). This information is the most recent data available for individuals (TY 2015) and corporations (TY 2014).

## INDIVIDUAL INCOME TAX LIABILITY

### FIGURE 1.1: AVERAGE AGI REPORTED AND AVERAGE INDIVIDUAL INCOME TAX LIABILITY FOR TY 2015




### FIGURE 1.2: INDIVIDUAL INCOME TAX LIABILITY AS A PERCENTAGE OF AGI FOR TY 2015

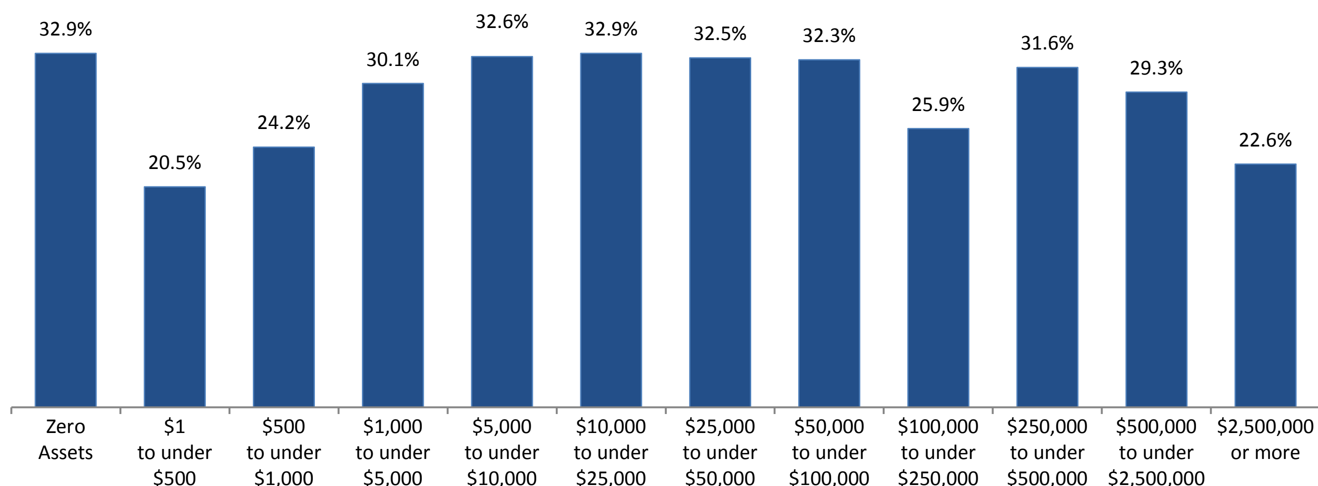


## TABLE 1: INDIVIDUAL INCOME TAX DATA BY AGI FOR TY 2015

| Adjusted Gross Income (AGI) | Number of taxable returns (in thousands) | AGI (in millions) | Total income tax (in millions) | Average AGI per return (in whole dollars) | Average Income tax per return (in whole) dollars) | Income tax as a percentage of AGI |
|---|---|---|---|---|---|---|
| Under $15,000 | 35,824 | $ 61,630 | $ 2,033 | $ 1,720 | $ 57 | 3.3% |
| $15,000 under $30,000 | 30,043 | 662,661 | 18,468 | 22,057 | 615 | 2.8% |
| $30,000 under $50,000 | 26,539 | 1,040,372 | 57,698 | 39,202 | 2,174 | 5.5% |
| $50,000 under $100,000 | 32,802 | 2,339,474 | 205,693 | 71,321 | 6,271 | 8.8% |
| $100,000 under $200,000 | 18,533 | 2,506,498 | 316,350 | 135,245 | 17,070 | 12.6% |
| $200,000 under $500,000 | 5,428 | 1,546,515 | 299,832 | 284,914 | 55,238 | 19.4% |
| $500,000 or more | 1,324 | 2,053,160 | 557,817 | 1,550,725 | 421,312 | 27.2% |
| **Total** | **150,493** | **$ 10,210,310** | **$ 1,457,891** | | | |

## CORPORATION TAX LIABILITY

### FIGURE 2: CORPORATION TAX LIABILITY AS A PERCENTAGE OF TAXABLE INCOME FOR TY 2014 DATA




### TABLE 2: CORPORATION TAX DATA BY TOTAL ASSETS FOR TY 2014

| Total Assets (in thousands) | Income subject to tax (in millions) | Total income tax after credits (in millions) | Percentage of income tax after credits to taxable income |
|---|---|---|---|
| Zero Assets | $ 16,236 | $ 5,347 | 32.9% |
| $1 under $500 | 8,728 | 1,786 | 20.5% |
| $500 under $1,000 | 3,787 | 918 | 24.2% |
| $1,000 under $5,000 | 13,567 | 4,080 | 30.1% |
| $5,000 under $10,000 | 8,587 | 2,802 | 32.6% |
| $10,000 under $25,000 | 13,741 | 4,526 | 32.9% |
| $25,000 under $50,000 | 12,827 | 4,170 | 32.5% |
| $50,000 under $100,000 | 15,225 | 4,919 | 32.3% |
| $100,000 under $250,000 | 32,119 | 8,303 | 25.9% |
| $250,000 under $500,000 | 29,921 | 9,453 | 31.6% |
| $500,000 under $2,500,000 | 120,328 | 35,316 | 29.3% |
| $2,500,000 or more | 1,126,109 | 254,458 | 22.6% |
| **Total** | **$ 1,401,175** | **$ 336,078** | |

# SECTION B: REDUCE THE FOOTPRINT

One of our key goals is the efficient and effective acquisition, utilization, management, and disposal of our real property assets. The Assistant Secretary for Management (ASM) is responsible for ensuring that we develop and maintain appropriate procedures, reviews, and reporting requirements in accordance with Treasury directives, as well as applicable OMB and General Service Administration (GSA) regulations that pertain to the acquisition, utilization and disposal of real property.

The ASM is responsible for tracking our real property square footage footprint and developing the annual agency evaluation of compliance for the implementation of the *Reduce the Footprint Policy*. To ensure the optimal utilization of our existing space inventory, and to achieve real property cost saving and footprint reductions, we direct our components to pursue consolidation or co-location opportunities into existing inventory before pursuing any new space acquisitions.

Additionally, we are taking other actions to reduce overall square footage and reduce the related costs associated with real property, including:

- Better utilizing real property by undertaking space realignment;
- Increasing teleworking, hoteling, and workspace sharing; and
- Maximizing utilization through improved workstation standards.

Our total square footage and related operation and maintenance costs associated with real property assets subject to the *Reduce the Footprint Policy* (from the latest available FY 2016 reporting compared to the FY 2015 Reduce the Footprint baseline, as assigned by GSA) are shown in the table below. We did not have excess domestic office or warehouse assets, as reflected in the below table:

| (in millions) | 2015 (Baseline) | 2016 | Change |
|---|---|---|---|
| Square Footage | 26.9 | 26.4 | (0.5) |
| Operation and Maintenance Costs | $ 93.0 | $ 91.9 | $ (1.1) |

# SECTION C: MANAGEMENT CHALLENGES

In accordance with the *Reports Consolidation Act* of 2000, the Inspectors General are required to identify specific management and performance challenges facing the Department. At the end of each fiscal year, the Treasury Office of Inspector General (OIG) and TIGTA send an update of these management challenges to the Secretary of the Treasury (hereafter referred to as "Secretary") and cite any new challenges for the upcoming fiscal year. The Special Inspector General for the Troubled Asset Relief Program (SIGTARP) did not identify any management or performance challenges for the Office of Financial Stability (OFS). This section contains the management and performance challenges reported by OIG and TIGTA.

## TREASURY INSPECTOR GENERAL MANAGEMENT CHALLENGES

OFFICE OF
INSPECTOR GENERAL

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

October 16, 2017

INFORMATION MEMORANDUM FOR SECRETARY MNUCHIN

**FROM:** Eric M. Thorson /s/
Inspector General

**SUBJECT:** Management and Performance Challenges Facing the Department of the Treasury (OIG-CA-18-002)

In accordance with the Reports Consolidation Act of 2000, we are providing you with our perspective on the most serious management and performance challenges facing the Department of the Treasury (hereinafter Treasury or the Department).

We are reporting four challenges of which one is new and three are updated from last year.

- Operating in an Uncertain Environment (New Challenge)
- Cyber Threats
- Anti-Money Laundering and Terrorist Financing/Bank Secrecy Act Enforcement
- Efforts to Promote Spending Transparency and to Prevent and Detect Improper Payments

This year, we removed "Management of Treasury's Authorities Intended to Support and Improve the Economy" that was reported as a challenge in the prior year's memorandum. We had reported this as a challenge for the past several years as Treasury has had to administer large dollar initiatives related to authorities created to address the financial crisis as enacted under the Housing and Economic Recovery Act of 2008, the American Recovery and Reinvestment Act of 2009, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), and the Small Business Jobs Act of 2010. In addition, Treasury was given authority under the Resources and Ecosystems Sustainability, Tourist Opportunities, and Revived Economies of the Gulf Coast States Act of 2012 to address the specific economic and environmental restoration of the Gulf Coast region. We no longer consider Treasury's management of these authorities as a continuing challenge since the offices and programs established to implement and administer the requirements have been in place for a number of years and several programs are reaching maturity.

In addition to the above challenges, we continue to report our elevated concerns about two matters: currency and coin production and documenting key activities and decisions.

### 2018 Management and Performance Challenges

### Challenge 1: Operating in an Uncertain Environment

In assessing the Department's most serious challenges, we remain mindful of external factors and future uncertainties that affect its operations. Most notable are the proposed budget cuts and new requirements imposed by Executive Order (E. O.) 13781, *Comprehensive Plan for Reorganizing the Executive Branch* (March 13, 2017). In its implementation of E. O. 13781, the Office of Management and Budget (OMB) required agencies to submit Agency Reform Plans, which include long-term workforce plans and that are in alignment with their strategic plans, to OMB concurrently with their fiscal year 2019 budget requests. These plans are to include proposals in four categories: eliminate activities; restructure or merge; improve organizational efficiency and effectiveness; and workforce management. After consideration of all Agency Reform Plans, OMB intends to work with agencies in developing crosscutting reform proposals that involve multiple agencies,

which could include merging agencies, components, programs, or activities that have similar missions. These proposals, along with the agency plans and public input, will be used by OMB in developing its comprehensive Government–wide Reform Plan to reorganize the Executive Branch.[1]

Needless to say, OMB's Government–wide Reform Plan may significantly impact the administration of the Department's programs and operations. With looming uncertainties as to the impact of the plan, the Department must plan for the potential long-term restructuring of certain functions or offices/bureaus and/or budget cuts. This may require the Department to take immediate actions to achieve near-term cost savings while focusing its limited resources on programs that are in the highest need to citizens and/or where there is a unique Federal role. That said, it is also essential that these reforms be managed and communicated effectively such that performance and accountability can be improved and missions can still be met throughout the Department.

Another related uncertainty facing the Department involves the repeated cycle of budget and debt ceiling stopgaps. As I reported in my last memorandum to you, Congress has yet to resolve unfinished business when it comes to the Nation's debt, and the long-term sustainability of the large programs. Although legislation was passed to temporarily extend the debt limit until December 8, 2017, no long-term solution has been found.

Tackling these more critical matters at hand could be more challenging as several Presidentially-appointed, Senate-confirmed leadership positions within Treasury remain vacant since January 2017. Further complicating this, the Federal Vacancies Reform Act of 1998 requires executive branch agencies to report to Congress and the Government Accountability Office (GAO) information on the temporary filling of executive agencies' vacant Presidentially-appointed, Senate-confirmed positions. The Department will soon, if not already, reach the 210 day provisions for some temporary acting positions.

**Challenge 2: Cyber Threats**

Cybersecurity is a long-standing and serious challenge facing the Nation today. A reliable critical infrastructure, including information systems and networks, is vital to our national security and economic stability. Cyber threats are a persistent concern as Treasury's information systems are critical to the core functions of government and the Nation's financial infrastructure. As cyber threats continue to evolve and become more sophisticated and subtle, they pose an ongoing challenge for Treasury to fortify and safeguard its internal systems and operations and the financial sector it oversees. Effective public-private coordination continues to be required to address the cyber threat against the Nation's critical infrastructure. In this regard, Treasury is looked upon to provide effective leadership to financial institutions in particular, and the financial sector in general, to strengthen awareness and preparedness against cyber threats.

Attackers frequently exploit vulnerable networks in a string of trusted connections to gain access to government systems. Attempted cyber-attacks against Federal agencies, including Treasury, and financial institutions are increasing in frequency and severity, and continue to evolve at an accelerated rate. Such attacks include distributed denial of service attacks, phishing or whaling attacks, fraudulent wire payments, malicious spam (malspam), and ransomware. Organized hacking groups leverage published and unpublished vulnerabilities and vary their methods to make attacks hard to detect and even harder to prevent. Criminal groups and nation-states are constantly seeking to steal information; commit fraud; and disrupt, degrade, or deny access to information systems. In addition to Treasury's own networks and systems, management must be cognizant of, and mitigate, the risks posed by attacks made against other agencies and Treasury contractors and subcontractors. Treasury frequently enters into interconnection agreements with other Federal, State, and local agencies, and service providers, to conduct its business. Treasury management must exercise due care when authorizing such internetwork connections and verify that third parties comply with Federal policies and standards. Management is also challenged with ensuring that critical data and information maintained by cloud service providers are properly protected.

Ensuring the government has a sufficient number of cybersecurity professionals is an ongoing challenge that was reported by GAO not long ago.[2] Similarly, the results of OMB's Cybersecurity Sprint identified the lack of cybersecurity and information technology talent as a major resource constraint for Federal agencies. The cybersecurity sprint highlighted the need for agencies to improve recruitment, retention, and training of their information technology workforce. In our audits of select Treasury bureaus, we continue to find that causes for many of our findings related to information systems'

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[1] OMB, M-17-22, *Comprehensive Plan for Reforming the Federal Government and Reducing the Federal Civilian Workforce* (April 12, 2017)

[2] GAO, *Actions Needed to Address Challenges* (GAO-16-885T; issued September 19, 2016)

security measures involved a lack of resources and/or management oversight, which echoed GAO and OMB's observations of agencies' impairments. I would like to note that my office has not been immune from these same difficulties as overseeing Treasury's cyber and information security programs becomes increasingly challenging with our current resources.

**Challenge 3: Anti-Money Laundering and Terrorist Financing/Bank Secrecy Act Enforcement**

As previously reported, identifying, disrupting, and dismantling the financial networks that support terrorists, organized transnational crime, weapons of mass destruction proliferators, and other threats to international security continue to be challenging. Treasury's Office of Terrorism and Financial Intelligence (TFI) is dedicated to disrupting the ability of terrorist organizations to fund such activities through intelligence analysis, sanctions, and international private-sector cooperation that identify donors, financiers, and facilitators funding terrorist organizations.

TFI's ability to effectively gather and analyze intelligence information on financial crimes and terrorism requires a stable cadre of staff. Concerns over TFI's ability to meet mission critical objectives are heightened by multiple vacant key positions. Some key leadership positions have been vacant for a number of years, including the Director of the Financial Crimes Enforcement Network (FinCEN), the Assistant Secretary of Intelligence and Analysis, and Deputy Assistant Secretaries. Because of TFI's complementary missions in intelligence gathering and coordination with international and domestic intelligence and law enforcement entities, stability and coordination within TFI is imperative to reduce duplication, enhance information gathering and intelligence analysis, and increase efficiency.

Major challenges for the U.S. and Treasury involve stopping the Islamic State of Iraq and Syria (ISIS), rogue regimes and countries, and other bad actors who want to harm people and properties and disrupt the global financial system. Stopping ISIS depends on a whole-of-government approach to combating terrorism and other illicit financing and requires collaboration and coordination within Treasury and with other Federal agencies. Coordination and collaboration are key to successfully tracking and disrupting terrorist and other criminal networks and requires TFI regularly work with interagency partners to leverage diplomatic engagement, regulatory and law enforcement, and intelligence collection and analysis tools. The effort to disrupt ISIS requires an effective and efficient working relationship within TFI, including FinCEN and the Office of Foreign Assets Control (OFAC).

OFAC's administration of U.S. sanction programs is constantly evolving. Most notable were the significant changes to the Iran and Cuba sanction programs. Trade sanctions with Cuba has eased some since 2014 resulting from a regime change and improved relations. The U.S. eased nuclear-related sanctions with Iran, but continued imposing sanctions made pursuant to existing laws and related to Iran's human rights policies, support for terrorism, interference in specified countries in the region, and missile and advanced conventional weapons programs. The sanctions continue to bar U.S. individuals and entities from most forms of investment in or trade with Iran. In other areas, the U.S. has increased sanctions against the North Korea for missiles testing and Russia for its assertiveness towards other countries, including the U.S.

Enhancing the transparency of the financial system is one of the cornerstones of the effort to disrupt the ability of terrorist organizations. FinCEN faces continuing challenges to enhance financial transparency and strengthen efforts to combat financial crime and collect, analyze, and report data on national and international threats. FinCEN has focused on enhancing enforcement efforts through compliance with the Bank Secrecy Act (BSA) in partnership with Federal banking regulators and law enforcement. FinCEN's key initiatives to strengthen financial transparency include, among other things, issuing rules and regulations such as the Customer Due Diligence rule that required financial institutions to identify beneficial ownership of financial accounts of legal entity customers. FinCEN is also challenged with providing clarifying guidance to financial institutions that are reluctant to do business with State-legalized marijuana dispensaries. While these dispensaries remain illegal under Federal law, increasingly, states have passed laws allowing businesses to dispense marijuana. Other areas of concern for FinCEN include the increasing use of (1) mobile banking, internet banking, internet gaming, and peer-to-peer transactions; and (2) money service businesses, including virtual currency administrators and exchanges.[3] FinCEN and other regulatory agencies will need to ensure that providers of these services who are covered by BSA understand their obligations to report information to FinCEN.

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[3] Bitcoins are an example of a virtual currency. These consist of a series of numbers created automatically on a set schedule and traded anonymously between digital addresses or "wallets." Certain exchange firms buy or sell Bitcoins for legal tender at a rate that fluctuates with the market. Congress and regulators continue their efforts to determine the legality, legitimacy, and regulatory framework for virtual currencies such as Bitcoins.

Given the criticality of Treasury's mission to combat terrorist financing and money laundering, we continue to consider anti-money laundering and combating terrorist financing programs and operations as inherently high-risk.

**Challenge 4: Efforts to Promote Spending Transparency and to Prevent and Detect Improper Payments**

Spending Transparency

Treasury continues to make progress in its Government-wide and Department-wide implementation of the Digital Accountability and Transparency Act of 2014 (DATA Act). The DATA Act requires the Federal Government to provide consistent, reliable, and useful online data about how it spends taxpayer dollars. To fulfill its purposes, the DATA Act imposed several mandates on the Director of OMB, the Secretary of the Treasury, the Inspector General of each Federal agency, and the Comptroller General of the United States. Several of these mandates have already been successfully met. As required within one year after enactment, on May 8, 2015, OMB and Treasury standardized 57 Government-wide financial data elements for Federal funds made available to or expended by Federal agencies and entities receiving Federal funds.

On May 9, 2017, Treasury, in consultation with OMB, met its second mandate to ensure that financial data was posted, in accordance with the financial data standards established by Treasury and OMB, and displayed on USAspending.gov[4] within two years after enactment of the DATA Act.

While there have been reported successes to date, OMB and Treasury must still ensure the data standards established are applied to the data made available on USAspending.gov by May 2018. The Department continues to make progress in its efforts to comply with the DATA Act by executing its comprehensive implementation plan that conforms to the Government-wide technical and informational guidance issued by OMB and Treasury. Given the broad implications and critical roles assigned to Treasury by the DATA Act, we consider this an ongoing high risk implementation project and management challenge.

It should be noted that we have initiated a series of audits of Treasury's efforts to meet its responsibilities under the DATA Act. As of this writing, we are performing two DATA Act audits focusing on Treasury's (1) Government-wide implementation efforts, and (2) Department-wide implementation efforts.

Detect Improper Payments

In light of the continuing problem with improper payments (estimated at $144 billion, or 4.67 percent of all program outlays, for fiscal year 2016), the Federal Government has intensified efforts to reduce improper payments in major Federal programs. The Do Not Pay Initiative and the Treasury Bureau of the Fiscal Service's (Fiscal Service) Do Not Pay Business Center are chief components of efforts designed to prevent and detect improper payments to individuals and entities.

The Do Not Pay Business Center provides two services to agencies: the Do Not Pay Portal and the Do Not Pay Data Analytics Service. The Do Not Pay Portal is intended to provide users with a single entry point to search data sources such as the Social Security Administration's (SSA) publicly available Death Master File, the Department of Health and Human Service Office of Inspector General's List of Excluded Individuals/Entities, the General Services Administration's System for Award Management, and Treasury's Debt Check Database. However, as we reported in November 2014, the effectiveness of the Do Not Pay Business Center as a tool to prevent and detect improper payments is hindered because the center does not have access to, among other things, SSA's full death data.[5] In October 2016, GAO reported that restrictions on the center's access to SSA's full death data remained in place.[6]

The Do Not Pay Data Analytics Service supports agencies' efforts to identify and prevent improper payments by identifying trends and patterns in agency payment and other information that may be indicative of improper payments. The results of these analyses are provided to agencies at no cost for further study so they can prevent future improper

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[4] In May 2017, Treasury launched a new version of USAspending.gov, currently referred to as Beta.USAspending.gov, which is being run parallel to USAspending.gov to minimize disruptions to users' access and add system enhancements. Treasury intends to retire the legacy USAspending.gov in fall 2017.

[5] OIG, *Fiscal Service Successfully Established the Do Not Pay Business Center But Challenges Remain* (OIG-15-006; November 6, 2014)

[6] GAO, *Improper Payments, Strategy and Additional Actions Needed to Help Ensure Agencies Use the Do Not Pay Working System as Intended* (GAO-17-15; issued October 14, 2016)

payments. We have on-going audit work assessing the services provided to agencies by the Do Not Pay Data Analytics Service.

With its potential to reduce improper payments, the Do Not Pay Business Center is a major and important undertaking by Fiscal Service and Treasury. As part of our ongoing audit work in this area, we will continue to monitor the steps taken by Fiscal Service to improve the effectiveness of the Do Not Pay Business Center. We are also planning to review the Do Not Pay Program's data analytic capabilities during the coming fiscal year.

**Other Matters of Concern**

Although we are not reporting these as management and performance challenges, we are highlighting two areas of concern that are repeated from last year's letter: (1) currency and coin production, and (2) documenting key activities and decisions.

Currency and Coin Production

Challenges continue to exist with coin and currency production at the Bureau of Engraving and Printing (BEP) and the United States Mint (Mint). In the case of the Mint, the costs of producing penny and nickel coins were double their face value because of rising metal prices resulting in higher production costs. The Mint continues to review U.S. currency to include the production and use of coins, the use of alternative metals, and the suitability of Mint facilities for production. The Mint must also ensure strong internal controls are in place to safeguard the integrity and protect U.S. coinage. This is done by preventing the acceptance of illegitimate coinage under its redemption program which is planned to be reinstated in 2017, as well as maintaining proper physical security at all Mint facilities. For BEP, it is imperative that effective project management practices are applied to thwart counterfeiters and identify and implement counterfeit deterrence features in a timely manner to safeguard U.S. currency from this significant threat.

In addition, BEP and the Mint need to consider the effect of alternative payment methods and other technological advances (such as stored value cards, the Internet, smartphones, and virtual currencies) as well as consumer demand on their respective business models, practices, future planning and interactions with their customers, and the Federal Reserve Bank.

Documenting Key Activities and Decisions

Over the years, my office repeatedly cites the Department's and bureaus' lapses in maintaining a complete and concurrent record of key activities and decisions. This continues to be identified as a problem as reported in our more recent audits of Fiscal Service's selection of a financial agent in its rebid of the Direct Express® Debit MasterCard,® the Office of the Comptroller of the Currency's supervision of banks' use of independent consultants, and FinCEN's case files supporting its Bank Secrecy Act enforcement actions.

We believe developing and maintaining proper documentation supports transparency and confidence in Treasury's decision making process. Maintaining proper documentation is a fundamental tenet of government accountability and transparency, and is in the best long-term interest of Treasury and its component offices and bureaus if actions are later questioned, as they have been.

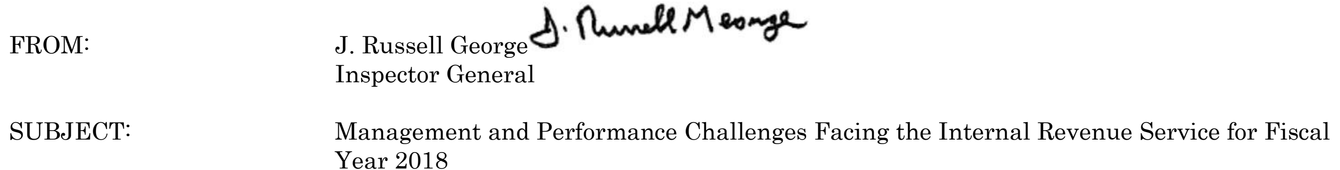
We would be pleased to discuss our views on the management and performance challenges and the other matters expressed in this memorandum in more detail.

cc: Kody H. Kinsley
Assistant Secretary for Management

# TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION MANAGEMENT CHALLENGES

October 13, 2017

MEMORANDUM FOR SECRETARY MNUCHIN



FROM: J. Russell George
Inspector General

SUBJECT: Management and Performance Challenges Facing the Internal Revenue Service for Fiscal Year 2018

The Reports Consolidation Act of 2000[1] requires that the Treasury Inspector General for Tax Administration (TIGTA) summarize, for inclusion in the annual *Department of the Treasury Agency Financial Report*, its perspective on the most serious management and performance challenges confronting the Internal Revenue Service (IRS).

Each year, TIGTA evaluates IRS programs, operations, and management functions to identify the areas of highest vulnerability to the Nation's tax system. For Fiscal Year (FY) 2018, the IRS's top management and performance challenges, in order of priority, are:

1. Security Over Taxpayer Data and Protection of IRS Resources;
2. Identity Theft and Impersonation Fraud;
3. Providing Quality Taxpayer Service and Expanding Online Services;
4. Upgrading Tax Systems;
5. Implementing Tax Law Changes;
6. Improving Tax Compliance;
7. Reducing Fraudulent Claims and Improper Payments;
8. Impact of Global Economy on Tax Administration;
9. Protecting Taxpayer Rights; and
10. Achieving Program Efficiencies and Cost Savings.

TIGTA's assessment of the major IRS management challenges for FY 2018 has changed from the prior fiscal year. The changes include reprioritizing challenges three through seven and revising three challenges to reflect the current nature of the challenges.

Although not listed separately, human capital is also a significant concern and it affects the IRS's ability to address the above challenges. It remains a serious, underlying issue with wide-ranging implications for both the IRS and taxpayers. Between FYs 2011 and 2016, the IRS budget decreased by more than $900 million and it lost approximately 12,000 full-time equivalents, including many employees with substantial institutional knowledge and technical expertise. The IRS will continue to be challenged to allocate sufficient resources to deliver its priority program areas, including customer service and enforcement activities.

The following information detailing the management and performance challenges is provided to promote economy, efficiency, and effectiveness in the IRS's administration of the Nation's tax laws.

## SECURITY OVER TAXPAYER DATA AND PROTECTION OF IRS RESOURCES

The IRS relies extensively on its computer systems to support both its financial and mission-related operations. These computer systems collect and process large amounts of taxpayer data. However, the threat landscape continues to evolve and bad actors are persistent in their pursuit of monetary gain and identity information. Recent cyber events against the IRS have illustrated that these bad actors are continually seeking new ways to attack and exploit IRS systems and processes in order to access tax information for the purpose of identity theft and filing fraudulent tax refunds. From the

[1] 31 U.S.C. § 3516(d) (2006).

exploitation of IRS's Get Transcript application to the Data Retrieval Tool exploitation, the IRS has closed one systemic weakness only to find that criminals have discovered another means to access tax information from the IRS. In addition, the recent breach at Equifax that exposed sensitive personal information, including Social Security Numbers (SSN), could increase the risk of identity theft. As a result, we believe that protecting the confidentiality of taxpayer information will continue to be a top concern for the IRS.

TIGTA has assessed the IRS's electronic authentication platforms and made recommendations to develop a Service-wide strategy that establishes consistent oversight of all authentication needs across IRS functions and programs, ensures that the level of authentication risk for all current and future online applications accurately reflects the risk, and ensures that the authentication processes meet Government Information Security Standards.[2] The IRS continues to take steps in response to TIGTA's recommendations to provide more secure authentication, including the implementation of two-factor authentication and the strengthening of application and network controls.[3] However, we remain concerned about the IRS's logging and monitoring capabilities over all connections to IRS online services. TIGTA is currently assessing the IRS's efforts to improve its authentication processes and has identified areas in which the IRS still needs improvement.[4] Specifically, the IRS has still not fully implemented network monitoring tools designed to improve prevention and detection of automated attacks and is not effectively monitoring audit logs for suspicious activity. Due to the importance of secure authentication of individuals' identities, we are planning to conduct additional reviews in this area.

The IRS also shares sensitive data with various outside entities, including other Federal, State, and local agencies; financial institutions; and contractors for tax administration purposes. However, TIGTA found that the IRS did not ensure that encryption requirements are being enforced or that applicable protocols are being used to fully protect sensitive information during transmission.[5] In addition, the IRS did not remediate high-risk vulnerabilities or install security patches on its servers used to transmit data in a timely manner.

In addition to external threats, the IRS must ensure that its systems and data are protected against internal threats. These threats may appear in the form of malicious insiders or disgruntled employees who seek to misuse their access to taxpayer data or sensitive IRS business practices for personal gain. These threats may also come in the form of employees who unintentionally do something to create a security weakness that may be exploited by others or unnecessarily expose data to unauthorized disclosure. For example, audits of various internal systems have identified that users have been given more access privileges than their job requires, systems have not been updated with security patches on a timely basis, and high-risk security vulnerabilities have not been mitigated as required.[6]

Additionally, TIGTA's Office of Investigations' data analysis techniques have identified IRS employees who access taxpayer records without authorization and then use the information to engage in illegal activities. In one recent investigation, TIGTA identified an IRS employee who accessed thousands of names, dates of birth, and SSNs from IRS data systems and then filed hundreds of fraudulent returns that claimed more than $550,000 in fraudulent tax refunds. The IRS employee worked with two co-conspirators to cash the refunds.[7] As a result of TIGTA's investigation, the former employee was sentenced to serve over nine years in Federal prison and was ordered to pay more than $438,000 in restitution.[8] We believe that the IRS must make significant gains in its deployment of audit trails for all of its data systems to enable TIGTA and the IRS to identify IRS employees who abuse their access authority in order to steal or improperly manipulate taxpayer data.

Besides safeguarding a vast amount of sensitive financial and personal data, the IRS must also protect its employees and more than 550 offices. In the last several years, threats directed at the IRS have remained the second largest component of the Office of Investigations' work. Recent incidents involving taxpayers who threatened or assaulted IRS employees underscore the dangers that these employees face each day. For example, a taxpayer mailed a device to the IRS campus in Ogden, Utah in July 2017 that appeared to be a pipe bomb. This incident caused the IRS to shut down the campus while the bomb squad examined the device.[9] Physical violence, harassment, and intimidation of IRS employees continue to pose challenges to the implementation of a fair and effective system of tax administration.

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[2] TIGTA, Ref. No. 2016-40-007, *Improved Tax Return Filing and Tax Account Access Authentication Processes and Procedures Are Needed* (Nov. 2015).
[3] TIGTA, Ref. No. 2016-20-082, *Improvements Are Needed to Strengthen Electronic Authentication Process Controls* (Sept. 2016).
[4] TIGTA, Audit No. 201720004, *Review of E-Authentication to IRS Online Services*, report planned for October 2017.
[5] TIGTA, Ref. No. 2017-20-004, *Improvements Are Needed to Ensure the Protection of Data Transfers to External Partners* (Oct. 2016).
[6]TIGTA, Ref. No. 2017-20-061, *The External Network Perimeter Was Generally Secure, Though the Security of Supporting Components Could Be Improved* (Sept. 2017); TIGTA, Ref. No. 2017-20-004, *Improvements Are Needed to Ensure the Protection of Data Transfers to External Partners* (Oct. 2016); and GAO, Ref. No. GAO-17-395, *Information Security: Control Deficiencies Continue to Limit IRS's Effectiveness in Protecting Sensitive Financial and Taxpayer Data* (July 26, 2017).
[7] N.D. Ala. Plea Agr. filed Feb. 8, 2016.
[8] N.D. Ala. Amended Judgment filed Oct. 14, 2016.
[9] W.D. Wash. Crim. Compl. filed July 7, 2017.

## IDENTITY THEFT AND IMPERSONATION FRAUD

Tax-related identity theft continues to have a significant impact on tax administration. Identity theft for the purpose of tax fraud occurs when an individual uses another person's name and Taxpayer Identification Number (TIN), generally a SSN, to file a fraudulent tax return to obtain a tax refund. Unscrupulous individuals are stealing identities at an alarming rate for this purpose. The IRS lists identity theft as one of the top "Dirty Dozen" tax scams.[10]

Since 2012, TIGTA has issued a series of reports assessing the IRS's efforts to detect and prevent fraudulent tax refunds resulting from identity theft. Our ongoing audit work shows that the IRS is making progress in detecting and resolving identity theft issues and providing victim assistance. Most recently, we reported in February 2017 that IRS efforts are resulting in improved detection of identity theft individual tax returns at the time returns are processed and before fraudulent tax refunds are released.[11]

However, because new identity-theft patterns are constantly evolving, the IRS needs to continuously adapt its detection and prevention processes. For example, identity theft also affects businesses. In September 2015, TIGTA determined that processing filters could be developed to identify business tax returns containing certain characteristics that could indicate potential identity theft cases.[12] In June 2017, TIGTA concluded that IRS processes are still not sufficient to identify all employment identity theft victims.[13] Specifically, the IRS did not identify instances in which identity thieves electronically filed tax returns with evidence that the thieves had used the victims' SSNs to gain employment. Further, we determined that IRS processes do not identify employment identity theft when processing paper tax returns.

In addition, the IRS must work to protect taxpayers by educating them on the numerous schemes employed by criminals posing as IRS employees that attempt to deceive taxpayers into providing their personal financial information or coerce them into paying money on phony tax obligations through wire transfers or preloaded debit cards. One of these schemes, the telephone impersonation scam, continues to be one of TIGTA's top priorities and has also landed at the top of the IRS's "Dirty Dozen" tax scams. The number of complaints TIGTA has received about this scam continues to climb, cementing its status as the largest, most pervasive impersonation scam in the history of our agency. As of September 1, 2017, more than two million people have reported to TIGTA that they received an impersonation call, and more than 11,500 victims have reported that they have paid the impersonators more than $60 million.

These criminals continuously change their tactics, hoping to ensnare even more victims. According to the victims we have interviewed, scammers demand that the victims immediately pay the money using Apple iTunes® gift cards,[14] Target gift cards, prepaid debit cards, wire transfers, Western Union payments, or MoneyGram® payments in order to avoid being immediately arrested. Because of the complexity of the scammers' call center operations, the telephone impersonation scam will continue to pose a challenge to both the IRS and TIGTA, given that scams such as these are not typically resolved quickly and place a strain on limited IRS and TIGTA resources. Many taxpayers are aware of the impersonation scam through public service announcements and other outreach efforts which, in turn, create other challenges for the IRS when those taxpayers question legitimate IRS employees who are conducting official IRS business. Taxpayers have even threatened employees or called the police because they thought IRS employees were impostors.

TIGTA investigations have resulted in more than 90 individuals being arrested or criminally charged for their involvement in this scam and numerous investigations are still underway. In addition to criminal prosecutions, we have created and instituted an "Advise and Disrupt" strategy to thwart scammers using robo-dialers. Sustained investigative efforts and ongoing outreach to ensure that people do not become victims in the first place are critical to ensure continued success in combating this scam.

In addition to the telephone impersonation scam, taxpayers also fall victim to other scams. We continue to receive reports of people who have become victims of lottery winning scams and are also seeing an uptick in the number of reported phishing attempts.[15] The lottery scam starts with an unsolicited e-mail or telephone call from an impersonator

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[10] Compiled annually, the "Dirty Dozen" lists a variety of common scams that taxpayers may encounter.

[11] TIGTA, Ref. No. 2017-40-017, *Efforts Continue to Result in Improved Identification of Fraudulent Tax Returns Involving Identity Theft; However, Accuracy of Measures Needs Improvements* (Feb. 2017).

[12] TIGTA, Ref. No. 2015-40-082, *Processes Are Being Established to Detect Business Identity Theft; However, Additional Actions Can Help Improve Detection* (Sept. 2015).

[13] TIGTA, Ref. No. 2017-40-031, *The Number of Employment-Related Identity Theft Victims Is Significantly Greater Than Identified* (June 2017).

[14] An Apple Inc.® gift card can be used to purchase anything available on the Apple App Store, iTunes Store, iBooks Store, or Mac App Store.

[15] A fraudulent attempt, usually made through e-mail, to steal an individual's personal information by posing as a trustworthy person or entity.

to an unsuspecting victim. The caller tells the intended victims that they have won a lottery or other valuable prize; however, in order to collect their prizes, the victims are advised that they must send money to prepay the tax on their "winnings" to the IRS. A new phishing scheme involves scammers sending e-mails purporting to be a business's Chief Executive or Financial Officer. These e-mails notify the employees that there is an error on their Form W-2, *Wage and Tax Statement*, and direct the employees to either e-mail their Form W-2 to the sender, or provide information that is on the Form W-2 for verification. Both approaches result in the theft of the employee's personal identifying information.

**PROVIDING QUALITY TAXPAYER SERVICE AND EXPANDING ONLINE SERVICES**

Providing taxpayers with quality customer service is a key component in the IRS's mission. Ensuring that taxpayers understand and meet their tax responsibilities is crucial for the IRS in its effort to encourage voluntary compliance with the tax laws. Resolving questions before tax returns are filed helps taxpayers avoid unintentional errors and noncompliance, and also reduces the burden on both taxpayers and the IRS that results from the issuance of notices and correspondence. Successfully addressing and resolving taxpayer inquiries through a quality customer service process allows the IRS to direct its limited resources more efficiently.

Taxpayers have multiple options to choose from when they need assistance from the IRS. These include toll-free telephone lines, face-to-face assistance at Taxpayer Assistance Centers (TAC) or Volunteer Program sites, and self-assistance using IRS.gov and other social media channels (*e.g.*, Twitter, Facebook, and YouTube). For the 2017 Filing Season, the IRS transitioned all the TACs to appointment service. The IRS indicated that budget cuts, the transition to appointment service, and continued promotion of alternative service options will result in the reduction of the number of TAC employees available to assist taxpayers. The IRS estimated it would assist approximately 3.4 million taxpayers at the TACs in FY 2017, down more than two million from FY 2015 when it assisted 5.6 million taxpayers. In addition, although the IRS reported 376 TACs for the 2017 Filing Season, 24 of those were not open because they had not been staffed.

To address declining budgets, the IRS continues to increase its dependence on technology-based services and external partners in an effort to direct taxpayers to the most cost-effective method to provide the needed service. The IRS notes that this approach allows it to focus limited telephone and walk-in resources on customer issues that can be best resolved with person-to-person interaction. The IRS's Future State[16] initiative, which includes expanding online tools available to taxpayers, will play a significant part in the IRS's effort to modernize the taxpayer experience and allow its limited staff to better serve taxpayers who require one-on-one assistance. The IRS's goal is to eventually provide taxpayers with dynamic online tax account access that will allow them to view recent payments, make minor changes and adjustments to their tax accounts, and correspond digitally with the IRS.

In recent years, TIGTA has also identified a number of customer service issues related to taxpayers who were victims of identity theft. In FY 2017, we completed a review to assess the IRS's actions to improve and expand the Identity Protection Personal Identification Number (IP PIN)[17] Program.[18] We identified approximately two million taxpayers for whom the IRS had resolved an identity theft case, but did not place a case resolution marker used to generate an IP PIN on the taxpayer's account. The IRS stated that this results from inconsistent case resolution guidance among different IRS functional areas in instances in which the victim's address is unknown. These inconsistent procedures will create burden for the two million taxpayers who do not have the marker on their account. For example, while these individuals do not have a marker that will result in the generation of an IP PIN, they do have an identity-theft indicator because they are a confirmed victim of identity theft. As such, when these taxpayers electronically file subsequent tax returns, they will experience delays while the IRS manually reviews and processes their returns.

**UPGRADING TAX SYSTEMS**

Successful modernization of IRS systems and the development and implementation of new information technology applications are critical to meeting the IRS's evolving business needs and to enhancing services provided to taxpayers. The IRS's reliance on legacy systems and its use of outdated programming languages pose significant risks to the IRS's ability to deliver its mission.

The IRS has a large and increasing amount of aged hardware, some of which is three to four times older than industry standards. In the IRS's FY 2016 President's Budget, the IRS noted that its information technology infrastructure poses significant risk of failures, although it is unknown when these failures will occur, how severe they will be, or whether they will have material impacts on tax administration during the Filing Season. Aged information technology hardware still in

[16] Preparing the IRS to adapt to the changing needs of taxpayers is described generally as the IRS Future State initiative. A key part of this effort is for taxpayers to have a more complete online experience for their IRS interactions.
[17] An IP PIN is a six-digit number assigned to taxpayers that allows their tax returns/refunds to be processed without delay and helps prevent the misuse of their SSNs on fraudulent Federal income tax returns.
[18] TIGTA, Ref. No. 2017-40-026, *Inconsistent Processes and Procedures Result in Many Victims of Identity Theft Not Receiving Identity Protection Personal Identification Numbers* (Mar. 2017).

use introduces an unnecessary risk that excessive system downtime could occur due to hardware failures. As information technology hardware ages, it becomes more difficult to obtain adequate support. Aged hardware failures have a negative impact on IRS employee productivity, security of taxpayer information, and customer service.

TIGTA reported that the IRS has not yet achieved its stated objective of reducing the percentage of its aged information technology hardware to an acceptable level of 20 to 25 percent. In fact, the IRS's percentage of aged information technology hardware has steadily increased from 40 percent at the beginning of FY 2013 to 64 percent at the beginning of FY 2017.[19]

Further, the IRS has been using the Individual Master File (IMF), which uses an outdated assembly language code, for more than 50 years. The IMF is the source for individual taxpayer accounts. Within the IMF, accounts are updated, taxes are assessed, and refunds are generated. Most of the IRS's information systems and processes depend on the IMF, either directly or indirectly. In 2009, the IRS began developing Customer Account Data Engine 2 (CADE 2) to address the issues regarding tax processing and to eventually replace the IMF. CADE 2 is a key component of IRS systems modernization that establishes the foundation for capturing, storing, managing, and sharing taxpayer information. CADE 2 is one of the most complex modernization programs in the Federal Government and involves major changes to several core information technology systems. The IRS has implemented Transition State 1 for the CADE 2, which began in October 2009 and was completed in July 2014. The first transition state provides daily processing and a single centralized relational database for all individual taxpayer accounts. However, CADE 2 is currently still being developed, and the IRS does not have a firm date on when the target state (completion) of CADE 2 will be operational. Therefore, the IRS will be relying on legacy systems for years to come.

Another area of concern regarding IRS systems modernization is ensuring that systems and data remain secure and reliable. The IRS implemented the Integrated Production Model (IPM) to provide a single point of access to core taxpayer data (such as taxpayer accounts and tax returns). The accuracy, completeness, and reliability of data on the IPM are essential to the IRS and its tax administration mission. The IRS made significant changes to the IPM system, including moving data to different software and hardware platforms. When these changes occurred, business ownership and security responsibilities of the IPM were moved to the Big Data Analytics General Support System.[20] TIGTA found that the IRS did not follow its change management procedures when absorbing the IPM system into the Big Data Analytics General Support System.[21] As a result, approximately 10 percent of security controls which previously protected IPM system data were not captured by the Big Data Analytics General Support System. Without following the security change management process, there is an increased risk that changes could expose taxpayer data to additional security vulnerabilities. Additionally, changes to operating environments or applications introduce new or increase existing security vulnerabilities, heightening risk to the overall information technology infrastructure.

Cloud computing holds tremendous potential for the Federal Government to deliver value to the public by increasing operational efficiency and responding faster to constituent needs. In December 2010, the U.S. Chief Information Officer directed all Federal agencies to shift to a "cloud first" policy. However, TIGTA reported that the IRS does not have an enterprise-wide cloud strategy.[22] Although the IRS formed a working group in July 2016 to develop this strategy, it is not complete and no timeline has been established for completion. In addition, the IRS did not comply with Office of Management and Budget guidance requiring agencies to use the Federal Risk and Authorization Management Program to conduct risk assessments, perform security authorizations, and grant Authorities to Operate for cloud services for the Form 990, *Return of Organization Exempt From Income Tax*, Cloud Project. Without a documented strategy for the selection, management, and inventory of cloud services, there is an increased risk that deployed cloud services will not meet the IRS's business and technical needs.

## IMPLEMENTING TAX LAW CHANGES

One of the continuing challenges the IRS faces each year in processing tax returns is the implementation of new tax laws as well as changes resulting from expired tax provisions. Legislative actions generating the changes often occur late in the year, shortly before the filing season begins. As a result, the IRS must act quickly to assess the change and determine the necessary actions to ensure that all legislative requirements are satisfied. These actions may require revisions to various tax forms, instructions, and publications, as well as reprogramming computer systems to ensure that tax returns are accurately processed based on the changes. Errors in the IRS's tax return processing systems may delay tax refunds, affect the accuracy of taxpayer accounts, or result in incorrect taxpayer notices.

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[19] TIGTA, Ref. No. 2017-20-051, *Sixty-Four Percent of the Internal Revenue Service's Information Technology Hardware Infrastructure Is Beyond Its Useful Life* (Sept. 2017).
[20] This system is a data warehouse. It provides the ability to conduct rapid advanced analytics.
[21] TIGTA, Ref. No. 2017-20-029, *The Big Data Analytics General Support System Security Controls Need Improvement* (June 2017).
[22] TIGTA, Ref. No. 2017-20-032, *The Internal Revenue Service Does Not Have a Cloud Strategy and Did Not Adhere to Federal Policy When Deploying a Cloud Service* (Aug. 2017).

For the 2017 Filing Season, tax law changes included the continued implementation of the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010 (collectively referred to as the Affordable Care Act or ACA),[23] and those provisions of the Protecting Americans from Tax Hikes Act of 2015 (PATH Act)[24] specifically intended to reduce fraudulent and improper refundable credit claims. The majority of the PATH Act's provisions were effective January 1, 2016, and affect the processing of Tax Year 2016 returns. The IRS has developed processes to implement key tax provisions of the PATH Act, including holding refunds for taxpayers claiming the Earned Income Tax Credit (EITC)[25] and Additional Child Tax Credit (ACTC)[26] until February 15 and identifying Child Tax Credit,[27] ACTC, and American Opportunity Tax Credit (AOTC)[28] claims filed by individuals with an inactive Individual Taxpayer Identification Number.

In addition, the IRS was affected in the 2017 Filing Season by the Trade Preferences Extension Act of 2015 (Trade Act).[29] The Trade Act retroactively extended the Health Coverage Tax Credit (HCTC) for Tax Year 2014 and continued the credit through Tax Year 2019. The Trade Act required the IRS to provide HCTC advance monthly payments on behalf of eligible applicants starting in June 2016. The IRS implemented an interim manual process to issue HCTC advance monthly payments on behalf of eligible applicants until the replacement systemic process was ready for use in January 2017. However, TIGTA found that many of the individuals identified as potentially eligible may not meet requirements to receive or claim the HCTC. Specifically, TIGTA identified 506,396 (57 percent) of the 896,213 individuals that the Pension Benefit Guaranty Corporation identified as potentially eligible to claim HCTC on the Tax Year 2015 return, as of December 2015, had a characteristic that disqualified them from claiming the HCTC.[30]

The Trade Act also requires that an individual claiming the AOTC, Lifetime Learning Credit, or the Tuition and Fees Deduction must receive a statement from the educational institution to claim these benefits. This statement, which is generally on Form 1098-T, *Tuition Statement*, provides the name, address, and Employer Identification Number (EIN) of the educational institution. This provision is effective for tax years beginning after June 29, 2015. However, the IRS has not developed processes to identify all AOTC claims for which the student did not receive a Form 1098-T from the educational institution or for which the institution's EIN is not provided.

The ACA created the refundable Premium Tax Credit (PTC) to help offset the cost of health care insurance for those with low or moderate income. Eligible individuals can elect to receive some, all, or none of the PTC in advance. TIGTA verified the PTC claims made during the 2016 Filing Season and reported that the IRS accurately determined the amount of allowable tax credit on 97 percent of the returns.[31] However, TIGTA found that not all the Exchanges[32] had provided the required Exchange Periodic Data to the IRS prior to the start of the 2016 Filing Season. Without the required data, the IRS was unable to perform computer matches to verify filed claims or verify that individuals who received the advance PTC had filed a tax return as required. In addition, TIGTA found that the IRS is sending erroneous notifications to the Exchanges and individuals indicating that the individuals had received the PTC in advance but did not file the required tax return. This could result in denial of the advance PTC for the 2016 coverage year or delay the receipt of advanced credit payments while the individuals provided proof that they had filed a tax return.

TIGTA also reported that some of the processes to ensure that employers were in compliance with the Employer Shared Responsibility Provision[33] did not function as intended.[34] Specifically, the IRS was unable to process paper information

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[23] Pub. L. No. 111-148, 124 Stat. 119 (2010) (codified as amended in scattered sections of the U.S. Code), as amended by the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029.
[24] Consolidated Appropriations Act of 2016, Pub. L. No. 114-113, Div. Q, (2015).
[25] The EITC was created in 1975 as part of the Tax Reduction Act of 1975 § 204, 26 U.S.C § 32. The EITC is used to offset the impact of Social Security taxes on low-income families and to encourage them to seek employment.
[26] The ACTC is intended to reduce the individual income tax burden for families, better recognize the financial responsibilities of raising dependent children, and promote family values.
[27] A tax credit for families with dependent children that is used to reduce the individual income tax burden for families, better recognize the financial responsibilities of raising dependent children, and promote family values.
[28] The AOTC is intended to help offset the costs of higher education for taxpayers, their spouses, and dependents who qualify as eligible students.
[29] Pub. L. No. 114-27, 129 Stat. 362.
[30] TIGTA, Ref. No. 2017-40-033, *Implementation of the Health Coverage Tax Credit Enrollment and Systemic Advance Monthly Payment Process* (May 2017).
[31] TIGTA, Ref. No. 2017-43-022, *Affordable Care Act: Verification of Premium Tax Credit Claims During the 2016 Filing Season* (Mar. 2017).
[32] The Exchanges are where taxpayers find information about health insurance options, purchase qualified health plans, and, if eligible, obtain help paying premiums and out-of-pocket costs.
[33] The Employer Shared Responsibility Provision requires employers with an average of 50 or more full-time employees (including full-time equivalent employees) to offer health insurance coverage to full-time employees and their dependents beginning in January 2015.
[34] TIGTA, Ref. No. 2017-43-027, *Affordable Care Act: Assessment of Efforts to Implement the Employer Shared Responsibility Provision* (Apr. 2017).

returns timely and accurately; the criteria used to identify validation errors in the submissions did not always work as intended; and the development and implementation of key systems needed to identify noncompliant employers have been delayed, not initiated, or cancelled. As a result, the IRS did not have accurate and complete data to identify noncompliant employers.

## IMPROVING TAX COMPLIANCE

Despite IRS efforts to reduce it, the Tax Gap remains a serious and persistent challenge. The Tax Gap is defined as the difference between the estimated amount taxpayers owe and the amount they voluntarily and timely pay for a tax year. In FY 2016, the IRS issued Tax Gap estimates for Tax Years 2008 through 2010 that suggest compliance is substantially unchanged since the last estimate for Tax Year 2006. The Tax Gap for Tax Years 2008 through 2010 is estimated to be $458 billion annually, compared to the $450 billion estimated for Tax Year 2006. In an effort to lower the Tax Gap, the IRS identifies questionable tax returns to determine if any adjustments to the information reported on the tax returns are needed. In addition, the IRS issues notices and contacts taxpayers to collect delinquent taxes. If necessary, the IRS takes enforcement action, such as filing liens and seizing assets, to collect the taxes.

The IRS's compliance programs continue to be affected by reductions in the number of staff assigned to work cases, although enforcement revenue produced by these programs did not change significantly in FY 2016. Specifically, the combined number of enforcement personnel decreased between 5 and 8 percent each year since FY 2012 (14,829) and resulted in the lowest number over the past 10 years in FY 2016 (11,195). Unpaid assessments increased from $411.8 billion in FY 2015 to $421.8 billion at the end of FY 2016. The IRS has projects underway to improve processes in a variety of areas, including contacting delinquent taxpayers earlier, developing new processes to deliver inventory to Collection and Examination functions, and optimizing outreach and communication.[35]

The Automated Substitute for Return (ASFR) Program is a key compliance program for the IRS and enforces filing compliance on taxpayers who have not filed individual income tax returns but appear to owe a significant tax liability. Through the ASFR, the IRS secures a valid income tax return or prepares a Substitute for Return for taxpayers with a proposed tax assessment based on third-party information returns reported to the IRS combined with other internal data. However, due to significant resource reductions, the Program is now used mainly as support for other key compliance programs. ASFR inventory receipts and 30-day letter issuances decreased by 89 and 98 percent, respectively, between FYs 2009 and 2016. With fewer cases entering inventory and ultimately being worked, the cases that are worked should be the highest priority cases. However, TIGTA's analysis showed the cases that have been worked have not resulted in more revenue per case.[36] IRS collections from closed ASFR cases were approximately $2.9 billion (87 percent) less in the 2015-2016 period than in the 2010-2011 period, and 85 percent fewer ASFR cases were closed. The decrease in tax dollars collected is significant and can be directly attributed to the decline in cases started and worked by the ASFR Program.

Employment tax noncompliance also continues to steadily grow. As of December 2015, 1.4 million employers owed approximately $45.6 billion in unpaid employment taxes, interest, and penalties. The Trust Fund Recovery Penalty (TFRP) is an enforcement tool the IRS can use to discourage employers from continuing egregious employment tax noncompliance and provides an additional source of collection for unpaid employment taxes.[37] In FY 2015, the IRS assessed the TFRP against approximately 27,000 responsible persons—38 percent fewer than just five years before, as a result of diminished revenue officer resources. In contrast, the number of employers with egregious employment tax noncompliance (20 or more quarters of delinquent employment taxes) is steadily growing—it has more than tripled in a 17-year period.

We also reported in July 2017 that billions of dollars of potential underreported taxes are not being addressed because most discrepancy cases identified by the IRS are not worked.[38] Discrepancy cases result when employers' wage and withholding information reported on filed Forms W-2, *Wage and Tax Statement*, and Forms W-3, *Transmittal of Wage and Tax Statements*, do not match what was reported on the employers' employment tax return. Our analysis found that the IRS did not work discrepancy cases that had a potential underreported total tax difference of more than $7 billion.

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[35] TIGTA, Ref. No. 2017-30-072, *Trends in Compliance Activities Through Fiscal Year 2016* (Sept. 2017).
[36] TIGTA, Ref. No. 2017-30-078, *A Significantly Reduced Automated Substitute for Return Program Negatively Affected Collection and Filing Compliance* (Sept. 2017).
[37] TIGTA, Ref. No. 2017-IE-R004, *A More Focused Strategy Is Needed to Effectively Address Egregious Employment Tax Crimes* (Mar. 2017).
[38] TIGTA, Ref. No. 2017-40-038, *Case Selection Processes Result in Billions of Dollars in Potential Employer Underreported Tax Not Being Addressed* (July 2017).

## REDUCING FRAUDULENT CLAIMS AND IMPROPER PAYMENTS

The Office of Management and Budget describes an improper payment as any payment that should not have been made, was made in an incorrect amount, or was made to an ineligible recipient. The Improper Payment Information Act of 2002[39] requires Federal agencies, including the IRS, to estimate the amount of their improper payments and report to Congress annually on the causes of and the steps taken to reduce such improper payments. The Improper Payment Elimination and Recovery Act of 2010[40] amended the 2002 Act by strengthening agency reporting requirements and redefining significant improper payments.

Although refundable credits provide benefits to individuals, the unintended consequence of these credits is that they can result in the issuance of improper payments and can be the targets of unscrupulous individuals who file erroneous claims. Refundable credits can result in tax refunds even if no income tax is withheld or paid; that is, the credits can exceed an individual's tax liability. Consequently, they pose a significant risk as an avenue for those seeking to defraud the Government.

The IRS issued an estimated $25 billion in potentially improper EITC, ACTC, and AOTC payments in FY 2016. This represents a significant loss to both the Federal Government and taxpayers. TIGTA remains concerned about the IRS's inability to significantly reduce these payments.

In April 2017, we reported that the IRS concluded that the ACTC and the AOTC presented a medium risk of improper payments for FY 2016.[41] However, the IRS's medium-risk rating continues to be contrary to its own compliance data, which shows that both the ACTC and AOTC programs present a high risk of improper payments. Our review of these revised assessments found that they still do not include the use of available IRS compliance data to quantify erroneous payments. Because the IRS does not rate these programs as high risk, it is not required to establish a corrective action plan to reduce the improper payments.

Using the IRS's own compliance data, we computed the FY 2016 potential estimated improper payment rate for the ACTC and the AOTC. We estimate that 25.2 percent ($7.2 billion) of ACTC payments were improper[42] and 24.1 percent ($1.1 billion) in AOTC payments were improper.[43] The IRS is not required to perform a risk assessment of the EITC because it is designated as a high-risk program by the Office of Management and Budget. For FY 2016, the IRS estimates EITC payments totaling $16.8 billion were issued improperly.

Congress enacted the PATH Act on December 18, 2015, which includes program integrity provisions intended to reduce fraudulent and improper EITC, Child Tax Credit, ACTC, and AOTC payments. For example, one of the PATH Act's provisions is intended to ensure that the IRS has the information and time needed to verify the income of individuals claiming the EITC and the ACTC before the related refund is issued. According to the U.S. House of Representatives Committee on Ways and Means, these integrity provisions are projected to save roughly $7 billion over 10 years by reducing fraud, abuse, and improper payments in refundable credit programs.

According to the IRS, approximately $1 billion (6 percent) of improper EITC payments are from program design limitations. However, as we continue to report, IRS compliance resources are limited, and, consequently, the IRS does not address the majority of potentially erroneous EITC claims despite having established processes that identify billions of dollars in potentially erroneous EITC payments. Although the PATH Act gives the IRS more time to verify EITC and ACTC claims before refunds are issued, it does not expand the IRS's authority to systemically correct erroneous claims. Currently, under the Internal Revenue Code, the IRS can use its math error authority to address erroneous EITC claims by systemically correcting mathematical or clerical errors on such claims. For example, it can correct entries made on the wrong line on the tax return or mathematical errors made in computing income or the EITC. However, the majority of potentially erroneous EITC claims that the IRS identifies do not contain the types of errors for which it has math error authority. To address those potentially erroneous EITC claims identified that cannot be addressed using math error authority, the IRS must conduct an audit. The IRS estimated that it costs $1.50 to resolve an erroneous EITC claim using math error authority compared to $278 to conduct a pre-refund audit.[44]

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[39] Pub. L. No. 107-300, 116 Stat. 2350.
[40] Pub. L. No. 111-204, 124 Stat. 2224.
[41] TIGTA, Ref. No. 2017-40-030, *Revised Refundable Credit Risk Assessments Still Do Not Provide an Accurate Measure of the Risk of Improper Payments* (Apr. 2017).
[42] We estimate that the potential ACTC improper payment rate for FY 2016 is between 22.7 percent and 27.8 percent and the potential amount of improper payments is between $6.5 billion and $7.9 billion.
[43] We estimate that the potential AOTC improper payment rate for FY 2016 is between 19.6 percent and 28.7 percent and the potential amount of improper payments is between $900 million and $1.3 billion.
[44] Cost to use math error authority as of June 25, 2014, as provided by the IRS. The IRS provided the cost of a pre-refund audit based on FY 2010 financial data, which is the most current available.

The IRS, in conjunction with the Assistant Secretary of the Treasury for Tax Policy, has in each year since FY 2013 set forth a legislative proposal requesting additional error correction authority as part of its annual budget submission. Such authority, if provided by law, would allow the IRS to correct, during processing, tax returns when the information provided by the taxpayer does not match the information contained in Government databases (*e.g.*, income information reported on the tax return does not match Forms W-2 from the Social Security Administration). Without this additional error authority, billions of dollars in identified potentially erroneous claims will continue to go unaddressed each year.

## IMPACT OF GLOBAL ECONOMY ON TAX ADMINISTRATION

The globalization of financial markets and the increased importance of multinational corporations are making it increasingly difficult for the IRS to administer and enforce tax compliance. As the IRS noted in its most recent strategic plan, the evolution and proliferation of virtual commerce has expanded the exchange of goods, services, and currencies – real and virtual – across jurisdictions, further complicating tax administration.[45]

As globalization and technological advancements continue to reduce barriers to cross-border commerce, tax authorities around the world have increased the sharing of tax-related information with other countries to administer and enforce the tax laws of their respective countries. The information received from these other countries presents a potentially important source of data, including data indicating whether taxpayers have foreign income and/or assets, and assists the IRS in effectively administering and enforcing tax law compliance. However, TIGTA found that the IRS did not have an adequate tracking system to account for the records that foreign countries sent on a regular basis and that access to the information is provided to a relatively small percentage of IRS compliance employees.[46]

Additionally, expanding overseas activities of U.S. entities (individuals, trusts, and businesses) have increased certain opportunities for tax avoidance and/or evasion. The IRS established an international enforcement program to address these issues and identified the Mutual Collection Assistance Request (MCAR) Program as a focus area. An MCAR is a request for assistance from another country to collect taxes covered by the treaty of the other country. While the MCAR Program is a useful collection tool, TIGTA found that the total dollar amount of U.S. liabilities collected by five mutual collection income tax treaty partners peaked in FY 2013 but dropped off significantly since then. This is largely because the IRS does not use the MCAR Program to its full potential.

Another area that has seen significant growth has been foreign investment in the U.S. housing market. The National Association of Realtors provides estimates of nonresident alien individuals' investment in U.S. property; based on those estimates, nonresident alien individuals' investment in U.S. property increased from $34.8 billion during the 12-month period ending March 2013 to $43.5 billion during the 12-month period ending March 2016.[47] With this increase comes a greater risk of noncompliance with tax laws and regulations. TIGTA found that the IRS can improve controls to ensure that nonresident aliens are properly reporting rental income from their U.S. property.[48] In a random sample of 149 nonresident aliens who rented their U.S. property in Tax Year 2013, TIGTA found 102 (68 percent) reduced their gross rental income without applying for a tax benefit by submitting an election statement. As a result, almost $1.8 million in gross rental income should have been subject to a 30 percent tax withholding of $533,000, or $56.2 million when projected to the population. The IRS needs to improve compliance checks for ensuring that election statements are made.

The IRS also needs to improve tools for identifying nonresident aliens who are not reporting rental income from U.S. property they own. From a sample of nonresident aliens owning property in five counties, TIGTA identified foreign property owners who appeared to have failed to report and pay tax on rental income earned. TIGTA estimates that there is potentially unreported rental income of $60.9 million for the counties included in the sample.

## PROTECTING TAXPAYER RIGHTS

The IRS must balance its tax compliance activities against the rights of taxpayers to receive fair and equitable treatment. This challenge will have increased significance now that the IRS has begun assigning certain taxpayer accounts to private debt collection companies, as mandated by the Fixing America's Surface Transportation (FAST) Act.[49] Enacted in December 2015, the FAST Act includes a provision that requires the IRS to use private debt collection companies to collect unpaid tax debts involving certain inactive tax receivables. As a condition of receiving a contract, the private collection companies must respect taxpayer rights, including abiding by the consumer protection provisions of the Fair

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[45] *Internal Revenue Service Strategic Plan – FY 2014 - 2017*, IRS Pub. 3744 (Rev. June 2014).
[46] TIGTA, Ref. No. 2017-30-077, *Exchange of Information Capabilities Are Underutilized by the IRS* (Sept. 2017).
[47] National Association of Realtors, *Profile of International Activity in US Residential Real Estate*, years 2013-2016, https://www.nar.realtor/research-and-statistics/research-reports.
[48] TIGTA, Ref. No. 2017-30-048, *Additional Controls Are Needed to Help Ensure That Nonresident Alien Individual Property Owners Comply With Tax Laws* (Aug. 2017).
[49] Pub. L. No. 114-94, Div. C, Title XXXII, § 32102, 129 Stat. 1312, 1733-36 (2015), codified in Internal Revenue Code § 6306.

Debt Collection Practices Act.[50] The IRS will need to ensure that collection company employees abide by these provisions and respect taxpayer rights during their contacts with taxpayers.

The IRS continues to dedicate significant resources and attention to complying with taxpayer rights provisions of the IRS Restructuring and Reform Act of 1998 (RRA 98).[51] As mandated by RRA 98, TIGTA conducts annual audits of a number of these taxpayer rights provisions. In general, the IRS has improved its compliance with these statutory taxpayer rights provisions and is documenting its protection of taxpayer rights. However, during the review of the IRS's compliance with Notice of Federal Tax Lien due process procedures, TIGTA found that the IRS did not always notify taxpayers' representatives of the Notice of Federal Tax Lien filings as required.[52] Based on the sample results, TIGTA estimated that 28,913 taxpayers may have been adversely affected because the IRS did not follow procedures to notify taxpayers' authorized representatives of the taxpayers' rights related to the Notices of Federal Tax Lien.

We also continued to identify errors related to the determination of the Collection Statute Expiration Date (CSED) on taxpayer accounts during our review of the IRS Office of Appeals Collection Due Process Program.[53] The CSED is the expiration of the time period established by law to collect taxes. From a statistically valid sample, TIGTA identified instances in which the IRS incorrectly extended the CSED, allowing the IRS additional time it should not have had to collect delinquent taxes.

In addition, TIGTA conducted an audit to evaluate the IRS's use of seizures against property owners suspected of structuring currency transactions to avoid Bank Secrecy Act[54] reporting requirements.[55] The Bank Secrecy Act requires financial institutions to report currency transactions in excess of $10,000. This Federal law also makes it a crime for property owners to structure currency transactions in such a way as to avoid the filing of the report and subjects structured amounts to civil or criminal forfeiture proceedings. TIGTA determined that the IRS enforced the Bank Secrecy Act's anti-structuring provisions primarily against individuals and businesses whose income was legally obtained, and compromised the rights of some individuals and businesses in these investigations. TIGTA determined that 91 percent of the 278 investigations in its sample in which source of funds could be determined were of businesses and individuals whose funds were obtained legally. While the Bank Secrecy Act does not distinguish between legal and illegal sources of funds, IRS procedures dictate that the overall purpose of its civil forfeiture program is to disrupt and dismantle criminal enterprises. Most people affected by the program did not appear to be criminal enterprises or engaged in other alleged illegal activity; rather, they were legal businesses such as jewelry stores, restaurant owners, gas station owners, and scrap metal dealers.

As part of this audit, we reviewed all 28 criminal investigations during FY 2015 that resulted in asset seizures in which structuring was the primary criminal basis for the seizure to determine if the IRS complied with a new policy. Under the new policy, the IRS will no longer pursue legal source structuring cases unless exceptional circumstances justify the seizure and the seizure is approved by the appropriate IRS executive. We reviewed available supporting documentation and determined that for 20 of the 28 investigations, the seizures either conformed to policy, were not actually for structuring violations, or occurred well before the policy change. However, for five cases, we believe that the actions taken by the Government were inconsistent with the new policy, and for three cases we did not find evidence that the IRS conformed to the new policy in making those seizures for structuring violations.

### ACHIEVING PROGRAM EFFICIENCIES AND COST SAVINGS

Continuing to identify and achieve greater program efficiencies and cost savings is imperative for the IRS as it strives to successfully accomplish its mission in a period of shrinking budgets and declining resources. Implementing cost saving strategies is particularly critical as the IRS is tasked with additional responsibilities, often without additional budgetary funding.

In its most recent strategic plan, which guides program and budget decisions, the IRS noted that it must meet the challenge of declining resources by working to achieve the optimal scale and scope for its programs and activities. While the IRS has taken steps to reduce costs and improve program effectiveness, TIGTA has identified a number of areas in which the IRS can more efficiently use its limited resources and make more informed business decisions.

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[50] 15 U.S.C. §§ 1601 note, 1692-1692p (2006).
[51] Pub. L. No. 105-206, 112 Stat. 685.
[52] TIGTA, Ref. No. 2017-30-070, *Fiscal Year 2017 Statutory Review of Compliance With Notice of Federal Tax Lien Due Process Procedures* (Sept. 2017).
[53] TIGTA, Ref. No. 2017-10-055, *Review of the Office of Appeals Collection Due Process Program* (Sept. 2017).
[54] Pub. L. No. 91-508, 84 Stat. 1114-4 (1970) (codified as amended in scattered sections of 12 U.S.C., 18 U.S.C., and 31 U.S.C.). Regulations for the Bank Secrecy Act and other related statutes are 31 C.F.R. §§ 103.11-103.77.
[55] TIGTA, Ref. No. 2017-30-025, *Criminal Investigation Enforced Structuring Laws Primarily Against Legal Source Funds and Compromised the Rights of Some Individuals and Businesses* (Mar. 2017).

For example, TIGTA completed an audit to assess the IRS's processes to ensure that employee salary overpayments or underpayments are prevented and detected when employees move into, within, and out of IRS pay bands.[56] Based on a statistical sample of employees who received salary increases of greater than 10 percent for promotions into management positions between FYs 2006 and 2015, 31 percent of sampled employees were not paid correctly. TIGTA estimates that the IRS overpaid more than 600 employees by approximately $4.2 million and underpaid more than 900 employees by approximately $2.7 million.

In another example of improving program efficiency, we also reported that the IRS has not effectively updated or implemented hiring policies to fully consider past IRS conduct and performance issues prior to making a tentative decision to hire former employees, including those who were terminated or separated during an investigation of a substantiated conduct or performance issue.[57] While most employees who are rehired do not have prior conduct or performance issues, TIGTA found that more than 200 (approximately 10 percent) of the more than 2,000 former employees who were rehired between January 2015 and March 2016 had previously been terminated from the IRS or had separated while under investigation for a substantiated conduct or performance issue. More than 150 (approximately 75 percent) of these employees were seasonal. Although the IRS may have had a valid basis to rehire some of the more than 200 former employees with prior conduct and/or performance issues, TIGTA has serious concerns about the IRS's decision to rehire certain employees, such as those who willfully failed to meet their Federal tax responsibilities.

In addition, we identified inefficiencies related to the IRS's records retention processes. Specifically, we determined that the IRS's policies do not comply with certain Federal requirements that agencies must ensure that all records are retrievable and usable for as long as needed.[58] For example, IRS e-mail retention policies are not adequate because e-mails are not automatically archived for all IRS employees. Instead, the IRS's current policy instructs employees to take manual actions to archive e-mails by saving them permanently on computer hard drives or network shared drives. This policy has resulted in lost records when computer hard drives are destroyed or damaged.

TIGTA also found that a more effective tax compliance strategy for ASFR casework would result in more efficient use of IRS resources.[59] The IRS prioritized ASFR cases involving Refund Holds[60] over cases with potential high net tax due ($100,000 or more), even though the average dollars collected per case in cases with potential high net tax due is five times higher than all other cases. TIGTA estimates that the IRS could collect $843 million over the next five years if it replaced 9 percent of Refund Hold inventory with high net tax due cases.

Similarly, we also reported that discrepancy case selection processes do not ensure that priority is given to working discrepancy cases with the highest potential tax assessment.[61] The Combined Annual Wage Reporting (CAWR) Program compares the employee wage and withholding information reported to the IRS on employment tax forms to withholding documents filed with the Social Security Administration. The purpose of the IRS-CAWR Program is to ensure that employers report the proper amount of employment taxes and Federal income tax withholding on their employment tax returns. TIGTA's analysis of the 114,088 TY 2013 unworked IRS-CAWR Program discrepancy cases showed that if the IRS had selected the 23,184 auto-generated cases with a higher average assessment potential to work, it would have selected cases with more than $128 million in assessment potential. In addition to changing its selection methodology to work case types with the highest potential tax assessment, the IRS could further increase its return on investment by including prior year discrepancy cases when working current year discrepancy cases for the same employer. TIGTA's analysis found that 3,137 of the discrepancy cases identified in TY 2013 also had discrepancy cases in TY 2012, with potential underreported tax totaling more than $448 million for TY 2012.

TIGTA also reported that the IRS has not maintained standard pricing and terms and conditions for its software acquisitions, compiled a reliable baseline inventory of software licenses, or documented cost savings and cost avoidance attributable to improved software license management, as required by recent laws and regulations.[62] Efficient and cost

[56] TIGTA, Ref. No. 2017-10-023, *Some Managerial Salaries Were Calculated Incorrectly Due to Complex Pay-Setting Rules* (Mar. 2017).
[57] TIGTA, Ref. No. 2017-10-035, *The Internal Revenue Service Continues to Rehire Former Employees With Conduct and Performance Issues* (July 2017).
[58] TIGTA, Ref. No. 2017-10-034, *Electronic Record Retention Policies Do Not Consistently Ensure That Records Are Retained and Produced When Requested* (July 2017).
[59] TIGTA, Ref. No. 2017-30-078, *A Significantly Reduced Automated Substitute for Return Program Negatively Affected Collection and Filing Compliance* (Sept. 2017).
[60] If a taxpayer files a tax return requesting an income tax refund, the IRS delays issuing the refund for up to six months while it investigates any delinquent returns filed within five years prior to the current filing year.
[61] TIGTA, Ref. No. 2017-40-038, *Case Selection Processes Result in Billions of Dollars in Potential Employer Underreported Tax Not Being Addressed* (July 2017).
[62] TIGTA, Ref. No. 2017-20-062, *The Internal Revenue Service Is Not in Compliance With Federal Requirements for Software Asset Management* (Sept. 2017).

effective management of the IRS's software assets is crucial to ensure that information technology services continue to support the IRS's business operations and to help provide services to taxpayers efficiently.

## CONCLUSION

This memorandum is provided as our annual summary of the most serious major management and performance challenges confronting the IRS in FY 2018. TIGTA's Fiscal Year 2018 Annual Audit Plan contains our proposed reviews, which are organized in accordance with these challenges. If you have any questions or wish to discuss our views on the challenges in greater detail, please contact me at (202) 622-6500.

cc: Assistant Secretary for Management
Deputy Chief Financial Officer
Commissioner of Internal Revenue

## MANAGEMENT RESPONSE TO OIG AND TIGTA REPORTED CHALLENGES

We concur with the reported challenges from the Treasury Inspector General (IG) and TIGTA. We continue to make progress on these challenges, but overcoming them will require long-term strategies for ensuring stable operations, as well as sustained management attention and resources. We have provided our responses to the identified management challenges in the following section.

| Summary of Challenges Facing Treasury | |
|---|---|
| **OIG Reported Challenge** | **Management's Response** |
| **Operating in an Uncertain Environment**<br>OMB's government–wide Reform Plan may significantly impact the administration of the Department's programs and operations. Additional uncertainty facing the Department are the recurring cycle of budget and debt ceiling stopgaps. | Treasury's reform plan proposals submitted to OMB in September 2017 included cross-agency initiatives and Treasury-specific reforms that reflect the significant breadth and depth of the Department's mission. While we assess the feasibility and potential impact of these targeted efficiency efforts with OMB, we are also actively planning for prospective near and long-term budget constraints, focusing our limited resources on critical programs and Departmental priorities. Our reform efforts and budget planning processes foster collaboration across the Department to effectively manage possible operational changes while mitigating uncertainly about future funding and workforce levels. |
| **Cyber Threats**<br>As cyber threats continue to evolve and become more sophisticated and subtle, they pose an ongoing challenge for Treasury to fortify and safeguard its internal systems and operations and the financial sector it oversees. Additionally, ensuring the government has a sufficient number of cybersecurity professionals is also an ongoing challenge. | Treasury employs a risk-based approach to cybersecurity, which includes: (a) assessing the likelihood of exploitation; (b) examining the number of dependencies required to exploit a given vulnerability; and (c) calculating the impact to the public if a system or data is compromised. In FY 2017, as a result of our system patching practices, we were not at risk of being affected by the large ransomware campaigns that immobilized numerous organizations. Additionally, our asset inventories and established data sharing channels allowed us to quickly identify and remediate any at-risk assets.<br><br>In FY 2017, we continued our efforts to recruit and retain cybersecurity expertise and further develop our cyber workforce strategies and Human Capital plan. We reduced the vacancy rate from 21 percent in FY 2016 to 14 percent in FY 2017. |
| **Anti-Money Laundering and Terrorist Financing/*Bank Secrecy Act* Enforcement**<br>Identifying, disrupting, and dismantling the financial networks that support terrorists, organized transnational crime, weapons of mass destruction proliferators, and other threats to international security, continue to be challenging. | The Office of Terrorism and Financial Intelligence (TFI) remains dedicated to countering the ability of these networks, organizations, and countries to fund such activities through intelligence analysis, sanctions, and international private-sector cooperation. The global dominance of the U.S. dollar, along with the unique inclusiveness and reach of U.S. financial institutions, creates inherent exposure to risk of money laundering and attempts at exploitation for terrorist finance. Despite these risks and the increasingly complicated environment in which TFI operates, the Financial Action Task Force 2016 Mutual Evaluation of the U.S. found the U.S. Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) framework to be robust and effective. As a result of the work of TFI and its myriad of law enforcement, national security, and private sector partners, the U.S. continues to be one of the world's most secure financial systems, able to effectively root out illicit activity and protect U.S. national security interests.<br><br>To combat terrorism and other criminal networks, TFI successfully applied its diverse authorities and tools, including sanctions, to major national security issues such as North Korea, Iran, Venezuela, the Islamic State in Iraq and Syria (ISIS)/Syria, and Russia, in an effort to identify, disrupt, and dismantle these threats. By doing so, TFI was able to deny revenue sources to illicit actors, such as terrorist organizations, rogue regimes, drug kingpins, transnational criminal organizations, and others who threaten the national security of the U.S. and our allies.<br><br>In 2017, TFI components have helped advance U.S. national security and law enforcement objectives in a range of ways. The Office of Foreign Assets Control (OFAC) has played a lead role in pressuring terrorist groups and rogue regimes through its use of powerful U.S. sanctions authorities. In particular on Iran, OFAC has ramped up the pressure on Iran and the Islamic Revolutionary Guard Corps (IRGC) for its malign activities. Since this Administration took office, OFAC has issued seven tranches of sanctions, designating 72 targets in China, Iran, Lebanon and Ukraine in connection with the IRGC, Iran's ballistic |

missile program, support for terrorism, and human rights abuses. Following the President's speech announcing the Administration's Iran strategy in October 2017, OFAC designated the IRGC under Executive Order 13224, consistent with section 105 of the *Countering America's Adversaries Through Sanctions Act* passed in August.

To further the fight against terrorist financing, all of the components of TFI have come together with our partners to establish the Terrorist Financing Targeting Center (TFTC), as announced by President Trump during his May 2017 visit to Saudi Arabia. The TFTC, co-chaired by the U.S. and Saudi Arabia, is a new initiative that brings together every country under the Gulf Cooperation Council, deepening our existing multilateral cooperation by coordinating disruptive action, enhancing information sharing, and institutionalizing capacity-building to target terrorist financing networks that pose national security threats to the U.S. and the Gulf. Our financial authorities in and of themselves are powerful, but are even more effective when coupled with complementary measures and corollary actions by partner countries in the region.

Driving the campaign against financial crime, Financial Crimes Enforcement Network (FinCEN) continues to promote transparency and accountability in the U.S. and international financial systems by focusing on preventing money laundering and illicit financing in new sectors and through new pathways. For example, FinCEN has taken steps to address the threat posed by money laundering and other illicit finance through certain real estate transactions, developing a strategy that incorporates Geographic Targeting Orders and industry outreach to establish a regulatory framework focused on mitigating threats while limiting compliance costs.

FinCEN is also focused on emerging technologies and trends such as cryptocurrency, ensuring that those operating in this space will be subject to enforcement actions if they violate U.S. laws. For example, in July 2017, FinCEN assessed a $110 million fine against BTC-e, a virtual currency exchange, for willfully violating U.S. anti-money laundering laws by facilitating transactions involving ransomware, computer hacking, identity theft, tax refund fraud schemes, public corruption, and drug trafficking. In addition, FinCEN is continuing to help safeguard the U.S. and international financial systems. In October 2017, FinCEN finalized the *Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act* (USA PATRIOT Act) Section 311 designation of Bank of Dandong, a Chinese bank facilitating North Korean money laundering and sanctions evasion.

The Office of Internal Affairs (OIA) is likewise playing a key role informing the formulation of Treasury policy and the execution of our regulatory and enforcement authorities. OIA includes a cadre of intelligence analysts whose all-source intelligence analysis has supported our actions taken under the *International Emergency Economic Powers Act*, the USA PATRIOT Act, and other authorities. In addition, OIA has published analytic products that inform policymakers at Treasury and throughout the government on North Korea, Iran, counterterrorism finance, sanctions, cyber, and other issues affecting the integrity of the international financial system.

In addition to playing a leading role in the TFTC, the Office of Terrorist Financing and Financial Crimes (TFFC) has actively engaged with international partners on a wide range of issues. While sanctions and related authorities are some of our most visible tools, a major part of what we do is quiet financial diplomacy. TFFC, working with foreign partners in Central Banks and Finance Ministries, has orchestrated scores of disruptions of hostile financial networks, ranging from the de-flagging of North Korean-affiliated vessels to closures of money exchange houses and bank accounts used by terrorists. This outreach and engagement includes serving as the lead U.S. participant in the Financial Action Task Force, working with the Group of 7 (G-7) on a range of national security issues, including the Democratic People's Republic of Korea, and working with our counterparts to strengthen their AML/CFT regimes, among many other proactive efforts.

We appreciate that the OIG recognizes the importance of TFI's human capital. We would note that with regard to the OIG's comments on long standing vacancies, progress has

<table>
<tr><td></td><td>been made. We recently announced a new Director of FinCEN, ensuring that this important national security position is now filled. As for the Assistant Secretary for OIA, the President nominated a career intelligence community professional to fill this post in the summer of 2017, and that vacancy will be filled as soon as Congress acts. We would also note that all TFI Deputy Assistant Secretary and Deputy Director positions are filled. In addition, we are focused on filling other relevant positions but, as is true with many national security positions, the clearance process can delay onboarding.</td></tr>
<tr><td rowspan="2">Efforts to Promote Spending Transparency and to Prevent and Detect Improper Payments<br>OMB and Treasury must continue to ensure that the data standards established are applied to the data made available on USAspending.gov by May 2018. Also, the effectiveness of the Do Not Pay Business Center as a tool to prevent and detect improper payments is hindered by challenges in acquiring access to certain data sources, such as Social Security Administration’s (SSA’s) death record database.</td><td><u>Digital Accountability and Transparency Act (DATA Act) Implementation.</u><br>The DATA Act government-wide implementation was a complex undertaking requiring a significant level of interagency coordination and cooperation to develop new financial data standards and an infrastructure to collect and validate the data within a short timeframe. We have taken steps to strengthen data quality by implementing refinements to the DATA Act Information Model Schema in September 2017, proposing a set of improvements to be implemented later this year, and collecting feedback from agencies about ways to improve the standards. Additionally, we continue to follow a fast-paced cadence to refining the software tools that ingest agency data (i.e., the Broker), implementing improvements every two weeks based on user feedback, further ensuring data standards are applied to government data made available on USAspending.gov.<br>In FY 2017, we also successfully certified Treasury’s first DATA Act submission. We established and aligned our systems and created a comprehensive governance framework to meet the submission and certification requirements. We continue to refine our processes to address implementation challenges through corrective actions to improve data quality for federal spending transparency.</td></tr>
<tr><td><u>Do Not Pay Business Center</u><br>In response to the Federal Improper Payments Coordination Act of 2015, the Do Not Pay (DNP) Business Center signed agreements with the Department of Defense and Department of State to incorporate death data collected by these agencies into the Treasury DNP Working System (Working System). DNP began receiving this data in September. Additionally, DNP resubmitted legislative proposals to obtain the authority to use both the SSA’s full death file as well as the National Directory of New Hires. DNP also actively engaged with OMB to review and approve a data designation that would add several new data sources to the Working System to help agencies address a broader range of improper payments beyond what can be detected through DNP’s current data sources. The data designation was published to the Federal Register for public comment in September 2017 and closed with no comments. OMB plans to publish the final designation in the Federal Register.</td></tr>
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| Summary of Challenges Facing IRS | |
|---|---|
| **TIGTA Reported Challenge** | **Management's Response** |
| **Security Over Taxpayer Data and Protection of IRS Resources**<br>Protecting the confidentiality of taxpayer information from internal and external threats continues to be a top concern for the IRS. | In FY 2017, the IRS established the Identity Assurance Executive Steering Committee (Identity Assurance) to provide a forum for building awareness and collaboration across the IRS, along with providing overall guidance and direction to the offices with Identity Assurance implementation responsibilities. The IRS implemented software to require a multi-factor authentication process for online tools and applications. The IRS also developed a tool to block emails with unencrypted Personally Identifiable Information (PII) (e.g., SSN's) from being sent outside the IRS infrastructure.<br><br>To further protect its employees, the IRS launched program initiatives to identify public trust and employee safety issues and develop recommendations to address or mitigate these risks through strategic deployment of new procedures, practices, and/or educational materials for the public, law enforcement, and IRS employees. |
| **Identity Theft and Impersonation Fraud**<br>Because new identity theft patterns are constantly evolving, the IRS needs to continuously adapt its detection and prevention processes. | The IRS consistently monitors information from various sources to identify new patterns and trends, update filters, and improve detection processes. Adjustments to filters, models, or processes are made when new patterns or challenges emerge. The IRS established several mailboxes to receive information related to W-2 phishing schemes, compromised business emails, and potential identity theft leads. Additionally, the IRS developed common identity theft communication script for employees, States, and the financial industry, and conducted outreach with institutions potentially affected by stolen refund fraud. The IRS also developed communications for software developers and tax professionals to educate stakeholders on authentication initiatives and requirements. |
| **Providing Quality Taxpayer Service and Expanding Online Services**<br>Ensuring that taxpayers understand and meet their tax responsibilities is crucial for the IRS in its effort to encourage voluntary compliance with the tax laws. | To further improve and expand its customer service process, the IRS partnered with the SSA to place IRS employees in SSA facilities to assist taxpayers requiring face-to-face service. This approach provides a one-stop service and creates potential real estate savings. Additionally, the IRS continued offering services to taxpayers through virtual delivery by increasing technology-based services and expanding the number of locations utilizing external partnerships to educate taxpayers on alternative ways for needed services. In addition to utilizing external partnerships and establishing new self-service tools for taxpayers, the IRS expanded the use of appointments to more Taxpayer Assistance Center (TAC) locations. By early FY 2017, all face-to-face locations were accepting appointments for service.<br><br>To enhance customer service for Identity Theft (IDT) victims, the IRS implemented a new toll-free number which enables victims to directly contact the IRS employee assigned to their case. In TIGTA's audit of the Identity Theft Victims Assistance organization, published in June 2017, TIGTA acknowledged that on average, accounts were taking 112 fewer days to resolve than reported in March 2015. Beginning in filing season 2017, the IRS also began notifying victims of employment-related IDT that someone was using their social security number for employment purposes. |
| **Upgrading Tax Systems**<br>The IRS's reliance on legacy systems and its use of outdated programming languages pose significant risks to the IRS's ability to deliver its mission. Additional concern regarding IRS systems modernization is ensuring that systems and data remain secure and reliable. | The FY 2018 President's Budget reallocates $179 million from the Business Systems Modernization appropriation and will be supplemented with approximately $20 million in user fees to reduce aged infrastructure. The IRS focuses its limited capacity for aged hardware and software replacement on critical filing season platforms and high value assets. This strategy has enabled the IRS to reduce instances of service outages.<br><br>The IRS developed an enterprise-wide cloud strategy. It is currently undergoing an internal review, which is scheduled to be completed by the end of calendar year 2017. The IRS cloud strategy plan defines a path to:<br>• A "cloud first" policy at the IRS;<br>• Cloud adoption driven by cloud strategy and following managed processes for selection, management and inventory of cloud based services;<br>• A risk framework to ensure safe cloud adoption; and<br>• An approach to assess and migrate legacy IRS IT functions to the cloud to reduce operational cost, increase operational efficiencies and help address the aging IRS hardware inventory. |

| | |
|---|---|
| | Additionally, the IRS completed a full review and update to the Security Change Management Standard Operating Procedures to ensure that the procedures clearly stipulate that the security change management process must be followed prior to new information systems being introduced to the IRS infrastructure and for changes to existing information systems. |
| **Implementing Tax Law Changes**<br>The IRS faces continuing challenges each year in processing tax returns due to implementation of new tax laws as well as changes resulting from expired tax provisions. | The IRS implemented all required actions outlined in the *Trade Preference Extension Act of 2015* (P.L. 114-27). Implementation of the advance monthly payment program included two phases: interim Health Coverage Tax Credit (HCTC) Advance Monthly Premium, implemented July 2016; and the HCTC monthly program, implemented in January 2017. To ensure that individuals meet HCTC eligibility qualifications before adding eligibility indicators to their tax accounts, the IRS developed programming changes that will perform the requisite automated checks. The IRS is on track to implement these changes for the TY 2017 filing season using Pension Benefit Guaranty Corporation and Department of Labor eligibility records.<br><br>To remind taxpayers of their requirement to reconcile payments received from the Exchange, the IRS mailed ACA notices and letters relating to unreconciled Advance Payments of the Premium Tax Credit (APTC). The notices were sent to taxpayers who failed to address health coverage on their tax return.<br><br>In FY 2017, the IRS participated in numerous external events to communicate the effect of the PATH Act on Individual Taxpayer Identification Number (ITIN) holders, and to recruit participation of tax professionals in the Certifying Acceptance Agent (CAA) Program to assist new and renewal applicants. To promote the CAA Program among partners, a robust strategic plan was developed to increase the number of CAAs and to ensure optimum coverage at Volunteer Income Tax Assistance/Tax Counseling for the Elderly sites. |
| **Improving Tax Compliance**<br>Despite IRS efforts to reduce it, the Tax Gap remains a serious and persistent challenge. | As part of ongoing efforts to reduce the tax gap, the IRS continues to evaluate and improve its processes and compliance programs. A cross-functional team conducted a study of the backup withholding program to identify improvement opportunities to current processes, including education and outreach needs. Enforcing payer backup withholding requirements will enhance the IRS's ability to collect taxes on all appropriate income, particularly income that is not usually subject to withholding.<br><br>In the spring of 2017, the IRS initiated a review of the non-filer program and is seeking to improve efficiencies by developing new models and allocating resources effectively to ensure the non-filer program is an integral part of overall compliance efforts. The IRS also reviewed the processes for creating the individual master file non-filer inventory and identified strategic break points. A checklist was developed to show the break points as well as fields to record the process results and to indicate whether the results met expected outcomes. |
| **Reducing Fraudulent Claims and Improper Payments**<br>Refundable credits can result in the issuance of tax refunds even if no income tax is withheld or paid and can be the targets of unscrupulous individuals who file erroneous claims. | Since the IRS does not have authority to systemically correct erroneous claims caused by taxpayer error or resulting from fraud, they must conduct audits to address potential erroneous claims. For the EITC, the IRS mailed educational and compliance letters and conducted pre-filing season EITC due diligence contacts and visits. Additionally, the IRS developed a Refundable Credit Operational Strategy which was incorporated into the development of the FY 2018 exam plan. Exam treatments were aligned with filing percentages by refundable tax credit type, ensuring that exam treatments were reflective of the filing population. Return on Investment data was used to select the most cost-effective treatments and those that had the most significant effect on reducing improper payments.<br><br>The IRS also performed a process analysis on returns to prevent improper premature release of potentially fraudulent returns. Based on the results of the process analysis, the IRS implemented several programming updates. |

| | |
|---|---|
| **Impact of Global Economy on Tax Administration**<br>The globalization of financial markets and the increased importance of multinational corporations are making it increasingly difficult for the IRS to administer and enforce tax compliance. | The IRS has implemented a compliance campaign that will risk assess all taxpayers who were denied access to, or withdrew from, the Offshore Voluntary Disclosure Program, and apply one of two treatment streams to "high risk" and "medium risk" taxpayers. The IRS has started audits for some high risk taxpayers identified. A letter and response form will be sent to medium risk taxpayers. The IRS also focused on identification, measurement, and monitoring of transfer pricing risk to improve selection of issues for examination and better allocate limited resources. These efforts include review of the Transfer Pricing Audit Roadmap, as well as implementation of new country-by-country reporting requirements.<br><br>In FY 2017, the IRS introduced an automated registration system to electronically process applications from foreign intermediary (or foreign branch of a U.S. intermediary) that has entered a qualified intermediary withholding agreement with the IRS. This electronic system facilitated and expedited the communication between the IRS and the foreign entities involved. Additionally, Foreign Financial Institutions (FFIs) had to renew their registration to continue their exemption from withholding. FFIs that are not registered face a penalty of a 30 percent withholding tax on certain payments (primarily interest and dividends). |
| **Protecting Taxpayer Rights**<br>The IRS must balance its tax compliance activities against the rights of taxpayers to receive fair and equitable treatment. | To enhance protection of taxpayer rights, the IRS implemented procedures that require the requestor of a Notice of Federal Tax Lien (NFTL) to ensure that the Centralized Lien Processing Operation is notified of all powers of attorney. The IRS revised Form 12636, *Request for Filing or Refiling Notice of Federal Tax Lien*, to include a checkbox indicating whether a valid power of attorney is required to be sent a copy of the lien notice. The IRS also revised procedures to require the lien unit to verify all NFTL requests for which the checkbox on Form 12636 was blank. Programming updates were completed for the use of the revised Form 12636.<br><br>To address errors related to the determination of the Collection Statute Expiration Date, clarifying examples and additional emphasis were placed in the IRS manual for technical employees to review the accuracy of statute start dates as part of their initial review of a case. |
| **Achieving Program Efficiencies and Cost Savings**<br>Continuing to identify and achieve greater program efficiencies and cost savings is imperative for the IRS as it strives to successfully accomplish its mission in a period of shrinking budgets and declining resources. | The IRS continues to take steps to reduce costs and improve program effectiveness by:<br>• Implementing tools to improve and automate Software Asset Management inventory, including its utilization and reporting functions;<br>• Creating a baseline inventory of software licenses to achieve savings due to improved license management;<br>• Deploying a new Enterprise Exchange e-mail solution to meet National Archives and Records Administration requirements and the requirements of OMB's M-12-18, *Managing Government Records Directive*; and<br>• Reviewing the non-filer program (including Automated Substitute for Return) to improve efficiencies, develop new models, and allocate resources effectively. The IRS is focused on identifying productive non-filer work that maximizes cases worked while minimizing staff resources and promoting continued filing compliance through programs built to encourage voluntary taxpayer filing and payment.<br><br>The IRS continues to support the web first strategy and encourage taxpayers to view, download, and print tax products from IRS.gov, where finalized tax products are usually available six to eight weeks before paper products are distributed. Taxpayers may still order a paper copy of any current-year form, instruction, or publication on IRS.gov or by calling a toll-free number.<br><br>The IRS has also utilized alternative delivery methods such as teleconferencing, video-conferencing, or other virtual delivery options whenever possible to deliver training. Alternative delivery methods help the IRS meet sustainable goals and reduce overall event costs. |

# SECTION D: SUMMARY OF FINANCIAL STATEMENT AUDIT AND MANAGEMENT ASSURANCES

The following tables present information pertaining to Treasury's reported material weaknesses, as well as information related to our conformance with FMFIA and compliance with FFMIA.

## SUMMARY OF FINANCIAL STATEMENT AUDIT

**Audit Opinion: Unmodified**
**Restatement: No**

| Material Weakness | Beginning Balance | New | Resolved | Consolidated | Ending Balance |
|---|---|---|---|---|---|
| Material Weakness in Internal Control Over Financial Reporting at the IRS | 1 | 0 | 0 | 0 | 1 |
| Total Material Weaknesses | 1 | 0 | 0 | 0 | 1 |

## SUMMARY OF MANAGEMENT ASSURANCES

### EFFECTIVENESS OF INTERNAL CONTROL OVER FINANCIAL REPORTING (FMFIA SECTION 2)

**Statement of Assurance: Modified**

| Material Weakness | Beginning Balance | New | Resolved | Consolidated | Reassessed | Ending Balance |
|---|---|---|---|---|---|---|
| IRS – Unpaid Tax Assessments [1] | 1 | 0 | 0 | 0 | 0 | 1 |
| Total Material Weaknesses | 1 | 0 | 0 | 0 | 0 | 1 |

### EFFECTIVENESS OF INTERNAL CONTROL OVER OPERATIONS (FMFIA SECTION 2)

**Statement of Assurance: Modified**

| Material Weaknesses | Beginning Balance | New | Resolved | Consolidated | Reassessed | Ending Balance |
|---|---|---|---|---|---|---|
| Fiscal Service – Control Deficiencies in the Processes used to Prepare the Consolidated Government-wide Financial Statements [2] | 1 | 0 | 0 | 0 | 0 | 1 |
| Total Material Weaknesses | 1 | 0 | 0 | 0 | 0 | 1 |

### CONFORMANCE WITH FMFIA SECTION 4

**Statement of Assurance:** **Federal Systems conform to financial management system requirements**

| Non-Conformances | Beginning Balance | New | Resolved | Consolidated | Reassessed | Ending Balance |
|---|---|---|---|---|---|---|
| Total non-conformances | 0 | 0 | 0 | 0 | 0 | 0 |

### COMPLIANCE WITH FFMIA SECTION 803(a)

| | Agency | Auditor |
|---|---|---|
| 1. Federal Financial Management System Requirements | Lack of compliance noted | |
| 2. Applicable Federal Accounting Standards | Lack of compliance noted | |
| 3. U.S. Standard General Ledger (USSGL) at Transaction Level | No lack of compliance noted | |

[1] GAO, Management Report: Improvements Needed in IRS's Internal Controls, GAO-08-368R; GAO, Management Report, Improvements are Needed in IRS's Internal Controls and Compliance with Laws and Regulations, GAO-10-565R; GAO, Management Report: Improvements Are Needed to Enhance the Internal Revenue Service's Internal Control over Financial Reporting, GAO-15-480R and GAO-17-454R

[2] GAO, Management Report: Improvements Needed in Controls over the Processes Used to Prepare the U.S. Consolidated Financial Statements, GAO-17-524

# TREASURY'S MATERIAL WEAKNESSES

## FMFIA AND FFMIA REQUIREMENTS

The *Federal Managers Financial Integrity Act of 1982* (FMFIA) requires agencies to establish and maintain internal control to ensure that federal programs operate efficiently, effectively, and in compliance with laws and regulations. The Secretary must evaluate and report annually on (a) whether there is reasonable assurance that the Agency's controls are achieving their intended objectives, and (b) material weaknesses in the Agency's controls (FMFIA Section 2). Additionally, the Secretary must evaluate and report separately on whether the Agency's financial management systems comply with government-wide requirements (FMFIA Section 4). The *Federal Financial Management Improvement Act of 1996* (FFMIA) requires agencies to implement and maintain management systems that substantially comply with federal financial management systems requirements. The requirements of the FMFIA of 1982 serve as an umbrella under which other reviews, evaluations, and audits should be coordinated and considered to support management's assertion about the effectiveness of internal control over operations, financial reporting, and compliance with laws and regulations.

As of September 30, 2017, we had two material weaknesses under Section 2 of the FMFIA, summarized as follows:

| Summary of FMFIA Material Weaknesses | Section 2 | Section 4 | Total |
|---|---|---|---|
| Balance at the Beginning of FY 2017 | 2 | 0 | **2** |
| Closures/Downgrades during FY 2017 | 0 | 0 | **0** |
| Reassessed during FY 2017 | 0 | 0 | **0** |
| New Material Weakness Declared during FY 2017 | 0 | 0 | **0** |
| Balance at the End of FY 2017 | 2 | 0 | **2** |

Below are highlights of Treasury's material weaknesses:

<table>
<tr><th colspan="2">Material Weakness Description</th></tr>
<tr><td colspan="2">INTERNAL REVENUE SERVICE – Improvements needed in internal control over unpaid tax assessments.<br><br><u>SUMMARY</u>: GAO identified control deficiencies that affected IRS's management and reporting of unpaid tax assessments. GAO reported that:<br>• The IRS's reported balances for taxes receivable and other unpaid tax assessments were not supported by its core general ledger system for tax transactions;<br>• System deficiencies in IRS's subsidiary ledger and supporting financial systems for unpaid tax assessments did not allow it to produce reliable and useful information with which to manage and report; and<br>• Various other control deficiencies that led to errors in taxpayer accounts.<br><br><u>GAO RECOMMENDATION</u>: The IRS Commissioner should direct the appropriate IRS officials to do the following:<br>1. Take appropriate action to correct the programs that control penalty assessments so that they function in accordance with the Internal Revenue Manual (IRM) (GAO-08-368R);<br>2. Implement control procedures to routinely prevent, or to detect and correct, the control weaknesses that result in inaccuracies or errors that affect the financial reporting of unpaid tax assessments (GAO-10-565R);<br>3. Develop and implement agency-wide procedures to routinely monitor the accuracy of penalties recorded in taxpayer accounts to timely detect and correct errors (GAO-15-480R);<br>4. Develop and implement a process to reasonably assure that programming changes affecting financial reporting are effectively coordinated with the Chief Financial Officer (CFO) organization (GAO-17-454R); and<br>5. Establish a process to better ensure compliance with existing policies for testing programming changes, including the use and review of the Applications Development transmittal checklist when developing program changes and retention of test results (GAO-17-454R).</td></tr>
<tr><th>Actions Completed in FY 2017</th><th>What Remains to be Done</th></tr>
<tr><td>✓ The CFO issued additional guidance to the IRS Executives establishing communication requirements for any program initiatives that may affect the IRS custodial financial systems, including unpaid assessments.<br>✓ The IRS continuously updated a series of long-term actions intended to address all issues impacting the material weakness which, based on funding, will be integrated into the unpaid assessments material weakness action plan.<br>✓ Completed the following six actions from the FFMIA remediation plan:<br>o Reviewed Unified Work Request 155806 for accuracy and resolution to address prior delinquency penalty errors;<br>o Conducted an analysis of the implementation of IRC 6404(c) to write-off specific uncollectable modules prior to the statute expiring, and made a business decision not to implement;<br>o Submitted a Unified Work Request to address significant movements out of financial class write-offs to improve the accuracy of the IRS's financial classifications;<br>o Documented the current status of all open issues related to penalties;<br>o Complete additional testing to confirm resolution of three open issues related to penalties; and<br>o Publish IRM 20.3.1, Civil Penalty Accuracy Review Process.<br>✓ Established a Financial Systems Enhancement Tiger Team that developed three unpaid assessments improvement recommendations.<br>✓ Established a Data Quality Task Force to improve the data within the taxpayer accounts.</td><td>☐ IT organization will review and update the affected current policies and implement any related process and policy changes as needed.<br>☐ Implement action items from the long-term action plan to close the material weakness.<br>☐ Implement the three Financial Systems Enhancement Tiger Team improvement recommendations; namely, Pending Payments II, Financial Status Notice History, and Revenue Data Mart once funding is identified.<br>☐ The Unpaid Assessments Data Quality Task Force will identify, document, and enhance existing data quality efforts, conduct pre-posting data quality review, review data posted to taxpayer accounts, expand large dollar review, and address legislative requests and emerging issues.<br>☐ Implement Customer Account Data Engine (CADE2) Transition State 2 (TS2) financial material weakness functionality.</td></tr>
</table>

**Material Weakness Description**

**BUREAU OF FISCAL SERVICE –** Improvements needed in controls over the processes used to prepare the *U.S. Consolidated Financial Statements* (CFS).[3]

**SUMMARY:** GAO identified control deficiencies in Treasury's and OMB's processes used to prepare the CFS. These control deficiencies contributed to material weaknesses in internal control that involve the federal government's inability to:

- Adequately account for and reconcile intragovernmental activity and balances between federal entities;
- Reasonably assure that the consolidated financial statements are: (1) consistent with the underlying audited entities' financial statements, (2) properly balanced, and (3) in accordance with U.S. Generally Accepted Accounting Principles; and
- Reasonably assure that the information in the (1) Reconciliations of Net Operating Cost and Unified Budget Deficit and (2) Statements of Changes in Cash Balance from Unified Budget and Other Activities is complete and consistent with the underlying information in the audited entities' financial statements and other financial data.

**GAO RECOMMENDATION**: The Secretary of the Treasury should direct the Fiscal Assistant Secretary, in coordination with the Controller of OMB's Office of Federal Financial Management, to do the following:

1. Ensure that federal agencies provide adequate information in their legal representation letters regarding the expected outcomes of the cases;
2. Establish written policies and procedures to help ensure that major treaty and other international agreement information is properly identified and reported in the CFS;
3. Ensure that these federal agencies report or disclose relevant criminal debt information in conformity with U.S. Generally Accepted Accounting Principles in their financial statements;
4. Establish effective processes and procedures to ensure that appropriate information regarding litigation and claims is included in the government-wide legal representation letter;
5. Develop and implement effective processes for monitoring and assessing the effectiveness of internal control over the processes used to prepare the CFS;
6. Establish and implement effective procedures for reporting amounts in the CFS budget statements that are fully consistent with the underlying information in significant federal entities' audited financial statements and other financial data;
7. Establish and implement effective procedures for identifying and reporting all items needed to prepare the CFS budget statements;
8. Establish and implement policies and procedures for accounting for and reporting all significant General Fund activity and balances, obtaining assurance on the reliability of the amounts, and reconciling the activity and balances between the General Fund and federal entities; and
9. Develop and implement procedures to determine whether user accounts already exist before establishing or recertifying user accounts in the Government-wide Treasury Account Symbol Adjusted Trial Balance System (GTAS) or the Government-wide Financial Reporting System (GFRS).

| | |
|---|---|
| ✓ Documented the controlled process that federal entities follow in using the "unable to determine" expected outcome of legal cases.<br>✓ Documented the process to be followed by federal entities to report and disclose relevant criminal debt information.<br>✓ Leveraged the existing legal representation letter schedules to perform analytics on the items below the threshold to determine the materiality at the aggregate level.<br>✓ Implemented effective processes to monitor and assess the effectiveness of internal controls over the CFS.<br>✓ Implemented processes to validate new users who do not already have an existing account in GTAS or GFRS, and to ensure that users do not have conflicting roles or privileges. | ☐ Document the process of reporting the three categories of treaties and international agreements in the U.S. government.<br>☐ Incorporate the new reporting requirement of the federal entities' *Reconciliation of Net Cost of Operations to Budget* footnote into the preparation of the government-wide financial statement, *Reconciliation of Net Operating Cost and Unified Budget Deficit.*<br>☐ Obtain independent audit assurance on the General Fund of the U.S. Government. |

[3] Based on the findings reported in the *GAO-17-283R, Financial Audit: FY 2016 and 2015 Consolidated Financial Statements of the U.S. Government.* The status of this material weakness may change as a result of the FY 2017 audit of the CFS to be published in January 2018.

# SECTION E: PAYMENT INTEGRITY

Our FY 2017 Payment Integrity reporting includes information required by the *Improper Payments Information Act of 2002* (IPIA), as amended by IPERA of 2010 and *Improper Payments Elimination and Recovery Improvement Act of 2012* (IPERIA), Executive Order 13520, *Reducing Improper Payments and Eliminating Waste in the Federal Government*, Appendix C to OMB Circular A-123, *Requirements for Effective Estimation and Remediation of Improper Payments* and OMB Circular A-136. Additional information on current and prior year reported improper payments can be found at https://paymentaccuracy.gov/.

## I. SAMPLING AND ESTIMATION

### EITC Program

Each year, bureaus and offices (hereafter referred to as "components") are required to conduct risk assessments on all material programs to identify the risk of susceptibility to improper payments. Programs identified as susceptible (i.e., programs with gross annual improper payments exceeding both 1.5 percent and $10 million in total program outlays, or $100 million at any rate), are required to perform (1) statistical sampling to determine an improper payment rate, and (2) develop and submit a corrective action plan to OMB. In FY 2017, risk assessments were performed on 75 programs that resulted in either low or medium risk levels of susceptibility to improper payments. The required actions for low and medium risk programs include annual monitoring through risk assessments, and review of payment controls for improvement opportunities, respectively.

The EITC is a refundable federal tax credit that offsets income taxes owed by low-income workers who qualify and provides a refund if the credit exceeds the amount of taxes owed. Since EITC is deemed a high risk and high priority program by the Department and OMB, a risk assessment is not required or performed.

As described below, the IRS engages in a number of activities to encourage voluntary compliance and prevent improper payments. The IRS performs certain automatic checks of all claims and audits some claims before tax refunds are paid. In addition, as with all tax provisions, the IRS performs some examinations after refunds are paid, and subsequently recovers some improper payments. The improper payment amounts reported below include improper overclaims plus the absolute value of underpayments, less certain erroneous payments that are prevented or recovered. The error rate is the net improper payment amount divided by the total amount of EITC claimed.

In accordance with the requirements of IPERIA, we update the improper payment estimates annually. The EITC improper payment rate is estimated using a statistically valid sample of about 2,700 returns audited through the IRS's NRP. This sample is sufficient to estimate the improper payment rate with plus or minus 2.5 percentage point precision and 90 percent confidence. For TY 2013 (the most recent study completed), the estimated gross amount of improper payments was $18.0 billion and the total amount of EITC claimed was $66.8 billion. The amount of erroneous EITC payments prevented or recovered on TY 2013 returns was $2.1 billion. This results in a net improper payment amount of $15.9 billion, or 23.9 percent of the total EITC claimed (or between 21.9 percent and 25.8 percent, accounting for sampling error).

The current estimated error rate of 23.9 percent is consistent with the five-year average error rate of about 24 percent. Applying this rate, estimated from TY 2013 data, to the estimated FY 2017 level of EITC claims ($68.0 billion) yields an estimated amount of improper payments for FY 2017 of $16.2 billion (or between $14.9 and $17.6 billion).

# II. Payment Reporting

## Improper Payment Estimate

While high priority programs are generally required to report reduction targets, setting improper payment reduction targets for the EITC program does not create meaningful goals for the IRS. This is due to the complexity of the tax law around EITC, lack of independent data regarding EITC eligibility, and the significant annual turnover within the participating population. The following table provides the EITC improper payment amounts for FY 2017 and the estimated improper payment rate for FY 2018:

### IMPROPER PAYMENT REDUCTION OUTLOOK ($ IN MILLIONS)

| Program | FY 2017 Outlays ($) [1] | FY 2017 Proper Payment Amount ($) | FY 2017 Proper Payment Rate (%) | FY 2017 Improper Payment Amount ($) [2] | FY 2017 Improper Payment Rate (%) [3] | FY 2017 Overpayments ($) | FY 2017 Underpayments ($) | FY 2018 Estimated Improper Payment Rate (%) [4] |
|---|---|---|---|---|---|---|---|---|
| EITC | $67,992.50 | $51,760.92 | 76.13% | $16,231.58 | 23.87% | $16,231.58 | [5] | 23.87% |
| **Total** | **$67,992.50** | **$51,760.92** | **76.13%** | **$16,231.58** | **23.87%** | **$16,231.58** | **[5]** | **23.87%** |

[1] EITC Outlays: FY 2017 Outlays are actually based on EITC outlays plus tax expenditures reported in the FY 2018 President's Budget, adjusted to account for the difference between EITC claims and the amounts actually received by taxpayers due to return processing and enforcement activities. EITC claims are the amounts that taxpayers report on their income tax return, without regard to whether IRS pays the claim.

[2] Improper Payment Amount: The estimated amount of improper payments (IP $) equals the estimated improper payment rate multiplied by the estimated outlays.

[3] Improper Payment Rate: The EITC improper payment rate is estimated from the latest data available from the IRS National Research Program (NRP) Individual Income Tax Reporting Compliance Study. The FY 2017 estimated improper payment rate was estimated using a statistically valid random sample of returns selected for the TY 2013 NRP study.

[4] FY 2018 Estimated Improper Payment Rate is assumed to be the same as the FY 2017 estimated net improper payment rate.

[5] None identified in the statistically valid random sample used to estimate the improper payment rate.

As an alternative to providing reduction targets for EITC, we have collaborated with OMB on the development of a series of supplemental measures. These measures should provide a more refined assessment of the EITC program and of our efforts to limit improper payments than would be provided by standard reduction targets.

The table below shows estimated values for these supplemental measures.

### FY 2017 EITC IMPROPER PAYMENT SUPPLEMENTAL MEASURES

| Measure | | FY 2017 Value | FY 2016 Value | FY 2015 Value |
|---|---|---|---|---|
| Annual Error Rate | Total Claims | $68 Billion | $69.8 Billion | $65.6 Billion |
| | Improper Payments | $16.2 Billion | $16.8 Billion | $15.6 Billion |
| Revenue Protected | Dollars | $4.5 Billion | $5.7 Billion | $7.3 Billion |
| | Returns | 1.5 Million | 1.9 Million [1] | 2.9 Million |
| Revenue Protected from Paid Preparer Treatments | Dollars | $415 Million | $384 Million | $399 Million |
| | Preparers | 25,473 | 26,253 | 20,598 |
| Preparer Due Diligence Penalties Proposed | Dollars | $22 Million | $32.8 Million | $34.3 Million |
| | Preparers | 1,038 | 1,137 | 1,042 |

[1] Value updated. Amount reported in Treasury's FY 2016 Agency Financial Report of 1.8 Million was based on preliminary data.

These measures are tracked and updated annually based on Tax Filing Season results. The supplemental measures include:

- The Annual Error Rate, which identifies the percentage of total EITC payments that are improper;
- The amount of Revenue Protected, which shows the total value of erroneous payments prevented, or recovered through compliance activities;
- The amount of Revenue Protected from Paid Preparer Treatments, which shows dollars erroneously or fraudulently claimed by paid tax preparers, but not paid out by Treasury; and
- The number of Preparer Due Diligence Penalties Proposed, reflecting the effectiveness of Treasury efforts to ensure paid tax preparers are submitting accurate, non-fraudulent EITC claims on behalf of taxpayers.

## Improper Payment Classification

Improper payments do not always result in a monetary loss to the government. For example, underpayments, payments made to the wrong recipient, or payments with insufficient documentation may not cause an actual monetary loss to the government. The following table identifies the actual monetary loss and the estimated total monetary loss to the government.

### IMPROPER PAYMENT CLASSIFICATION ($ IN MILLIONS)

| Program | Actual Monetary loss to the Government identified in Sample [1] | Estimated Total Monetary loss to the Government [2] |
|---|---|---|
| EITC | $2.28 | $17,459.45 |
| **Total** | **$2.28** | **$17,459.45** |

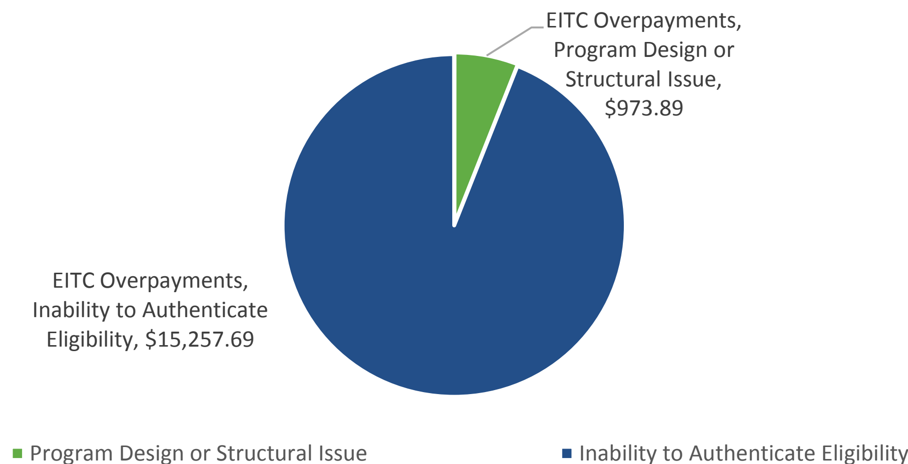
[1] The actual monetary loss to the government identified in the sample is from a statistically valid random sample of TY 2013 individual income tax returns that claimed the EITC. The amount reported here reflects the unweighted results of the audits that had closed at the time of the development of the improper payment estimate.

[2] Of the reported $17.459.45 million estimated total monetary loss to the government, $1,227.87 million will be recovered through the IRS enforcement activities. Subtracting the recovered amount from the estimated total monetary loss to the government yields the FY 2017 total improper payment amount of $16,231.58 million reported on the Improper Payment Reduction Outlook table on the previous page. The Estimated Total Monetary Loss to the Government equals the EITC Overclaims Paid.

## Improper Payment Root Cause(s)

Since FY 2015, our components are required to categorize improper payments using one or more of the following root causes: program design or structural issues, inability to authenticate eligibility, failure to verify, administrative or process errors, medical necessity, insufficient documentation to determine, and other. Based on the OMB updated improper payment root cause categories, the IRS identified the root causes for EITC improper payments as (1) inability to authenticate eligibility and (2) program design or structural issues. The chart below illustrates the distribution of EITC improper payments by root causes.

IMPROPER OVERPAYMENT ROOT CAUSE CATEGORY ($ IN MILLIONS)




### Inability to Authenticate Eligibility

Approximately $15.3 billion, or 94 percent, of EITC improper payments are from the inability to authenticate eligibility. This root cause includes errors associated with the inability to authenticate qualifying child eligibility requirements, due to relationship and residency requirements and the exceptions to the age requirement (full-time student and disability). Authentication is difficult because there is a lack of internal or external databases available with information that would help the IRS to make a determination of eligibility.

Another major cause of error in this category is taxpayer income misreporting due to self-employment income, where the income is not reported to the IRS by a third party. This category of errors also includes filing status errors, when married couples incorrectly file as single or head of household, and data on marital status and living arrangements are not available. Finally, this category includes a small amount of error related to rules for all taxpayers claiming EITC related to valid SSNs, residency of non-citizens, and when the taxpayer qualifies as a qualifying child of another taxpayer, none of which can be authenticated by the IRS at time of filing.

### Program Design or Structural Issues

Approximately $1.0 billion, or six percent, of improper payments are from program design limitations. Errors caused by program design occur when information needed to confirm payment accuracy is not available at the time the return is processed. These errors relate to certain income misreporting, tiebreaker errors, and joint return errors of qualifying children. For income misreporting, payer information, such as Form W-2, is typically not available to the IRS until after the filing season. Thus, the IRS is unable to fully match wages and other income sources against the return at time of filing.

A very small portion of errors are attributable to tiebreaker errors, where more than one taxpayer claims the same qualifying child. The IRS processes returns as they are filed and are unaware of duplicate situations when the first return is filed or who is actually qualified in a tiebreaker situation. Situations where a qualifying child files a joint return also make up a small portion of this category. A child cannot be a qualifying child if he or she files a joint return for a reason other than claiming a refund. Since all returns are not filed at the same time, the IRS cannot identify this situation until both returns are filed.

## Corrective Actions

The IRS's strategy with respect to improper payments is to intervene early to ensure compliance with the law. In FY 2017, the IRS addressed improper payments through its compliance programs, as well as through expansive outreach and education efforts to taxpayers and preparers. The table below illustrates the corrective actions implemented by the IRS to address the root causes identified.

### CORRECTIVE ACTION CATEGORIES

| Reason for Improper Payment | Examination Closures | Math Error Notices | Document Matching | Amended Returns | Two and 10 Year Bans | Identity Theft and Fraud | Criminal Investigations | Soft Notices | Return Preparer Initiatives | Return Preparer Outreach and Education | Software Developer Working Group |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Program Design or Structural Issue | X | | X | X | X | X | X | X | X | X | |
| Inability to Authenticate Eligibility | X | X | | X | X | X | X | X | X | X | X |

The IRS's EITC enforcement programs protected approximately $3.1 billion. The revenue includes EITC and other credits and taxes recovered or prevented from being paid in error in FY 2017, on returns filed in calendar year 2017 or earlier years. The chart below shows that the IRS conducted 327,878 EITC program examinations, issued 154,000 math error notices, and performed 666,334 document matching reviews.

## COMPLIANCE ACTIVITIES

| | FY12 | FY13 | FY14 | FY15 | FY16 (1) | FY17 (2) | FY18 (3) | FY12-FY18 Total |
|---|---|---|---|---|---|---|---|---|
| Audit Closures | 487,408 | 483,070 | 435,638 | 445,594 | 380,260 | 327,878 | 296,800 | 2,856,648 |
| Math Error Notices | 270,492 | 241,975 | 194,127 | 166,611 | 159,906 | 154,000 | 142,000 | 1,329,111 |
| Document Matching | 985,172 | 906,994 | 1,053,304 | 1,710,904 | 852,733 | 666,334 | 513,000 | 6,688,441 |
| Amended Returns (4) | 13,284 | 8,130 | 17,723 | 24,282 | 9,895 | 10,297 | 10,000 | 93,611 |

(1) Restated actual.

(2) Preliminary data.

(3) Estimate based on FY 2017 preliminary data and FY 2018 plans.

(4) Amended returns are a subset of audit closures.

These compliance activities have a significant effect, protecting $3.1 billion of revenue in FY 2017. Treasury projects that continued enforcement efforts will protect a total of nearly $25.6 billion in revenue through FY 2018, as shown below.

## PROTECTED REVENUE FROM COMPLIANCE ACTIVITIES ($ IN MILLIONS)

| | FY12 | FY13 | FY14 | FY15 | FY16 (1) | FY17 (2) | FY18 (3) | FY12-FY18 Total |
|---|---|---|---|---|---|---|---|---|
| Audit Closures | $ 2,049.23 | $ 2,113.73 | $ 1,751.32 | $ 1,991.06 | $ 1,826.30 | $ 1,599.00 | $ 1,455.09 | $ 12,785.73 |
| Math Error Notices | 314.34 | 299.03 | 243.34 | 226.82 | 237.24 | 242.00 | 252.00 | 1,814.77 |
| Document Matching | 1,554.75 | 1,422.60 | 1,385.06 | 2,313.96 | 1,570.54 | 1,248.26 | 1,248.00 | 10,743.17 |
| Amended Returns (4) | 38.45 | 26.18 | 52.42 | 76.63 | 34.56 | 33.38 | 33.00 | 294.62 |
| **Total** | **$ 3,956.77** | **$ 3,861.54** | **$ 3,432.14** | **$ 4,608.47** | **$ 3,668.64** | **$ 3,122.64** | **$ 2,988.09** | **$25,638.29** |

(1) Restated actual.

(2) Preliminary data.

(3) Estimate based on FY 2017 preliminary data and preliminary FY 2018 plans.

(4) Amended returns are a subset of audit closures.

In addition to the base compliance program efforts described above, the following efforts contributed to the IRS's strategy of identifying and reducing improper EITC refund claims in FY 2017:

- **EITC IPERA Methodology and Estimate**: Completed a new error rate estimate based on the EITC portion of the TY 2013 NRP study that meets IPIA standards for measuring and reporting on improper payments.
- **FY 2018 Action Plan**: Completed the FY 2018 action plan to reduce improper payments.
- **Compliance Studies**: Continued analysis of the most recent compliance study and the NRP data to influence our compliance strategy and amend EITC administration, where feasible.
- **Base Enforcement Efforts**: Delivered key compliance activities including 327,878 audits, 666,334 misreported income cases, and an estimated 154,000 math error adjustments, protecting revenue of over $3.1 billion.
- **Two and 10 Year Bans**: Imposed 2,443 two-year bans and 215 10-year bans for cases where the IRS determined during an EITC audit that the taxpayer intentionally disregarded the rules and regulations or committed fraud.

- **Identity Theft and Fraud**: Through our fraud detection filters, the IRS detected and stopped over 341,000 fraudulent returns. Thus, preventing nearly $1.6 billion in improper EITC payments.
- **Criminal Investigations:** Continued to stop fraudulent EITC refund claims through our Criminal Investigation (CI) division indictments. CI issued 204 EITC Questionable Refund Program scheme indictments with 196 convictions as well as 83 EITC Return Preparer indictments with 92 convictions.
- **Soft Notices:** Sent approximately 85,000 letters to alert taxpayers that a qualifying child for the EITC claimed on their returns had also been claimed by another person.
- **Return Preparer Initiatives:** As a part of the FY 2017 Refundable Credits Return Preparer Strategy, IRS completed activities associated with a suite of progressive EITC preparer treatments, addressing nearly 25,500 preparers selected through our risk-based scoring model, before and during the filing season. Approximately 22,000 were EITC preparers.
    - The IRS completed 744 pre-filing season Due Diligence Visits (DDVs) with a penalty rate of 85 percent and nearly $20 million in proposed penalties. Criminal investigation and revenue agents completed 64 EITC educational Knock-and-Talk Visits (KTV). The IRS also mailed over 14,100 EITC educational notices and successfully made nearly 500 calls to EITC preparers before the FY 2017 filing season.
    - The IRS proposed penalties of over $346,000 on 17 of 20 DDVs completed as a follow-up for those preparers who received pre-filing season KTVs but did not improve their due diligence. The IRS also mailed over 8,500 educational notices and successfully made nearly 1,600 calls to preparers during the 2017 filing season.
    - The analysis of the FY 2017 Refundable Credits Return Preparer Strategy revealed that, in addition to the penalties protected above, the preparer treatments protected over $505 million ($415 million EITC and $90 million Child Tax Credit).
- **Return Preparer Penalties**: Proposed almost $4.8 million in penalties to 300 TY 2016 EITC, AOTC and ACTC return preparers for failure to exercise due diligence by attaching Form 8867, *Paid Preparer's Due Diligence Checklist*, to taxpayer returns, in accordance with IRC Section 6695(g) and Treasury Regulation Section 1.6695–2. The IRS also sent over 6,500 warning letters and over 1,600 electronic alerts to warn preparers that did not attach Form 8867 to TY 2016 taxpayer returns.
- **Return Preparer Outreach and Education**: Focused outreach and education efforts on EITC return preparers to educate them on EITC and due diligence requirements. Over 21,800 preparers received a certificate of completion for the English and Spanish interactive EITC Due Diligence Training module. Delivered webinars to nearly 3,200 tax professionals on due diligence requirements. Additionally, 4,774 preparers attended the 'One Year Down, but Wait! There's More on Refundable Credits' Due Diligence seminar at the 2017 National Tax Forums.
- **Service-wide EITC Strategy**: Continued activities to evaluate potential new solutions identified to address improper payments.
- **Supplemental Measures**: Continued to report supplemental measures that capture key components of revenue protected through compliance activities and paid return preparer treatments, as well as paid return preparer due diligence penalties proposed.
- **Software Developer Working Group**: Continued our partnership with members of key tax software associations to reduce EITC errors and assist preparers in meeting their EITC due diligence requirements.

- **Taxpayer Outreach and Education**: IRS conducted its EITC outreach campaign, including the eleventh annual EITC Awareness Day, which centered on EITC underserved populations and included focused compliance messages. Through collaboration with IRS national, state, and local partners as well as Congressional and government officials, the IRS held 183 nationwide events, resulting in media coverage that helped disseminate information about the EITC tax credit. The IRS also issued over 327,000 and 43,000 news releases in English and Spanish, respectively. Social media outreach continued to expand with Twitter EITC messages reaching over 9.6 million people and Thunderclap reaching over 926,000 people. Additionally, over 496,000 taxpayers visited the EITC Assistant on IRS.gov, a tool that allows taxpayers to determine whether they qualify for the credit.
- **Implemented Legislation**: The IRS took the following actions in implementing the PATH Act of 2015:
    - Held taxpayers' refunds until February 15, 2017 on returns claiming EITC and/or ACTC as directed in Section 201(b);
    - Rejected the amended or late filed original returns by taxpayers retroactively claiming EITC for any prior year in which he or she did not have a valid social security number as directed in Section 204; and
    - Submitted to Congress a study of the effectiveness of tax return preparer due diligence requirements for claiming EITC as directed in Section 207.
- **Legislative Proposals**: The following legislative proposals were included in the FY 2018 budget request:
    - Provide greater flexibility to address correctable errors to help IRS deny certain erroneous EITC claims before refunds are paid; and
    - Increase oversight of paid tax return preparers to help promote high quality services and improve voluntary compliance.
- **Enterprise Research**: Assessed the results of the FY 2017 enterprise research strategy and developed the FY 2018 strategy in partnership with internal organizations to better focus EITC compliance and outreach activities using research data.
- **EITC Summit**: The IRS hosted a second EITC Summit that was attended by numerous EITC stakeholders, including tax industry professionals, representatives of federal agencies, consumer advocates, and representatives from non-government organizations. The objective was to share progress on implementing PATH Act provisions, to provide information on both current program activities and plans for the 2018 filing season, and to solicit input on ways to improve EITC compliance.

## Refundable Tax Credits

In the risk assessments for material programs, ACTC, AOTC, and PTC were identified as medium risk. The ACTC and AOTC include large dollar amounts claimed annually for the credits that provide tax benefits to millions of taxpayers—many of whom are low-income—working, raising children, or pursuing higher education. These credits are refundable in that, in addition to offsetting tax liability, any excess credit over the tax liability is refunded to the taxpayer. Estimating improper payments does not take into consideration all aspects of administering tax provisions in a system that relies heavily on voluntary reporting. Additionally, statutory requirements mandate the IRS to process tax returns and pay any related tax refunds within 45 days of receipt of the tax return or the tax return due date, whichever is later. If payment to the taxpayer is not timely, interest is accrued on the refund amount beyond this 45-day period.

Since the largest portion of the tax gap falls outside of traditional refundable tax credit payments, reporting refundable tax credits under the tax gap section of the AFR allows for the appropriate discussion of misreporting errors in the context of overall tax compliance, and the appropriate consideration of how best to allocate the IRS's finite compliance resources. As fully integrated components of the tax administration system, refundable credits are paid as part of the taxpayer's refund, rather than existing as a separate payment program. Eligibility rules for claiming refundable credits can be complex due to the lack of third party data making pre-refund validation challenging. Additionally, the volume of claims and the need to allocate finite compliance resources makes post-refund adjudication of all potentially erroneous returns impossible. These challenges, coupled with high turnover in the claimant population and the difficulty of measuring and reporting on taxpayer adherence to refundable credit requirements, necessitate that the IRS estimate compliance as part of the tax gap in order to assess the effect of the credits on the tax administration system. The tax gap estimates provide a more accurate picture of overall taxpayer behavior than would be achieved by narrowly focusing on internal control weaknesses that may or may not exist to influence how funds are distributed to taxpayers.

To maintain accountability for all refundable credit programs, the IRS will continue to perform risk assessments on all IPERA implicated refundable tax credit programs, and will describe the outcome of this determination in the AFR. The IRS will also develop estimates for any program that exceed the thresholds delineated in IPERA as part of the overall tax gap estimation process. The IRS has summarized estimates from a compliance analysis of both the refundable and non-refundable portions of the CTC in Part 3, Section A, of this report titled "*Tax Gap and Tax Burden*." The IRS is currently analyzing compliance with the education credits, including the AOTC, and expects to complete a report on the analysis in FY 2018. The IRS has made a commitment to OMB to complete a quantitative risk assessment for PTC when the NRP data becomes available next year.

## III. Barriers

A number of factors continue to serve as barriers to reducing overclaims in the EITC program. These include:

- **Complexity of the tax law**: The EITC eligibility requirements are numerous and complex. Child-related rules are not consistent with other child-related tax benefits. Confusion among taxpayers about their eligibility contributes to the reported improper payment overclaims and underclaims.
- **Lack of eligibility information for taxpayers**: Statutory eligibility requirements cannot be independently confirmed using third party corroborating data.
- **Lack of correctible error authority**: The IRS has limited ability to make automatic changes (which would require Congressional authorization) and must use lengthy deficiency procedures.
- **High turnover of eligible claimants**: The IRS estimates that approximately one-third of the applicants change each year, meaning that each year a new population must learn about the complex EITC eligibility requirements.
- **Unscrupulous and/or incompetent return preparers**: About 52 percent of EITC returns are prepared by paid preparers, and most are unenrolled preparers who are not subject to professional oversight. Compliance studies show that EITC returns prepared by these unenrolled preparers have significant errors.
- **Fraud**: In FY 2017, the IRS reported a total of approximately $1.1 million in confirmed EITC fraud cases where civil actions were proposed and asserted. This amount does not include the nearly $1.6 billion in fraudulently claimed EITC that was prevented from being processed by the IRS's EITC fraud and identity theft programs.

None of these factors, on their own, can be considered the primary driver of program error. However, these barriers severely impede the IRS's dual mission of issuing refunds to those who are entitled, while ensuring refunds are paid only to those who truly qualify for the credit. Additionally, statutory requirements further constrain the IRS's ability to ensure that EITC claims are valid before they are processed and paid.

Since the EITC is administered through the IRC, it is claimed by taxpayers during the filing and processing of their tax returns. The IRC requires the IRS to process tax returns and pay any related tax refunds within 45 days of receipt of the tax return or the tax return due date, whichever is later. Beyond this 45 day period, interest begins accruing on the refund amount, which must be paid along with the refund to the taxpayer. This interest period was unaffected by the PATH Act provision that required IRS to hold EITC refunds until February 15 of the filing season.

In FY 2017, the changes enacted under the PATH Act to accelerate the filing of wage and non-employee compensation information, allowed the IRS to use the data to address refund fraud and improper payments. However, delays and extensions given for the forms limited IRS's ability to use the information at the time of filing or within a reasonable period thereafter in which a taxpayer would expect their refund. The IRS continues to face challenges when attempting to validate the EITC claims of filers with non-wage income that may not have a reporting requirement by third parties. The requirements, expectations, and data accessibility relative to the timely payment of refunds constrain the IRS's ability to conduct up-front verification of claims. These conditions distinguish EITC and its administration through the tax system from the extensive validity checks conducted by agencies administering other federal programs that typically establish eligibility prior to the issuance of payments or benefits.

We submitted legislative proposals in the FY 2018 budget proposal to help address EITC improper payments.

## IV. ACCOUNTABILITY

The Secretary has delegated responsibility for addressing improper payments to the ASM. Improper payments fall under the Department's management and internal control program. A major component of the internal control program is risk assessments, which are an extension of each Treasury component's annual improper payment elimination and recovery review process, as required under OMB Circular A-123, Appendix C. Under Treasury Directive 40-04, *Treasury Internal Control Program*, executives and managers are required to take all necessary steps to create an environment within their respective organizations or programs to ensure operational efficiency and adherence to all applicable statutory and regulatory standards related to internal controls. Managerial responsibility and accountability in all internal control areas are visible and well documented with our oversight mechanisms, such as the Treasury CFO Council and the Management Controls Executive Steering Committee. We have identified executives who are responsible and accountable for reducing the level of EITC overclaims, while other senior and mid-level officials have responsibility for monitoring progress in this area as bureau and program internal control officers.

## V. AGENCY INFORMATION SYSTEMS AND OTHER INFRASTRUCTURE

Overall, we have the internal controls, human capital, and information systems and other infrastructure needed to reduce improper payments to the targeted levels.

## VI. Recapture of Improper Payments Reporting

In accordance with IPERA and OMB Circular A-123, Appendix C*,* we perform and report annually on our payment recapture program. During FY 2017, we issued approximately $16.9 billion in payments subject to the payment recapture audit. The IPERA, as amended, expanded the payment types reviewed beyond just contracts to include grants, benefits, loans, and miscellaneous payments.

Our annual risk assessment process includes a review of pre-payment controls that minimize the likelihood and occurrence of improper payments. We require each Treasury component to conduct post-award audits and report on payment recapture activities, improper payments made, and recoveries achieved. Our components perform their payment recapture audit and identify candidates for payment recapture action in accordance with the Treasury-wide guidance.

We consider both pre- and post-reviews to identify payment errors a sound management practice that should be included among basic payment controls. All of our components have a process in place to identify improper payments during pre- and post-reviews. When applicable, our components may use the results of the Treasury Inspectors General and GAO reviews to help identify payment anomalies and target areas for improvement. However, we apply extensive payment controls at the time each payment is processed to minimize recapture activity. The table below illustrates the results from our payment recapture audit process.

## RECAPTURED OVERPAYMENTS WITH AND WITHOUT RECAPTURE AUDIT PROGRAMS ($ IN MILLIONS)

| Program | Total Improper Payment Amount Identified for Recapture | Total Amount Recovered via Payment Recapture [1] | % Recovered via Payment Recapture | Total Amount Recovered via Outside Source | % Recovered via Outside Source | Total Amount Outstanding [1] | Amount Determined to be not Collectable [2] |
|---|---|---|---|---|---|---|---|
| BEP | $ 0.0000 | $ 0.0000 | 0% | $ 0.0000 | 0% | $ 0.0845 | $ 0.0000 |
| CDFI | 0.0002 | 0.0002 | 100% | 0.0000 | 0% | 0.0000 | 0.0000 |
| DCP | 1.3318 | 1.1552 | 87% | 0.0000 | 0% | 0.5463 | 0.6319 |
| DO | 0.2942 | 0.3331 | 113% | 0.0000 | 0% | 0.0276 | 0.0051 |
| FinCEN | 0.0036 | 0.0034 | 94% | 0.0000 | 0% | 0.0001 | 0.0001 |
| DFF (ARC) | 0.1000 | 0.0994 | 99% | 0.0000 | 0% | 0.0006 | 0.0008 |
| FSA | 0.1227 | 0.1908 | 156% | 0.0000 | 0% | 0.0137 | 0.0233 |
| Mint | 0.0609 | 0.0758 | 124% | 0.0000 | 0% | 0.0276 | 0.0116 |
| OCC | 0.0511 | 0.0509 | 100% | 0.0000 | 0% | 0.0003 | 0.0000 |
| OFS | 0.3633 | 0.2699 | 74% | 0.0000 | 0% | 0.0935 | 0.3157 |
| OIG | 0.0031 | 0.0044 | 142% | 0.0000 | 0% | 0.0009 | 0.0000 |
| SIGTARP | 0.0026 | 0.0024 | 92% | 0.0000 | 0% | 0.0005 | 0.0016 |
| TIGTA | 0.0192 | 0.0071 | 37% | 0.0000 | 0% | 0.0140 | 0.0034 |
| TTB | 0.0020 | 0.0026 | 130% | 0.0000 | 0% | 0.0002 | 0.0004 |
| Prior Year bureau combined balances [3] | - | - | - | - | - | - | 0.0751 |
| **Total** | **$ 2.3547** | **$ 2.1952** | **93%** | **$ 0.0000** | **0%** | **$ 0.8097** | **$ 1.0690** [4] |

[1] Cumulative total of FY 2017 amount and prior year amount.

[2] Cumulative balances from FY 2012 to FY 2017.

[3] Combined bureau cumulative balances prior to FY 2012.

[4] Of this amount, approximately $0.13 million is from payments made in FY 2017 (or approximately six percent of total improper payments made in FY 2017).

Of our components reporting an Amount Determined to be not Collectable in the table above, we determined all of the write-off amounts to be immaterial, with the exception of the Office of D.C. Pensions (DCP). The amount determined not to be collectable is based on individual debt cases. After thorough reviews, active collection was ceased when cases were either waived as part of due process, or deemed uncollectable.

In FY 2017, we determined that conducting a Payment Recapture Audit on the following six low risk components was not cost-effective:

- Fiscal Service's Fiscal Service Debt (FSD) Programs;
- Fiscal Service's Fiscal Service Umbrella (FSU) Programs;
- Fiscal Service's Funds Management Branch (FSM) Programs;
- IRS's Administrative Fund Programs;
- Treasury International Programs; and
- Treasury Executive Office for Asset Forfeiture / Treasury Forfeiture Fund (TEOAF/TFF).

The Fiscal Service's FSD, FSU, and FSM programs continued to reflect a low risk level in nearly every group and payment type category assessed.

The IRS's Administrative Fund Programs are low risk level programs, with no GAO or TIGTA identified deficiencies and no prior payment recapture audit identified improper payments.

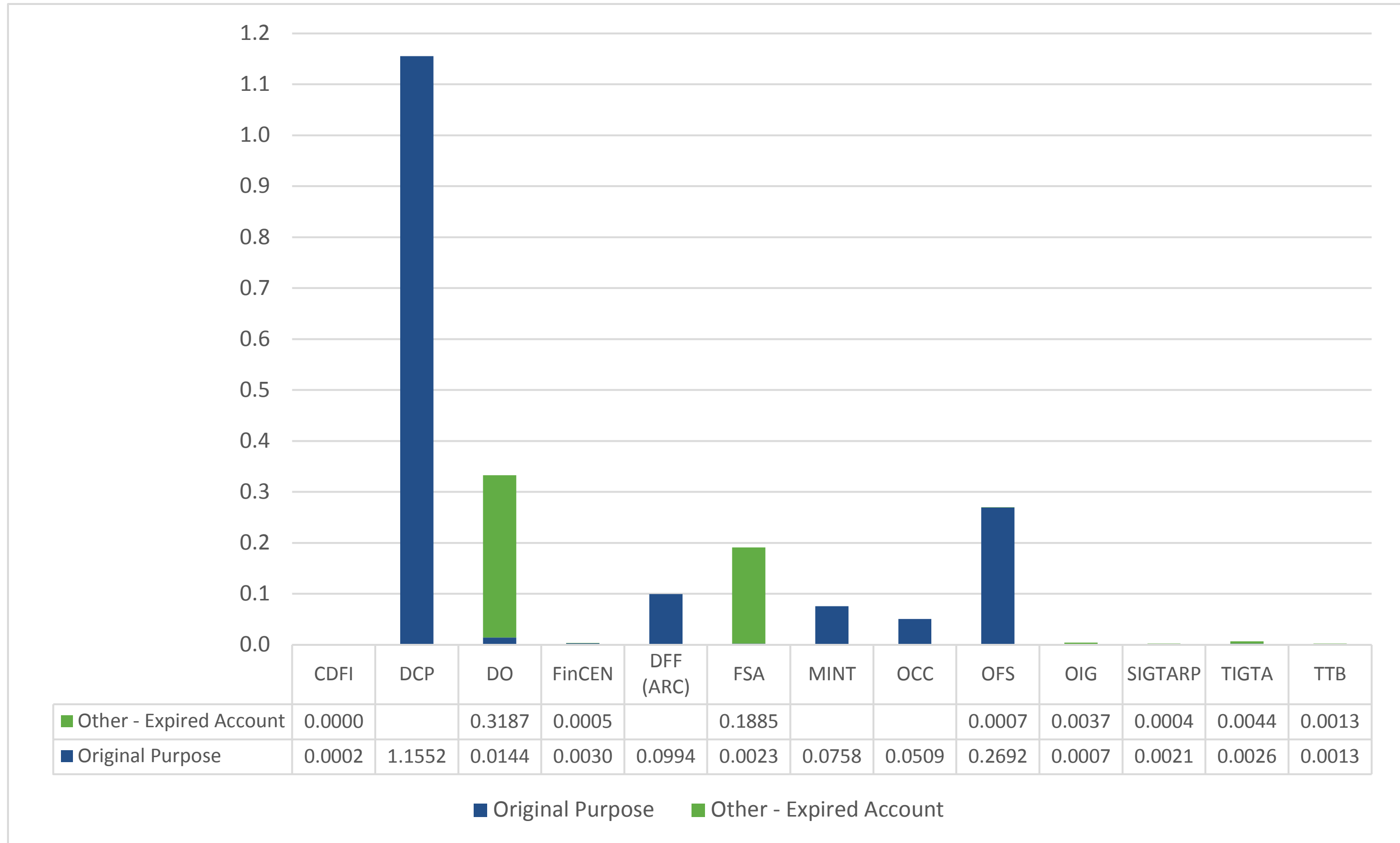
The Treasury International Programs disburse non-federal payments to the Multilateral Development Banks. Payments are made via payment vouchers on a letter of credit administered by the Federal Reserve Bank of New York, or direct cash payments through the Secure Payment System. The International Programs also disburse federal payments for Debt Restructuring via Intra-Governmental Payment and Collection (IPAC) or Standard Form (SF) 1081. Internal reviews are performed before all payments are issued.

The TEOAF/TFF program is a low risk level program, with no identified prior improper payment issues. In addition, program payments are made to state and local law enforcement agencies, reducing the risk of improper payments.

Based on the above justifications, payment recapture audits for these programs were not deemed cost effective. We sent notifications of these justifications to OMB and the Treasury OIG in October 2017.

Through the payment recapture audit, we recaptured approximately $2.2 million, of which approximately $1.7 million was used for original purposes, and the remaining $0.5 million was credited back to the expired account from which the overpayment was made. The following table represents the disposition of the recaptured improper payments by our components:

## DISPOSITION OF FUNDS RECAPTURED THROUGH PAYMENT RECAPTURE AUDIT PROGRAMS ($ IN MILLIONS)




| | CDFI | DCP | DO | FinCEN | DFF (ARC) | FSA | MINT | OCC | OFS | OIG | SIGTARP | TIGTA | TTB |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Other - Expired Account | 0.0000 | | 0.3187 | 0.0005 | | 0.1885 | | | 0.0007 | 0.0037 | 0.0004 | 0.0044 | 0.0013 |
| Original Purpose | 0.0002 | 1.1552 | 0.0144 | 0.0030 | 0.0994 | 0.0023 | 0.0758 | 0.0509 | 0.2692 | 0.0007 | 0.0021 | 0.0026 | 0.0013 |

As of September 30, 2017, there were approximately $0.8 million identified improper overpayments outstanding, with approximately $0.3 million identified in FY 2017 and $0.5 million identified in prior fiscal years. The table below shows the aging of the improper overpayments outstanding.

### AGING OF OUTSTANDING OVERPAYMENTS IDENTIFIED IN THE PAYMENT RECAPTURE AUDITS ($ IN MILLIONS)

| | 0 to 6 months | | 6 months to 1 year | | Over 1 year | |
|---|---|---|---|---|---|---|
| Program or Activity | Amount Outstanding | Percent Outstanding | Amount Outstanding | Percent Outstanding | Amount Outstanding | Percent Outstanding |
| BEP | N/A | N/A | N/A | N/A | $0.0845 | 10% |
| DCP | $0.0588 | 7% | $0.0323 | 4% | $0.4551 | 56% |
| DO | $0.0225 | 3% | $0.0003 | <1% | $0.0048 | 1% |
| FINCEN | $0.0001 | <1% | N/A | N/A | N/A | N/A |
| DFF (ARC) | $0.0006 | <1% | N/A | N/A | N/A | N/A |
| FSA | $0.0112 | 1% | $0.0004 | <1% | $0.0021 | <1% |
| MINT | $0.0225 | 3% | $0.0003 | <1% | $0.0048 | 1% |
| OCC | N/A | N/A | $0.0003 | <1% | N/A | N/A |
| OFS | $0.0935 | 12% | N/A | N/A | N/A | N/A |
| OIG | $0.0008 | <1% | N/A | N/A | $0.0001 | <1% |
| SIGTARP | N/A | N/A | $0.0005 | <1% | N/A | N/A |
| TIGTA | $0.0140 | 2% | N/A | N/A | N/A | N/A |
| TTB | $0.0002 | <1% | N/A | N/A | N/A | N/A |
| **Total** | **$0.2242** | **28%** (1) | **$0.0341** | **4%** (1) | **$0.5514** | **68%** (1) |

(1) Percentages may not foot due to rounding.

## VII. AGENCY REDUCTION OF IMPROPER PAYMENTS WITH THE DO NOT PAY INITIATIVE

The IPERIA requires pre-payment and pre-award reviews to determine program or award eligibility and to prevent improper payments before the release of any federal funds. This review must include the relevant databases as prescribed by IPERIA, including:

- The publicly available Death Master File (DMF) of the Social Security Administration;
- General Services Administration's Excluded Parties List System (or the updated System for Award Management [SAM]);
- Debt Check Database (Debt Check);
- Credit Alert System or Credit Alert Interactive Voice Response System of the Department of Housing and Urban Development;
- List of Excluded Individuals/Entities of the Office of Inspector General of the Department of Health and Human Services (HHS); and
- Information regarding incarcerated individuals maintained by the commissioner of Social Security, as added to IPERIA by the *Bipartisan Budget Act of 2013*, P.L. 113–67, which is provided to the IRS.

All of our components have incorporated pre-payment and pre-award reviews, as mandated by IPERIA, through established internal control processes and procedures that require reviews against the databases consolidated within the DNP Business Center (hereafter referred to as "DNP"), or through their own established databases. All Treasury non-tax payments are then compared against the DMF and SAM Exclusion Records at the time of payment via the DNP's online Portal. Matches that occur are then reviewed by staff at the appropriate bureau to determine if the payment was proper or improper. In FY 2017, no bureau identified incorrect information within their own established databases or after comparing the payments against the DNP.

# SECTION F: FRAUD REDUCTION REPORT

## BACKGROUND

The *Fraud Reduction and Data Analytics Act* (FRDA) of 2015, mandates agencies to take steps to improve financial and administrative controls and procedures to assess and mitigate fraud risks, and to improve federal agencies' development and use of data analytics for identifying, preventing, and responding to fraud, including those arising from improper payments. Each agency is required to report its progress in implementing: (1) the financial and administrative controls; (2) the fraud risk principle in the GAO Standards for Internal Control in the Federal Government (Green Book); and (3) management of fraud risk in accordance with OMB Circular A-123.

In response to FRDA, GAO issued the *Framework for Managing Fraud Risks in Federal Programs* in July 2015, based on leading practices for mitigating fraud risks and enhancing program integrity. The objective of fraud risk management is to proactively facilitate a program's mission by continuously and strategically mitigating the likelihood and impact of fraud. Whether an act is in fact fraud is a determination made through the judicial or other adjudicative system, and is beyond management's professional responsibility for assessing risk.[4]

## FRAUD RISK MANAGEMENT

All of our components have a shared responsibility in preventing, detecting, and responding to potential fraud, including improper payments. Our components have ownership and responsibility for managing fraud risk. The Office of Risk Management (ORM) is responsible for providing expertise and guiding principles to assist our components in the management of fraud risk. The Risk and Control Group within the Office of Deputy Chief Financial Officer, establishes Treasury-wide guidance designed to ensure that financial, programmatic, and administrative internal controls provide an appropriate level of assurance towards operational and fiscal effectiveness and efficiency. The OIG Office of Investigation (OI) is responsible for receiving and assessing complaints, and investigating potential fraud cases.

### First Line of Defense

Our components are the first line of defense to prevent, detect, and respond to potential fraud. They are the risk owners for their programs, and have responsibility for mitigating fraud risk and enhancing program integrity, by designing and implementing processes and controls that effectively prevent and detect potential fraud, both internal and external to Treasury. Components must establish policies, procedures, techniques, and mechanisms to comply with risk management, and internal control requirements to manage and respond to fraud risk.

While the Treasury DNP focuses on identifying, preventing and detecting improper payments, many of the tools and data analytics implemented through DNP can also serve as a first line of defense against potential fraud. The DNP's primary methodology for detecting improper payments (some of which could be due to fraud) is matching payment data to eligibility data. For example, Treasury disbursed payments are automatically matched to death data. If DNP's tools detect a payment to a deceased individual, DNP can help agencies stop future payments or quickly move to reclaim payments. Data matching is used both in the DNP's online Portal as well as in its analytics reports, and the data matching can be performed at different phases of the payment life cycle. For instance, DNP can continuously monitor a list of payees against lists of vendors excluded from working with the federal government so that an agency can take appropriate steps if a contractor has been debarred. In FY 2017, and in the final quarter of FY 2016, no Treasury program disbursements were identified as improper as a result of the DNP data matching.

[4] GAO-14-704, *Standards for Internal Control in the Federal Government*, September 2014.

The DNP analytics team has also been working on payment integrity checks for agencies to detect anomalies through its Agency Insight Reports, which are an analysis of all of an agency's Treasury-disbursed Payment Automation Manager (PAM) data. The results of the analysis are provided to the agency for review. The agency must then make a determination regarding whether the high risk payments or trends identified by DNP correspond to actual improper payments. The agency is also responsible for following up on any payments or trends that they believe are due to potential fraud.

## Internal Controls

Through our OMB Circular A-123 assessments, controls are monitored and evaluated to provide assurances that our components are effectively preventing, detecting, and responding to potential fraud. We incorporated GAO's Green Book Principle 8, Assess Fraud Risk, into our Treasury Implementation Guide for OMB Circular A-123, Appendix A. Our guidance conforms to the requirements of the GAO Green Book (revised in September 2014) and addresses internal control elements of the FRDA.

All of our components are required to integrate the GAO definitions for fraud, and consider risks for fraudulent financial reporting, misappropriation of assets, or corruption during their risk assessment process. Additionally, leading practices for mitigating fraud risk are required to be incorporated into our component's internal control system design to prevent, detect, and respond to fraud. In FY 2017, our components identified and implemented several fraud risk management practices, including, but not limited to, the development of fraud policies and indicators, the inclusion of fraud activities in the development of business processes, and the continued assessment of security policies.

In addition to assessing fraud risk as part of Appendix A to OMB Circular A-123, we also assess fraud risk during our improper payment reporting and recovery activities as part of Appendix C to OMB Circular A-123, *Requirements for Effective Estimation and Remediation of Improper Payment*. Through our improper payment reporting efforts, our components identify the programs deemed most susceptible to improper payments, based on total program disbursements and inherent risks to the integrity of the program. Additional assessments are performed on those susceptible programs to identify improper payments and determine potential fraud cases.

Additional information on Payment Integrity can be found in Part 3, Section E, of this report.

## Enterprise Risk Management

Fraud risk is addressed in the course of the ORM's general risk advisory work. Our leadership team has the opportunity to discuss potential fraud and other types of risks during regular Risk Committee meetings led by the Deputy Secretary and the Chief Risk Officer. The ORM conducts regular Enterprise Risk Management Council meetings with the bureau-level risk management contacts to discuss various risk topics, including fraud risk. Fraud risk is considered when our components are developing and updating their annual risk profiles, or top risk lists, to be shared with the ORM. The ORM is also in the process of developing a Treasury-wide enterprise risk management playbook that will include discussion of the types of risk that should be considered when developing risk profiles, including fraud risk.

## Investigations

Complaints come to the OIG's OI from our components, the public, and other government agencies by telephone, facsimile, U.S. mail, electronic mail, online complaint forms, referrals from other law enforcement agencies, and referrals from prosecutorial offices (U.S. Attorney's Offices and District or State Attorney's Offices). The following factors are used to determine if a complaint is investigated:

- The impact on Treasury's programs and operations;
- Alleged participation in the fraud, waste, or abuse by Treasury employees or contract employees;
- Financial loss to Treasury or the government; and
- Criminal allegations or activity that would be accepted for prosecution by the U.S. Attorney's Offices or State Attorney's Offices.
    - OI will investigate if there is a loss to Treasury that is prosecutable by subjects that are not employees of Treasury.
    - OI will also investigate all criminal activity alleged against Treasury employees, particularly senior Treasury employees.

# SECTION G: CIVIL MONETARY PENALTIES INFLATION ADJUSTMENT

The *Federal Civil Penalties Inflation Adjustment Act Improvements Act of 2015* (the 2015 Act) amended the *Federal Civil Penalties Inflation Adjustment Act of 1990* (Inflation Adjustment Act), to improve the effectiveness of civil monetary penalties (CMPs) and to maintain their deterrent effect. The 2015 Act requires agencies to: 1) use an interim final rulemaking (IFR) to adjust the level of civil monetary penalties in 2016 with an initial "catch-up" adjustment, 2) make subsequent annual adjustments for inflation, beginning in 2017; and 3) report annually in AFRs on these inflation adjustments. The 2015 Act requires that agencies make annual inflation adjustments based on annual OMB guidance and publish the latest penalty levels in the Federal Register no later than January 15 each year. The Inflation Adjustment Act and the 2015 Act exclude penalties under the IRC and the *Tariff Act of 1930*. The table below depicts the covered civil monetary penalties that are under our purview.

| Statutory Authority | Penalty (Name or Description) | Year Enacted | Latest Year of Adjustment (via Statute or Regulation) | Current Penalty Level ($ Amount or Range) [(1)] | Sub-Agency Bureau/ Entity | Location for Penalty Update Details |
|---|---|---|---|---|---|---|
| 50 USC App. 16(b)(1) Trading with the Enemy Act (TWEA), Section 16(b) | Sanctions violation | 1917 | 2017 | $85,236 | DO (OFAC) | 82 Federal Register 10434 (February 10, 2017) https://www.treasury.gov/resource-center/sanctions/Documents/fr82_10434.pdf |
| 50 USC 1705 International Emergency Economic Powers Act (IEEPA), Section 206 | Sanctions violation | 1977 | 2017 | The greater of $289,238 or twice the value of the underlying transaction | DO (OFAC) | Same as above |
| 18 USC 2339B(b) Antiterrorism and Effective Death Penalty Act (AEDPA) of 1996 | Sanctions violation | 1996 | 2017 | The greater of $76,351 or twice the amount of which a financial institution was required to retain possession or control | DO (OFAC) | Same as above |
| 21 USC 1906(b) Foreign Narcotics Kingpin Designation Act (FNKDA), Section 807 | Sanctions violation | 1999 | 2017 | $1,437,153 | DO (OFAC) | Same as above |
| 19 USC 3901-3913 Clean Diamond Trade Act (CDTA) | Sanctions violation | 2003 | 2017 | $13,066 | DO (OFAC) | Same as above |
| 15 USC 6701 note Terrorism Risk Insurance Act (TRIA), as amended | Civil Penalty | 2002 | 2017 | $1,333,312 | DO (Federal Insurance Office) | 82 Federal Register 10434 (February 10, 2017) https://www.treasury.gov/resource-center/sanctions/Documents/fr82_10434.pdf |

| Statutory Authority | Penalty (Name or Description) | Year Enacted | Latest Year of Adjustment (via Statute or Regulation) | Current Penalty Level ($ Amount or Range) [1] | Sub-Agency Bureau/ Entity | Location for Penalty Update Details |
|---|---|---|---|---|---|---|
| | | | | | | |
| 12 USC 1829b(j) Bank Secrecy Act, as amended | Recordkeeping Violations for Funds Transfers | 1988 | 2017 | $20,111 | FinCEN | 82 Federal Register 10440 (February 10, 2017) https://www.treasury.gov/resource-center/sanctions/Documents/fr82_10434.pdf |
| 12 USC 1955 Bank Secrecy Act, as amended | Willful/Grossly Negligent Recordkeeping Violations | 1988 | 2017 | $20,111 | FinCEN | Same as above |
| 31 USC 5318(k)(3)(C) Bank Secrecy Act, as amended | Failure to Terminate Correspondent Relationship with Foreign Bank | 2001 | 2017 | $13,603 | FinCEN | Same as above |
| 31 USC 5321(a)(1) Bank Secrecy Act, as amended | General Civil Penalty Provision for Willful Violations of Bank Secrecy Act requirements | 1986 | 2017 | $54,789 to $219,156 | FinCEN | Same as above |
| 31 USC 5321(a)(5)(B)(i) Bank Secrecy Act, as amended | Foreign Financial Agency Transaction - Non-willful Violation | 2004 | 2017 | $12,663 | FinCEN | Same as above |
| 31 USC 5321(a)(5)(C) Bank Secrecy Act, as amended | Foreign Financial Agency Transaction - Willful Violation | 2004 | 2017 | $126,626 | FinCEN | Same as above |
| 31 USC 5321(a)(6)(A) Bank Secrecy Act, as amended | Negligent Violation by Financial Institution or Non-Financial Trade or Business | 1986 | 2017 | $1,096 | FinCEN | Same as above |
| 31 USC 5321(a)(6)(B) Bank Secrecy Act, as amended | Pattern of Negligent Activity by Financial Institution or Non-Financial Trade or Business | 1992 | 2017 | $85,236 | FinCEN | Same as above |
| 31 USC 5321(a)(7) Bank Secrecy Act, as amended | Violation of Due Diligence Requirements for Correspondent Bank Accounts Involving Foreign Persons/Private Banking Accounts | 2001 | 2017 | $1,360,317 | FinCEN | Same as above |
| 31 USC 5330(e) Bank Secrecy Act, as amended | Civil Penalty for Failure to Register as Money Transmitting Business | 1994 | 2017 | $8,084 | FinCEN | Same as above |

| Statutory Authority | Penalty (Name or Description) | Year Enacted | Latest Year of Adjustment (via Statute or Regulation) | Current Penalty Level ($ Amount or Range) (1) | Sub-Agency Bureau/ Entity | Location for Penalty Update Details |
|---|---|---|---|---|---|---|
| 12 USC 93(b) Section 5239(b) of the Revised Statutes | Tier 1 Violation of Various Provisions of the National Bank Act | 1978 | 2017 | $9,623 | OCC | 82 Federal Register 8584 (January 27, 2017) https://www.gpo.gov/fdsys/pkg/FR-2017-01-27/pdf/2017-00592.pdf |
| 12 USC 93(b) Section 5239(b) of the Revised Statutes | Tier 2 Violation of Various Provisions of the National Bank Act | 1978 | 2017 | $48,114 | OCC | Same as above |
| 12 USC 93(b) Section 5239(b) of the Revised Statutes | Tier 3 Violation of Various Provisions of the National Bank Act | 1978 | 2017 | $1,924,589 | OCC | Same as above |
| 12 USC 164 Section 5213 of the Revised Statutes | Tier 1 Violation of Reporting Requirements | 1869(2) | 2017 | $3,849 | OCC | Same as above |
| 12 USC 164 Section 5213 of the Revised Statutes | Tier 2 Violation of Reporting Requirements | 1869(2) | 2017 | $38,492 | OCC | Same as above |
| 12 USC 164 Section 5213 of the Revised Statutes | Tier 3 Violation of Reporting Requirements | 1869(2) | 2017 | $1,924,589 | OCC | Same as above |
| 12 USC 481 Section 5240 of the Revised Statutes | Refusal of Affiliate to Cooperate in Examination (NB) | 1864(2) | 2017 | $9,623 | OCC | Same as above |
| 12 USC 504 Section 29 of the Revised Statutes | Tier 1 Violation of Various Provisions of the Federal Reserve Act | 1978 | 2017 | $9,623 | OCC | Same as above |
| 12 USC 504 Section 29 of the Revised Statutes | Tier 2 Violation of Various Provisions of the Federal Reserve Act | 1978 | 2017 | $48,114 | OCC | Same as above |
| 12 USC 504 Section 29 of the Revised Statutes | Tier 3 Violation of Various Provisions of the Federal Reserve Act | 1978 | 2017 | $1,924,589 | OCC | Same as above |
| 12 USC 1817(j)(16) Section 7(j)(16) of the Federal Deposit Insurance Act | Tier 1 Violation of Change in Bank Control Act | 1978 | 2017 | $9,623 | OCC | Same as above |
| 12 USC 1817(j)(16) Section 7(j)(16) of the Federal Deposit Insurance Act | Tier 2 Violation of Change in Bank Control Act | 1978 | 2017 | $48,114 | OCC | Same as above |
| 12 USC 1817(j)(16) Section 7(j)(16) of the Federal Deposit Insurance Act | Tier 3 Violation of Change in Bank Control Act | 1978 | 2017 | $1,924,589 | OCC | Same as above |
| 12 USC 1818(i)(2) Section 8(i)(2) of the Federal Deposit Insurance Act | Tier 1 Violation of Law, Unsafe or Unsound | 1978 | 2017 | $9,623 | OCC | Same as above |

| Statutory Authority | Penalty (Name or Description) | Year Enacted | Latest Year of Adjustment (via Statute or Regulation) | Current Penalty Level ($ Amount or Range) [(1)] | Sub-Agency Bureau/ Entity | Location for Penalty Update Details |
|---|---|---|---|---|---|---|
| | Practice, or Breach of Fiduciary Duty | | | | | |
| 12 USC 1818(i)(2) Section 8(i)(2) of the Federal Deposit Insurance Act | Tier 2 Violation of Law, Unsafe or Unsound Practice, or Breach of Fiduciary Duty | 1978 | 2017 | $48,114 | OCC | Same as above |
| 12 USC 1818(i)(2) Section 8(i)(2) of the Federal Deposit Insurance Act | Tier 3 Violation of Law, Unsafe or Unsound Practice, or Breach of Fiduciary Duty | 1978 | 2017 | $1,924,589 | OCC | Same as above |
| 12 USC 1820(k)(6)(A)(ii) Section 10(k)(6)(A)(ii) of the Federal Deposit Insurance Act | Violation of Post-Employment Restrictions | 2004 | 2017 | $316,566 | OCC | Same as above |
| 12 USC 1832(c ) Section 2 of Public Law 93-100 | Violation of Withdrawals by Negotiable or Transferable Instrument for transfers to Third Parties (National Bank) | 1973 | 2017 | $2,795 | OCC | Same as above |
| 12 USC 1832(c ) Section 2 of Public Law 93-100 | Violation of Withdrawals by Negotiable or Transferable Instrument for transfers to Third Parties (Federal Savings Associations) | 1973 | 2017 | $2,541 | OCC | Same as above |
| 12 USC 1884 Section 5 of the Bank Protection Act of 1968 | Violation of the Bank Protection Act | 1968 | 2017 | $279 | OCC | Same as above |
| 12 USC 1972(2)(F) Section 106(b)(2)(F) of the Bank Holding Company Act Amendments of 1970 | Tier 1 Violation of Anti-Tying Provisions Regarding Correspondent Accounts, Unsafe or Unsound Practices, or Breach of Fiduciary Duty | 1978 | 2017 | $9,623 | OCC | Same as above |
| 12 USC 1972(2)(F) Section 106(b)(2)(F) of the Bank Holding Company Act Amendments of 1970 | Tier 2 Violation of Anti-Tying Provisions Regarding Correspondent Accounts, Unsafe or Unsound Practices, or Breach of Fiduciary Duty | 1978 | 2017 | $48,114 | OCC | Same as above |
| 12 USC 1972(2)(F) Section 106(b)(2)(F) of the Bank Holding Company Act Amendments of 1970 | Tier 3 Violation of Anti-Tying Provisions Regarding Correspondent Accounts, Unsafe or Unsound Practices, or Breach of Fiduciary Duty | 1978 | 2017 | $1,924,589 | OCC | Same as above |

| Statutory Authority | Penalty (Name or Description) | Year Enacted | Latest Year of Adjustment (via Statute or Regulation) | Current Penalty Level ($ Amount or Range) (1) | Sub-Agency Bureau/ Entity | Location for Penalty Update Details |
|---|---|---|---|---|---|---|
| 12 USC 3110(a) Section 16(a) of the International Banking Act of 1978 | Violation of Various Provisions of the International Banking Act (Federal Branches and Agencies) | 1991 | 2017 | $43,983 | OCC | Same as above |
| 12 USC 3110(c) Section 16(c) of the International Banking Act of 1978 | Tier 1 Violation of Reporting Requirements of the International Banking Act (Federal Branches and Agencies) | 1991 | 2017 | $3,519 | OCC | Same as above |
| 12 USC 3110(c) Section 16(c) of the International Banking Act of 1978 | Tier 2 Violation of Reporting Requirements of the International Banking Act (Federal Branches and Agencies) | 1991 | 2017 | $35,186 | OCC | Same as above |
| 12 USC 3110(c) Section 16(c) of the International Banking Act of 1978 | Tier 3 Violation of Reporting Requirements of the International Banking Act (Federal Branches and Agencies) | 1991 | 2017 | $1,759,309 | OCC | Same as above |
| 12 USC 3909(d)(1) Section 910(d)(1) of the International Lending Supervision Act of 1983 | Violation of International Lending Supervision Act | 1983 | 2017 | $2,394 | OCC | Same as above |
| 15 USC 78u-2(b) Section 21B(b) of the Securities Exchange Act of 1934 | Tier 1 (natural person) Violation of Various Provisions of the Securities Act, the Securities Exchange Act, the Investment Company Act or the Investment Advisers Act | 1990 | 2017 | $9,054 | OCC | Same as above |
| 15 USC 78u-2(b) Section 21B(b) of the Securities Exchange Act of 1934 | Tier 1 (other person) Violation of Various Provisions of the Securities Act, the Securities Exchange Act, the Investment Company Act or the Investment Advisers Act | 1990 | 2017 | $90,535 | OCC | Same as above |
| 15 USC 78u-2(b) Section 21B(b) of the Securities Exchange Act of 1934 | Tier 2 (natural person) Violation of Various Provisions of the Securities Act, the Securities Exchange Act, the Investment Company Act or the Investment Advisers Act | 1990 | 2017 | $90,535 | OCC | Same as above |

| Statutory Authority | Penalty (Name or Description) | Year Enacted | Latest Year of Adjustment (via Statute or Regulation) | Current Penalty Level ($ Amount or Range) [(1)] | Sub-Agency Bureau/ Entity | Location for Penalty Update Details |
|---|---|---|---|---|---|---|
| 15 USC 78u-2(b) Section 21B(b) of the Securities Exchange Act of 1934 | Tier 2 (other person) Violation of Various Provisions of the Securities Act, the Securities Exchange Act, the Investment Company Act or the Investment Advisers Act | 1990 | 2017 | $452,677 | OCC | Same as above |
| 15 USC 78u-2(b) Section 21B(b) of the Securities Exchange Act of 1934 | Tier 3 (natural person) Violation of Various Provisions of the Securities Act, the Securities Exchange Act, the Investment Company Act or the Investment Advisers Act | 1990 | 2017 | $181,071 | OCC | Same as above |
| 15 USC 78u-2(b) Section 21B(b) of the Securities Exchange Act of 1934 | Tier 3 (other person) Violation of Various Provisions of the Securities Act, the Securities Exchange Act, the Investment Company Act or the Investment Advisers Act | 1990 | 2017 | $905,353 | OCC | Same as above |
| 15 USC 1639e(k) Section 129E(k) of the Truth in Lending Act | First Violation - Violation of Appraisal Independence Requirements | 2010 | 2017 | $11,053 | OCC | Same as above |
| 15 USC 1639e(k) Section 129E(k) of the Truth in Lending Act | Subsequent Violations - Violation of Appraisal Independence Requirements | 2010 | 2017 | $22,105 | OCC | Same as above |
| 42 USC 4012a(f)(5) Section 102(f)(5) of the Flood Disaster Protection Act of 1973 | Flood Insurance | 1994 | 2017 | $2,090 | OCC | Same as above |
| 12 USC 1464(v) Section 5(v) of the Home Owners' Loan Act | Tier 1 Reports of Condition - Savings Associations | 1989 | 2017 | $3,849 | OCC | Same as above |
| 12 USC 1464(v) Section 5(v) of the Home Owners' Loan Act | Tier 2 Reports of Condition - Savings Associations | 1989 | 2017 | $38,492 | OCC | Same as above |
| 12 USC 1464(v) Section 5(v) of the Home Owners' Loan Act | Tier 3 Reports of Condition - Savings Associations | 1989 | 2017 | $1,924,589 | OCC | Same as above |
| 12 USC 1467(d) Section 9(d) of the Home Owners' Loan Act | Refusal of Affiliate to Cooperate in Examination | 1989 | 2017 | $9,623 | OCC | Same as above |
| 12 USC 1467a(r) Section 10(r) of the Home Owners' Loan Act | Tier 1 Late/Inaccurate Reports (Savings and Loans) | 1989 | 2017 | $3,849 | OCC | Same as above |

| Statutory Authority | Penalty (Name or Description) | Year Enacted | Latest Year of Adjustment (via Statute or Regulation) | Current Penalty Level ($ Amount or Range) (1) | Sub-Agency Bureau/ Entity | Location for Penalty Update Details |
|---|---|---|---|---|---|---|
| 12 USC 1467a(r) Section 10(r) of the Home Owners' Loan Act | Tier 2 Late/Inaccurate Reports (Savings and Loans) | 1989 | 2017 | $38,492 | OCC | Same as above |
| 12 USC 1467a(r) Section 10(r) of the Home Owners' Loan Act | Tier 3 Late/Inaccurate Reports (Savings and Loans) | 1989 | 2017 | $1,924,589 | OCC | Same as above |
| 27 USC 218 Federal Alcohol Administration Act, as amended; Section 207 of the Alcohol Beverage Labeling Act of 1988, P.L. 100-690 | Violation | 1988 | 2017 | $20,111 | TTB | Federal Register 82 (10 January 2017) 2892 – 2893 https://www.ttb.gov/regulation_guidance/ablapenalty.shtml |
| 31 USC 333 Prohibition of Misuse of Department of the Treasury Names, Symbols, etc. | Misuse of Treasury name or symbol | 1994 | None | $5,000 | Department Wide | None |
| 31 USC 333 Prohibition of Misuse of Department of the Treasury Names, Symbols, etc. | Misuse of Treasury name or symbol in broadcast or telecast | 1994 | None | $25,000 | Department Wide | None |
| 31 USC 3729 False Claims Act | False Claims Act | 1986 | 2017 | $10,957 to $21,916 plus 3 times the amount of damages which the Government sustains because of the act | Department Wide | Department of Justice (DOJ) issued regulations at Federal Register 82 (3 February 2017) 9131 - 9136 |
| 31 USC 3802 Program Fraud Civil Remedies Act | Program Fraud Civil Remedies Act | 1986 | 2017 | Up to $10,957 for each claim plus 2 times the amount of the claim | Department Wide | DOJ issued regulations at Federal Register 82 (3 February 2017) 9131 - 9136 |

(1) *Current penalty level amounts represent the maximum penalty amounts.*

(2) *For purposes of calculating the appropriate inflation factor, OMB's guidance issued February 24, 2016 uses the calendar year 1914 CMP Catch-Up Adjustment Multiplier for all penalties enacted prior to 1914.*

# SECTION H: GRANTS OVERSIGHT AND NEW EFFICIENCY ACT REQUIREMENTS

The *Grants Oversight and New Efficiency Act of 2016* (GONE Act) requires the head of each agency to submit to Congress, in coordination with the Secretary of HHS, a report on federal grant and cooperative agreement awards for which close out has not yet occurred and the period of performance, including any extensions, has been expired for more than two years. Other types of financial assistance, including loans, are excluded from the reporting requirements. With the goal of improving the timely closeout of federal grant awards, and thereby improving the accountability and oversight in grants management under the GONE Act, OMB also set forth follow-on reporting and analysis requirements for subsequent years. The summary table below shows the total number and balances of federal grants and cooperative agreements that we awarded for which closeout has not yet occurred and the period of performance has elapsed by more than two years.

| CATEGORY | 2-3 Years | >3-5 Years | >5 Years |
|---|---|---|---|
| Number of Grants/Cooperative Agreements with Zero Dollar Balances | 68 | 1 | - |
| Number of Grants/Cooperative Agreements with Undisbursed Balances | 16 | - | - |
| **Total Amount of Undisbursed Balances** | **$ 93,816** | **$ -** | **$ -** |

The majority of these awards are with the Low Income Taxpayer Clinic (LITC) program. LITC started using a new grants management system in FY 2014. Unfamiliarity with the new system, coupled with the need to manually reconcile differences between the new system and the Payment Management System (PMS) administered by HHS caused delays in grant closeouts. LITC recently finished identifying the tools needed to conform the data between the two systems and all the closeout steps required in the new grants management system. We anticipate having these awards closed out by the end of 2017. Delay in closeout of the few awards remaining are either a result of pending audit or PMS updates for the grant funds that grant recipients are required to return.

# APPENDIX: GLOSSARY OF ACRONYMS

| Abbreviation | Description |
|---|---|
| 2015 Act | Federal Civil Penalties Inflation Adjustment Act Improvements Act of 2015 |
| ACA | Patient Protection and Affordable Care Act |
| ACH | Automated Clearinghouse |
| ACTC | Additional Child Tax Credit |
| AEDPA | Antiterrorism and Effective Death Penalty Act |
| AFR | Agency Financial Report |
| AGI | Adjusted Gross Income |
| AIG | American International Group, Inc. |
| AML/CFT | Anti-Money Laundering and Combating the Financing of Terrorism |
| AMP | Advance Monthly Premium |
| AMT | Alternative Minimum Tax |
| AOTC | American Opportunity Tax Credit |
| APR | Annual Performance Report |
| APTC | Advance Payments of the Premium Tax Credit |
| ARC | Administrative Resource Center |
| ARRA | American Recovery and Reinvestment Tax Act of 2009 |
| ASAP | Automated Standard Application for Payments |
| ASFR | Automated Substitute for Return |
| ASM | Assistant Secretary for Management |
| BDP | Banknote Development Process |
| BEP | Bureau of Engraving and Printing |
| BSA | Bank Secrecy Act |
| CAA | Certifying Acceptance Agent |
| CADE 2 | Customer Account Data Engine |
| CAWR | Combined Annual Wage Reporting |
| CDFI | Community Development Financial Institutions |
| CFIUS | Committee on Foreign Investment in the United States |
| CFO | Chief Financial Officer |
| CFS | U.S. Consolidated Financial Statement |
| CI | Criminal Investigation |
| Civil Service Fund | Civil Service Retirement and Disability Trust Fund |
| CMP | Civil Monetary Penalties |
| COO | Chief Operating Officer |
| CPI | Consumer Price Index |
| CRO | Chief Risk Officer |
| CSED | Collection Statute Expiration Date |
| CSR | Cost Sharing Reduction |
| CSRS | Civil Service Retirement System |
| CTC | Child Tax Credit |
| D.C. | District of Columbia |
| DATA Act | Digital Accountability and Transparency Act |

| Abbreviation | Description |
| --- | --- |
| DCP | Office of D.C. Pensions |
| DDV | Due Diligence Visits |
| DFF | Departmental Franchise Fund |
| DHS | Department of Homeland Security |
| DMF | Death Master File |
| DNP | Do Not Pay |
| DO | Departmental Offices |
| Dodd-Frank Act | Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 |
| DOJ | Department of Justice |
| DOL | Department of Labor |
| EESA | Emergency Economic Stabilization Act of 2008 |
| EIN | Employer Identification Number |
| EITC | Earned Income Tax Credit |
| EOAF | Executive Office for Asset Forfeiture |
| EPLS | Excluded Parties List System |
| ERM | Enterprise Risk Management |
| ESA | Exchange Stabilization Agreement |
| ESF | Exchange Stabilization Fund |
| Fannie Mae | Federal National Mortgage Association |
| FARS | Financial Analysis and Reporting System |
| FASAB | Federal Accounting Standards Advisory Board |
| FAST | Fixing America’s Surface Transportation |
| FCDA | Foreign Currency Denominated Assets |
| FCRA | Federal Credit Reform Act |
| FDC | Funds from Dedicated Collections |
| FDIC | Federal Deposit Insurance Corporation |
| FECA | Federal Employees’ Compensation Act |
| FEGLI | Federal Employees Group Life Insurance |
| FEHBP | Federal Employees Health Benefits Program |
| FERS | Federal Employees’ Retirement System |
| FEVS | Federal Employee Viewpoint Survey |
| FFB | Federal Financing Bank |
| FFI | Foreign Financial Institutions |
| FFMIA | Federal Financial Management Improvement Act of 1996 |
| FHFA | Federal Housing Finance Agency |
| FinCEN | Financial Crimes Enforcement Network |
| Fiscal Service | Bureau of the Fiscal Service |
| FISMA | Federal Information Security Management Act |
| FMB | Funds Management Branch |
| FMFIA | Federal Managers’ Financial Integrity Act |
| FOMC | Federal Open Market Committee |
| FR System | Federal Reserve System |
| FRB | Federal Reserve Bank |

| Abbreviation | Description |
|---|---|
| FRBNY | Federal Reserve Bank of New York |
| FRDA | Fraud Reduction and Data Analytics Act of 2015 |
| Freddie Mac | Federal Home Loan Mortgage Corporation |
| FRN | Floating Rate Note |
| FSA | Fiscal Service Administration |
| FSD | Fiscal Service Debt |
| FSU | Fiscal Service Umbrella |
| FTO | Fine Troy Ounce |
| FY | Fiscal Year |
| G-7 | Group of Seven |
| G-20 | Group of 20 |
| GAAP | Generally Accepted Accounting Principles |
| GAB | General Arrangements to Borrow |
| GAO | U.S. Government Accountability Office |
| General Fund | General Fund of the U.S. Government |
| GFRS | Government-wide Financial Reporting System |
| GONE Act | Grants Oversight and New Efficiency Act of 2016 |
| GPRA | Government Performance and Results Act of 1993 |
| GPRAMA | GPRA Modernization Act of 2010 |
| GSA | General Services Administration |
| GSE | Government Sponsored Enterprise |
| GTAS | Government-wide Treasury Account Symbol Adjusted Trial Balance System |
| HCTC | Health Coverage Tax Credit |
| HERA | Housing and Economic Recovery Act |
| HFA | Housing Finance Agency |
| HHS | Department of Health and Human Services |
| HUD | Department of Housing and Urban Development |
| IAP | International Assistance Programs |
| IDT | Identify Theft |
| IDTVA | Identity Theft Victims Assistance |
| IEEPA | International Emergency Economic Powers Act |
| IFR | Interim Final Rulemaking |
| IG | Inspector General |
| IMF | International Monetary Fund |
| IMF | Individual Master File (IRS Use Only) |
| Inflation Adjustment Act | Federal Civil Penalties Inflation Adjustment Act of 1990 |
| IP | Improper Payment |
| IP PIN | Identity Protection Personal Identification Number |
| IPAC | Intra-Governmental Payment and Collection |
| IPERA | Improper Payments Elimination and Recovery Act |
| IPERIA | Improper Payments Elimination and Recovery Act Improvement Act of 2012 |
| IPIA | Improper Payments Information Act of 2002 |
| IPM | Integrated Production Model |

| Abbreviation | Description |
|---|---|
| IRC | Internal Revenue Code |
| IRGC | Islamic Revolutionary Guard Corps |
| IRM | Internal Revenue Manual |
| IRS | Internal Revenue Service |
| ISIL | Islamic State of Iraq and the Levant |
| ISIS | Islamic State of Iraq and Syria |
| IT | Information Technology |
| ITIN | Individual Taxpayer Identification Number |
| JOBS Act | 2012 Jumpstart Our Business Startups Act |
| KTV | Knock-and-Talk Visits |
| LEIE | List of Excluded Individuals/Entities |
| LITC | Low Income Taxpayer Clinic |
| MADR | Market Adjusted Discount Rate |
| MCAR | Mutual Collection Assistance Request |
| MDB | Multilateral Development Bank |
| Mint | United States Mint |
| NAB | New Arrangements to Borrow |
| NAFA | North American Framework Agreement |
| NFTL | Notice of Federal Tax Lien |
| NIBP | New Issue Bond Program |
| NRP | National Research Program |
| OAS | International Assistance Programs |
| OCC | Office of the Comptroller of the Currency |
| ODCP | Office of D.C. Pensions |
| OFAC | Office of Foreign Assets Control |
| OFR | Office of Financial Research |
| OFS | Office of Financial Stability |
| OI | Office of Investigation |
| OIA | Office of Internal Affairs |
| OIG | Office of the Inspector General |
| OMB | Office of Management and Budget |
| OPEB | Other Post-Employment Benefits |
| OPM | Office of Personnel Management |
| ORB | Other Retirement Benefits |
| ORM | Office of Risk Management |
| OTA | Office of Technical Assistance |
| OTC | Over-the-Counter |
| OVDP | Offshore Voluntary Disclosure Program |
| P.L. | Public Law |
| PAM | Payment Automation Manager |
| PATH Act | Protecting Americans from Tax Hikes Act |
| PB | President's Budget |

| Abbreviation | Description |
|---|---|
| **PII** | Personally Identifiable Information |
| **PIO** | Performance Improvement Officer |
| **Postal Benefits Fund** | Postal Service Retiree Health Benefits Fund |
| **PP&E** | Property, Plant, and Equipment |
| **PTC** | Premium Tax Credit |
| **PTIN** | Preparer Tax Identification Number |
| **QPR** | Quarterly Performance Review |
| **QRP** | Questionable Refund Program |
| **RCG** | Risk and Control Group |
| **RTC** | Resolution Trust Corporation |
| **SAM** | Software Asset Management |
| **SAR** | Suspicious Activity Report |
| **SBLF** | Small Business Lending Fund |
| **SBR** | Statement of Budgetary Resources |
| **SDR** | Special Drawing Rights |
| **SEC** | Securities and Exchange Commission |
| **Secretary** | Secretary of the Treasury |
| **SFFAC** | Statement of Federal Financial Accounting Concepts |
| **SFFAS** | Statement of Federal Financial Accounting Standards |
| **SIGTARP** | Special Inspector General for the Troubled Asset Relief Program |
| **SLGS** | State and Local Government Series |
| **SOAR** | Strategic Objective Annual Review |
| **SOMA** | System Open Market Account |
| **SPSPA** | Senior Preferred Stock Purchase Agreements |
| **SSA** | Social Security Administration |
| **SSI** | Supplemental Security Income |
| **SSN** | Social Security Number |
| **TAC** | Taxpayer Assistance Centers |
| **TANF** | Temporary Assistance for Needy Families |
| **TARP** | Troubled Asset Relief Program |
| **TFF** | Treasury Forfeiture Fund |
| **TFFC** | Office of Terrorist Financing and Financial Crimes |
| **TFI** | Terrorism and Financial Intelligence |
| **TFRP** | Trust Fund Recovery Penalty |
| **TFS** | TIER Financial Statements |
| **TFTC** | Terrorist Financing Targeting Center |
| **TGA** | Treasury General Account |
| **TIER** | Treasury Information Executive Repository |
| **TIGTA** | Treasury Inspector General for Tax Administration |
| **TIN** | Taxpayer Identification Number |
| **TIPS** | Treasury Inflation-Protected Securities |
| **Trade Act** | Trade Preferences Extension Act of 2015 |
| **TRIA** | Terrorism Risk Insurance Act |

| Abbreviation | Description |
|---|---|
| **TRIP** | Terrorism Risk Insurance Program |
| **TS2** | Transition State 2 |
| **TSP** | Thrift Savings Plan |
| **TTB** | Alcohol and Tobacco Tax and Trade Bureau |
| **TWEA** | Trading with the Enemy Act |
| **TY** | Tax Year |
| **U.S.** | United States |
| **USC** | United States Code |
| **USPS** | United States Postal Service |
| **USSGL** | United States Standard General Ledger |

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