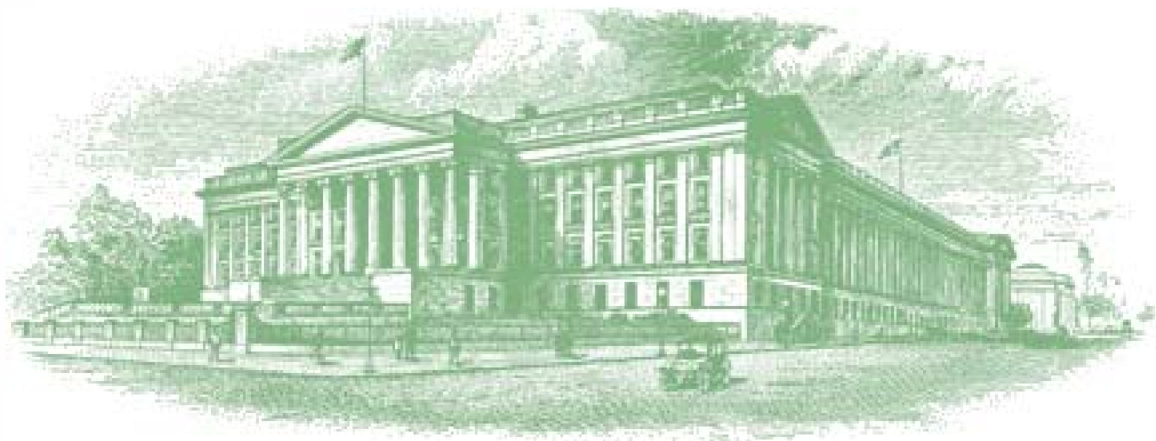
# Audit Report



OIG-06-010

**BILL AND COIN MANUFACTURING: The Bureau of Engraving and Printing Should Ensure That Its Currency Billing Rates Include All Costs and That Excess Working Capital Is Deposited in the General Fund**

December 2, 2005

# Office of Inspector General

## Department of the Treasury

# Contents

## Audit Report



## Appendices



## Abbreviations

| | |
|---|---|
| BEP | Bureau of Engraving and Printing |
| CFO | Associate Director (Chief Financial Officer) |
| DOL | Department of Labor |

# Contents

## Abbreviations (cont.)

| | |
|---|---|
| FASAB | Federal Accounting Standards Advisory Board |
| FECA | Federal Employees' Compensation Act |
| FY | Fiscal Year |
| GAAP | Generally Accepted Accounting Principles |
| GAO | Government Accountability Office |
| JAMES | Joint Audit Management Enterprise System |
| OFM | Office of Financial Management |
| OIG | Office of Inspector General |
| OMB | Office of Management and Budget |
| OPM | Office of Personnel Management |
| U.S.C. | United States Code |

December 2, 2005

Thomas A. Ferguson
Director
Bureau of Engraving and Printing

This report provides the results of our review of the Bureau of Engraving and Printing's (BEP) methodology for pricing currency.

BEP operations are financed by means of a revolving fund that is reimbursed through product sales for direct and indirect costs of operations, including administrative expenses. BEP is also authorized to include in the prices charged for products an amount sufficient to fund future capital investment and to meet working capital requirements, thus eliminating the need for appropriations from Congress.

The audit objective was to determine the adequacy of BEP's pricing methodology to (1) cover all costs of manufacturing products and services performed, (2) provide for acquisition of capital equipment, and (3) provide for working capital needs. Sales of currency to the Federal Reserve System currently represent more than 90 percent of BEP's revenue, with sales of postage stamps to the U.S. Postal Service representing the majority of the balance until June 2005, when BEP stopped producing postage stamps. For this reason, we focused our audit on the pricing of currency.

We performed our field work primarily from March 2004 to July 2004 at BEP's Headquarters in Washington, D.C. We interviewed BEP personnel assigned to the Office of Financial Management and evaluated financial reports, cost accounting data, and budgetary information. During our review, we considered BEP's financial operations and pricing data for

Fiscal Years (FY) 1998 through FY 2004. A more detailed description of our objective, scope, and methodology is included in Appendix 1.

## Results in Brief

BEP's practice of using working excess capital to reduce currency billing rates should be revisited. BEP, instead of depositing excess working capital funds into the general fund of the Treasury, has used the excess to address planned decreases in revenue that resulted from intentional reductions in the currency billing rates and to issue refunds directly to the Federal Reserve. There was a general lack of explanation regarding the underlying rationale for this practice and the methodology used. We recommend that the BEP Director ensure that excess working capital is returned to the Treasury general fund directly by BEP and enhance the discussion in BEP's annual *Chief Financial Officer Performance and Accountability Report (CFO-PAR)* to include BEP management's rationale and methodology for setting its currency prices.

The full cost of BEP's currency operations is not reflected in the currency billing rates. The rates did not include post-retirement benefit costs paid by the Office of Personnel Management (OPM), which were paid through appropriated funds and amounted to $9.8 million for FY 2004. We recommend that currency billing rates consider the full cost of operations, including imputed costs, such as those for employee benefits paid by OPM. To the extent the currency rates result in excess monies to the BEP revolving fund, these should be deposited as miscellaneous receipts to the Treasury general fund.

BEP's currency billing process lacks written policies and procedures as well as documentation of sufficient internal controls over the establishment of billing rates, and the funding of capital projects in the calculation of working capital. BEP management has not developed written policies and procedures regarding how these responsibilities are to be implemented, documented, or reviewed.

We recommend the issuance of policies and procedures to document the process for determining currency billing rates. We also recommend that the BEP Director require that the CFO document that excess working capital funds earmarked to reduce actual currency billing rates are not needed to fund current and future capital projects. In addition, we recommend that the BEP Director and the CFO document that they are satisfied that the excess funds are not needed to address BEP's capital needs.

In its response to our draft report, BEP management stated that it would continue its practice to reduce currency rates for excess working capital instead of returning the excess directly to the Treasury general fund. While we continue to believe that our recommendation would improve the overall transparency of BEP's financial operations, we consider the recommendation to have a management decision. BEP management also did not concur with our recommendation to include post-retirement benefit costs paid by OPM as part of the billing rate. As discussed in the Findings and Recommendations section of this report, we believe the recommendation should be implemented. Accordingly, this disagreed recommendation will need to be referred to the Department for resolution in accordance with Treasury Directive 40-03, *Treasury Audit Resolution, Follow-Up, and Closure*.

BEP management concurred with our other recommendations. The text of the management response is included as Appendix 3.

# Background

Mission

BEP's mission is to design and manufacture high quality security documents that meet customer requirements for quality, quantity, and performance, including counterfeit deterrence. BEP operates under the general authority conferred upon the Secretary of the Treasury by 31 U.S.C. 321(a)(4) to engrave and print currency and other security documents.

Financial Operations

BEP operations are financed by means of a revolving fund established in 1950 in accordance with Public Law 81-656. This fund is reimbursed through product sales for direct and indirect costs of operations, including administrative expenses. In Treasury Order 135-05, *Delegation to Director, Bureau of Engraving and Printing Over Prices for Their Work and to Determine Fair Value of Capitalization of Inventories*, dated July 2, 1951, the Secretary of the Treasury delegated to the BEP Director the authority to determine prices charged for work or services by BEP, and to determine fair and reasonable values for the capitalization of inventories and other physical assets.

Public Law 95-81, July 31, 1977, [31 U.S.C. 5142(c)(3)], authorized the establishment of reimbursement prices from customer agencies at a level intended to provide funding for the acquisition of capital equipment and future working capital.

The Comptroller General Decision B-114801, dated February 12, 1980, stated that if amounts withheld for working capital and acquisition of capital equipment by BEP were considered excessive, the excess funds should paid into miscellaneous receipts in the general fund. However, the decision noted that the Government Accountability Office (GAO) could not require BEP to deposit such amounts into miscellaneous receipts since there was no legal requirement as to the amounts needed for capital purposes.

## Major Components of the Currency Billing Rates

BEP determines the billing rates to be charged for the currency it produces and supplies to the Federal Reserve based on three major components. The first component includes estimated direct and indirect costs, including administrative expenses, for the production the currency. These estimates are prepared by the Cost Analysis and Pricing Division, and reviewed by the Chief, Office of Financial Management (OFM).

The second component is the estimated cash outlays required for approved capital projects. These cash outlays are related to capital projects that were subjected to a comprehensive BEP approval process and were selected for funding by the capital investment review board.

The final component is the amount required to maintain a reasonable amount of working capital needed to ensure the financial integrity of the revolving fund. The amount is determined by the Chief (OFM) and approved by the CFO.

BEP calculates a separate billing rate for each currency type. For the newly-designed series, which to date involves the $20 and $50 denominations, additional billing rates are determined. BEP then computes an average billing rate based upon its estimates of the total number of notes for each currency denomination and series to be manufactured in the coming year.

## Accounting Policies

Revenue is generated from the sale of currency to the Federal Reserve System and is recognized when finished goods are delivered to the respective onsite depository vaults. All currency is transferred to the Federal Reserve depository immediately upon completion.

Property and equipment are recorded at cost. Depreciation of property and equipment is calculated using the straight-line method. Currently, BEP's annual depreciation expense is approximately $40 million and is factored into the computation of the currency billing rates.

The annual depreciation expense that BEP is reimbursed through its billings is used to fund its capital acquisitions. Funds not required to meet current and future capital needs become part of BEP's working capital.

BEP has historically prepared annual financial statements in conformity with generally accepted accounting principles based on accounting standards issued by the Financial Accounting Standards Board, the private-sector standards-setting body. BEP has received an unqualified audit opinion on its financial statements from an independent public accounting firm for the past 19 years. During the period FY 2001 through FY 2003, an independent public accountant, under Office of Inspector General supervision, rendered unqualified opinions on the annual financial statements. These audits did not identify any matters involving internal control over financial reporting and BEP operations that were considered to be material weaknesses, or any instances of noncompliance with laws and regulations that were required to be reported.

## Findings and Recommendations

### Finding 1 BEP's Practice of Using Excess Working Capital to Reduce Currency Billing Rates Should Be Revisited

Our review noted that BEP, due to increases in cost savings, increased productivity, and limited capital expenditures, was continuing to accumulate excess working capital. Rather than return the excess as a miscellaneous receipt to the general fund of the Treasury, BEP used it to address planned decreases in revenue that resulted from intentional reductions in the currency billing rates and to issue refunds directly to the Federal Reserve.

According to BEP management, the excess working capital is ultimately returned to the general fund through the Federal Reserve.[1] This practice, while not expressly prohibited, is an indirect method for returning the funds to the Treasury, and we believe the practice should be revisited by management to improve the transparency of BEP financial operations.

A common feature of most Federal government revolving funds is that they are intended to operate on a break-even basis or reasonably close to it, at least over the long term. One thing this means is that the fund should not augment its working capital by retaining excess profits.

[1] Federal Reserve Banks are required by the Board of Governors of the Federal Reserve System to transfer to the Treasury excess earnings, after providing for their cost of operations, payment of dividends, and reservation of an amount necessary to equate surplus with capital paid in. In the event of losses, or a substantial increase in capital, a Federal Reserve Bank will suspend its payments to the Treasury until such losses or increases in capital are recovered through subsequent earnings. The Financial Management Service records earnings deposited by the Federal Reserve as non-entity custodial revenue. For fiscal year 2004, these custodial earnings totaled nearly $19.7 billion.

In this regards, revolving fund statutes frequently include the requirement for the periodic payment of surplus amounts to the general fund of the Treasury. With respect to the BEP revolving fund, 31.U.S.C. 5142(d) requires that:

> *The Secretary shall deposit each fiscal year, in the Treasury as miscellaneous receipts, amounts accruing to the Fund in the prior fiscal year that the Secretary decides are in excess of the needs of the Fund. However, the Secretary may use the excess amounts to restore capital of the Fund reduced by the difference between charges for services of the Bureau and the cost of providing those services.*

Under this statute and related Treasury Orders and Directives, BEP has wide discretion in setting charges for its services, and determining excess funds requiring deposit into the Treasury as miscellaneous receipts.

For the period FY 2001 through FY 2003, BEP reported in its audited financial statements an excess of expenses over revenue in the amounts of $44.7 million, $29 million, and $12.1 million, respectively. BEP disclosed in its FY 2001 statements that the $44.7 million shortfall was due to a mid-year reduction in the Federal Reserve currency order, which BEP covered with excess working capital funds. However, for FY 2002 and FY 2003, the excess of expenses over revenues was intentionally planned by BEP in order to avoid increasing its working capital. Instead of billing the Federal Reserve for all costs associated with the production of currency, BEP reduced the billing rates and used its excess working capital funds to cover the planned losses.

A comparison of BEP's estimated costs for FY 2002 through FY 2004 and the effect of using excess working capital to reduce the annual billing rates are contained in the following table.

Table 1. Computation of Average Currency Billing Rates

| Components of Billing Rates | FY 2002 | FY 2003 | FY 2004 |
|---|---|---|---|
| Manufacturing Costs | $26.40 | $31.00 | $29.84 |
| Prepress/Engraving | 1.34 | 1.29 | 1.16 |
| Manufacturing Support | 20.39 | 19.37 | 18.60 |
| Research and Development | 1.31 | 1.81 | 0.96 |
| General and Administrative | 5.48 | 5.36 | 5.48 |
| Public Education Ad Campaign | | 2.45 | 2.23 |
| Total Costs (Per 1,000 Bills) | $54.92 | $61.28 | $58.27 |
| Working Capital/Capital Investment (Amount of Working Capital Applied To Reduce Billing Rates) | (4.18) | (3.03) | (2.25) |
| **Billing Rate (Per 1,000 Bills)** | **$50.74** | **$58.25** | **$56.02** |

**Note:** The manufacturing costs include paper, ink, direct labor, and variable and fixed overhead.

In addition to using excess working capital to reduce its billing rates, BEP also has issued refunds directly to the Federal Reserve. In FY 1997, for example, BEP refunded $25 million that was assessed and earmarked for capital acquisitions that were subsequently cancelled. Another refund occurred in FY 2003 and involved $6.25 million resulting from savings from lower than anticipated spoilage costs associated with production of the new currency.

We also noted that while the operating losses were reported in BEP's annual financial statements, there was a general lack of explanation by BEP regarding the underlying rationale for the practice and methodology used. For example, for FY 2003, BEP discussed its planned loss in its CFO-PAR as follows. The introductory message from the CFO stated that *the excess of expenses over revenue was planned and funded out of working* *capital*. The Management Discussion and Analysis (MD&A) included the following:

> *The net operating loss for the year was within planned parameters. Funding for the Bureau remains adequate since depreciation, a non-cash expense, offset capital investment and the planned operating loss in 2003.*

The Statement of Operations (unaudited) noted that *the net operating loss for the year, while within planned parameters, was less than anticipated*....

There was no further explanation given by BEP in its CFO-PAR.

BEP personnel stated that the general fund does ultimately benefit from BEP's use of excess working capital to reduce the Federal Reserve's costs. The reduction in the billing rates results in lower costs to the Federal Reserve. The resulting savings to the Federal Reserve are invested by the Federal Reserve, according to BEP personnel, and the savings plus interest earned are subsequently deposited into the general fund by the Federal Reserve.

While this may be true, this is an indirect method for returning BEP's excess working capital funds to the Treasury general fund compared to BEP depositing the excess funds directly as miscellaneous receipts, which we believe would provide greater transparency in BEP's financial operations. During our audit, BEP management could not provide a compelling reason for the practice. One reason cited by management, however, was that lower currency rates enabled the Federal Reserve to return more of its earnings to the Treasury.

## Recommendations

1. The BEP Director should, to improve transparency in BEP financial operations and reporting, and absent a compelling reason for its current practice, ensure that excess working capital is returned to the Treasury general fund directly by BEP.

   Management Comments

   In its response, BEP stated that, in setting prices, BEP projects both capital and operating expenses and allocates them to products. BEP reserves the right to adjust prices upward if actual expenses exceed planned expenses. Conversely, when capital and/or operating expenses are less than anticipated, this money is returned to the customer through a pricing adjustment or retained if needed for future requirements.

   While BEP has the authority to retroactively classify such funds as reserved for future capital expenditures, its preference has been to return them to the Federal Reserve. This is because future years' depreciation expense can be used to fund planned capital investment, and the Federal Reserve can put the funds to better use in the short term because they have investment authority, which BEP lacks. In addition, the Federal Reserve transfers its surplus to Treasury weekly, which provides the funds to Treasury sooner than an annual reimbursement from BEP would. Based on this, BEP does not intend to take action on this recommendation.

   OIG Response

   We consider the recommended approach preferable because it would improve transparency in BEP financial operations and reporting. However, we consider the recommendation to have a management decision.

   We would like to point out that we do not agree with BEP’s comments regarding the timing of transfers to the Treasury general fund. BEP uses the amount of excess working capital funds as of the end of the year to compute currency billing rates for the following year. Immediate deposit of excess funds at year-end would result in earlier receipt by Treasury than the current periodic transfer by the Federal Reserve of currency billing rate savings over the following year.

2. The BEP Director should enhance the discussion in its annual *Chief Financial Officer Performance and Accountability Report* to include BEP management's rationale and methodology for setting its currency prices.

   Management Comments

   BEP concurs with this recommendation. Additional discussion related to the pricing methodology will be added to BEP's future Chief Financial Officer Performance and Accountability Reports.

   OIG Response

   The OIG believes that the actions taken or planned by BEP address the intent of the recommendation.

## Finding 2 — Full Cost of BEP's Currency Operations Is Not Reflected In Billing Rates

BEP did not include certain employee benefit costs paid by the OPM in establishing its currency billing rates. As allowed by current accounting principles for the Federal government, such costs were not recorded on BEP's financial statements and therefore were not reflected in BEP's reported operating losses during our audit period. However, BEP does disclose these costs in the notes to its financial statements. For example, it reported that the amounts paid by OPM for post-retirement benefits (health care costs and life insurance) through appropriated funds for FY 2004 and FY 2003 were $9.8 million and $8.5 million, respectively. In effect, appropriated funds are being used to subsidize the cost of currency sold to the Federal Reserve.[2]

Office of Management and Budget (OMB) Circular A-25, *User Charges,* establishes Federal policy regarding fees assessed for the sale or use of Government goods or resources. Circular A-25 (see Section 6.d.1) defines *full cost* as including all direct and indirect costs to any part of the Federal Government of providing a good, resource, or service. These costs include, but are not limited to, an appropriate share of direct and indirect personnel costs, including salaries and fringe benefits such as medical insurance and retirement. Retirement costs should include all (funded or unfunded) accrued costs not covered by employee contributions as specified in OMB Circular A-11.

As an observation, our office reported in connection with the annual audit of the Department of the Treasury's consolidated financial statements that certain Treasury components, including BEP, continue to report their financial results in conformity with private-sector accounting principles instead of generally accepted

[2] If BEP were to include the cost of employee benefits paid by OPM as part of its currency billing rates, the amounts collected from the Federal Reserve would become excess monies to the BEP revolving fund available for deposit as miscellaneous receipts into the Treasury general fund.

accounting principles (Federal GAAP) prescribed by the Federal Accounting Standards Advisory Board (FASAB), the accounting standards-setting body for the Federal Government.[3] In this regard, FASAB allows the continued use of private-sector accounting standards by Federal agency component reporting entities if those entities first began issuing financial statements before October 1999.

Among other things, when compared to Federal GAAP, the use of private sector accounting principles can result in inconsistencies in how certain costs are reported. For example, Federal GAAP requires that non-reimbursed costs paid by the OPM for retirement plans and post-retirement benefits be recognized by the receiving entity as an "imputed cost" in order to report the full cost of operations. Since private sector accounting principles do not provide guidance for the reporting of imputed costs, they are not reported, or are reported inconsistently, by the Treasury components.

As a further observation, Public Law 108-458, the *Intelligence Reform and Terrorism Prevention Act of 2004*, grants the Secretary of the Treasury the authority to produce currency, postage stamps, and other security documents for foreign governments. Adopting a billing methodology that fully reflects and consistently reports operating costs, such as would occur under Federal GAAP, would, in our opinion, facilitate the BEP billing process for all entities in the future.

Absent a specific statutory requirement, we believe that the continued use of private sector accounting principles instead of Federal GAAP by these Treasury components, including BEP, decreases the usefulness of information reported by these entities for users of Federal financial statements. This issue is currently under review by the Department.

[3] *Management Letter for Fiscal Year 2004 Audit of the Department of the Treasury's Financial Statements* (OIG-05-017, issued December 14, 2004).

Recommendation

3. The BEP Director should ensure that currency billing rates consider the full cost of operations, including imputed costs such as the imputed cost of employee benefits paid by OPM. To the extent the currency rates result in excess monies to the BEP revolving fund, they should be deposited as miscellaneous receipts to the Treasury general fund.

   Management Comments

   BEP does not concur with this recommendation. BEP believes that the issue regarding charging for imputed costs for post-retirement benefits is government-wide and is best addressed by the Office of Management and Budget or the government-wide CFO Council. BEP has not been able to identify any entity or fund that is including such costs in its billing rates. This may be due to the fact that Federal Accounting Standards provide for the recognition of imputed revenue as a financing source to offset the imputed costs. As a result, these imputed costs are non-cash expenses to the entities, financing is provided (imputed), and there is no charge or cost to reimburse. In addition, BEP stated that charging these costs to the Federal Reserve will not result in any increase in funding to Treasury. Because the Federal Reserve provides weekly cash transfers to Treasury, having BEP charge for these costs would only serve to lessen this weekly reimbursement and replace them with an annual reimbursement from BEP.

   While these imputed costs are being allocated to entities across the government, there is no traceability for the cost allocation or any charge-back. That is, the costs being allocated for post-retirement benefits to BEP are not traceable to any BEP retiree or any service provided to BEP. This has been an issue at the U.S. Postal Service that the Government Accountability Office has been unable to satisfactorily resolve for more than a decade. BEP believes that post-retirement expenses should be traceable and, once traceable, charged to the responsible entity and reimbursed.

Also, it is BEP's position that including these post-retirement costs in BEP's billing rates will not in any manner impact the funding situation for these costs/liabilities if such reimbursement is classified as a miscellaneous receipt to Treasury. If any reimbursement were made for these costs it should go to the paying office, the Office of Personnel Management, and their appropriation reduced accordingly. Further, in BEP's opinion, the use of imputed costs and revenues does not improve the financial statement presentation. Based on the foregoing, BEP does not intend to take further action on this recommendation.

OIG Response

We believe the recommendation should be implemented. These post-retirement benefits are costs incurred by the Federal government, and should therefore be factored into the billing rates. We have considered the traceability issue mentioned by BEP, including the related issues between GAO and the U.S. Postal Service, an independent establishment of the Executive Branch of the Federal government. We do not believe that these arguments are relevant to our recommendation to a Bureau of the Treasury Department.

In addition, we believe that existing policy, particularly OMB Circular A-25, adequately addresses the requirements to include indirect costs in billing rates. In our opinion, reflecting the full cost of BEP's currency operations in the billing rates is further made necessary with the granting of authority to produce security products for foreign governments. As mentioned, the matter of whether entities such as BEP should report under Federal GAAP is under review by the Department.

For these reasons, this disagreed recommendation will need to be referred to the Department for resolution in accordance with Treasury Directive 40-03, *Treasury Audit Resolution, Follow-Up, and Closure*.

## Finding 3 Currency Billing Process Lacks Written Policies and Procedures and Documentation of Sufficient Internal Controls

BEP's currency billing process lacks written policies and procedures as well as documentation of sufficient internal controls over the establishment of billing rates, and the funding of capital projects in the calculation of working capital. BEP management has not developed written policies and procedures regarding how these responsibilities are to be implemented, documented, or reviewed. As a result, there is a lack of evidence that BEP is ensuring that these responsibilities are being properly executed and are subject to management oversight.

<u>Billing Process Lacks Written Documentation</u>

Our review of the three components that make up BEP's currency billing rates determined that the process lacks formal policies and procedures and evidence of management review. As a result, BEP's currency billing rates and its determination of excess working capital is difficult to evaluate and verify.

The Chief (OFM) does not maintain documentation or files regarding his responsibilities for reviewing estimated costs and expenses in manufacturing the currency, determining the amount of funds needed to meet capital acquisition needs, and calculating working capital levels and determining excess working capital.

According to the Chief (OFM), all decisions regarding the components of the proposed currency billing rates, including the amount factored in to reduce the level of working capital, are subject to review and approval by the CFO. However, there is no documentation being maintained that provides evidence that the CFO reviewed and approved the basis for determining the currency billing rates.

We believe that BEP's current process regarding the setting of billing rates carries with it a certain amount of risk. BEP's oversight is based almost entirely on the experience and judgment of the Chief (OFM) and the CFO. While we found that these officials to have a good understanding of their responsibilities, we believe that operating in this manner increases the risk to BEP. At a future date, for example, another individual could assume the position of Chief (OFM), and he or she may have difficulty in determining his or her role as it relates to establishing valid and reliable billing rates.

A major component of effective program management is good internal control. According to the *Standards for Internal Control in the Federal Government*, internal control comprises the plans, methods, and procedures used to meet missions, goals, and objectives of a program. According to this GAO publication, control activities include approvals, authorizations, verifications, and the creation and maintenance of related records, which provide evidence of execution of these activities. Internal controls, transactions, and significant events need to be clearly documented and available for examination and confirmation. The documentation should appear in administrative policies and operating manuals.

The lack of written policies, the lack of supporting documentation, and the absence of documentation pertaining to supervisory review and approval may all undermine effective program management. These internal control deficiencies require immediate attention by BEP management.

<u>Excess Working Capital Needs Justification</u>

BEP lacks sufficient evidence that its excess working capital amounts are valid and reliable. BEP does not have written policies and procedures regarding the process of determining excess working capital. As a result, we were unable to determine whether BEP is including sufficient funds in its billing rates to address current and future capital needs.

One of the primary objectives of our review was to determine whether BEP was including in its currency billing rates an amount sufficient to cover the costs of current and future capital investments. We determined that during the period FY 2003 through FY 2004, BEP had excluded approximately $41 million in surplus funds from the billing rates that it assessed the Federal Reserve to avoid accumulating excess working capital. During FY 1997 and FY 2003, BEP had also directly refunded a total of an additional $31 million to the Federal Reserve as a result of operating efficiencies. BEP personnel had decided these excess funds were not needed to meet BEP's current or future capital acquisition needs.

The amount of money that BEP needs to fund approved current and future capital projects directly impacts the balance of working capital. Therefore, BEP needs to ensure that its capital requirements are being met when determining its billing rates and before identifying its excess working capital funds.

Lack of Written Documentation in Determining Excess Working Capital

When we requested copies of the policies and procedures pertaining to determining the amount of excess working capital, we were told that these did not exist. In addition, BEP had not implemented a formal process documenting how working capital requirements are determined. Also, there was no documentation available to support that the decisions were subject to supervisory review and approval. The decision process involved primarily verbal discussions.

The CFO and the Chief (OFM) review all projects that have been or may be obligated in the next year. The obligated funds from previous years are combined with the funds to be obligated during the new fiscal year. The total projected capital project outlays are then included in the billing rates.

The Chief (OFM) explained that funds had not been obligated for certain projects because processing delays, lack of resources, and "pipeline" problems prevent BEP from obligating funds for all approved capital projects. As a result, the Chief (OFM) and the CFO focus on those projects that they feel require funds to be obligated in the coming year. Projects that are not selected will have funds obligated in subsequent years. The Chief (OFM) did not want to obligate funds for capital projects that BEP would not be implementing in the near future. He felt that BEP's current approach was sufficient, because the projects that had the highest priorities were being addressed, while lower priority projects could be delayed until a later date when resources and circumstances would enable BEP to implement those projects.

As part of our review of capital projects, we identified six projects that had been approved for approximately $5.7 million. However, these projects were not being funded. According to BEP personnel, the funding for these projects had been put on hold pending the results of a Treasury-contracted review of the possible merging of BEP with the U.S. Mint.

According to the CFO and the Chief (OFM), BEP has historically been very conservative in approving and expending funds to replace capital equipment. BEP requires all proposed capital projects be subject to a comprehensive and lengthy capital review and approval process. This process helps ensure that managers will only submit capital projects that show a positive return on investment or are necessary for security or safety. BEP management personnel acknowledged that the more rigorous process resulted in a 50 percent reduction in the number of business cases being submitted for review and approval.

The CFO stated that the Bureau traditionally prefers to repair its older capital equipment whenever possible rather than invest in new equipment. In addition, the CFO stated that he would like to be able, sometime in the future, to implement a systematic plan for replacing BEP's capital goods on a predetermined cycle.

However, given BEP's conservative approach regarding capital acquisitions, the CFO felt that it was unlikely that such a plan would be implemented.

BEP often consults the Federal Reserve when considering making major capital improvements or expenditures. We acknowledge that the Federal Reserve should be consulted on such matters since costs associated with capital acquisitions will ultimately be paid by the Federal Reserve. However, an increase in the funding of capital improvements also increases the currency billing rates. As a result, BEP is faced with the dilemma of trying to ensure that its capital needs are being addressed while at the same time trying to achieve customer satisfaction by reducing the billing rates.

BEP needs to develop procedures that document the working capital reduction that is reflected in the currency billing rates. The procedures should document that a thorough review of all capital needs has been conducted, current and future capital needs have been identified, and all approved projects have either been funded or an explanation provided why funding was not provided. Before BEP identifies and transfers the excess funds, the BEP Director and the CFO should certify that they are satisfied that the excess funds are not needed to address BEP's capital needs.

**Recommendations**

4. The Director should require that policies and procedures be written and implemented that document the process for determining currency billing rates. These should outline the process by which BEP determines how each component of the billing rates is determined. The policies and procedures should also require evidence that the process and its results were properly documented, reviewed, and approved by BEP management.

Management Comments

BEP concurs and will document existing policies and procedures used to determine currency billing rates. Plans are to have the policies and procedures prepared by June 2006.

OIG Response

The OIG believes that the actions taken or planned by BEP address the intent of the recommendation.

5. The Director should require the CFO to document that excess working capital funds earmarked to reduce currency billing rates are not needed to fund current and future capital projects. In addition, the BEP Director and the CFO should document that they are satisfied that the excess funds are not needed to address BEP's capital needs.

   Management Comments

   BEP will continue to review and revise billing rates annually as needed to maintain working capital and provide for capital investment. Billing rates for currency, which are revised each calendar year, will be completed and approved by the Director by December 1st.

   OIG Response

   The OIG believes that the actions taken or planned by BEP address the intent of the recommendation.

* * * * * * *

Please be advised that we are recording a revenue enhancement of $29.4 million relating to the recommendation in Finding 2 in the Joint Audit Management Enterprise System (JAMES).

This recommendation is identified in Appendix 2 of our report. We will also include this amount in the OIG Semiannual Report to the Congress.

We would like to extend our appreciation to the Associate Director (Chief Financial Officer) and his staff for the cooperation and courtesies extended to our staff during the review. If you have any questions, please contact me at (202) 927-6512 or Maria V. Carmona, Audit Manager, at (202) 927-6345. The major contributors to this report were Ms. Carmona; Thomas Mason, Auditor-in-Charge; Myung Han, Economist; and Horace Bryan, Auditor.

Donald R. Kassel

Donald R. Kassel
Director, Fiscal Service Audits

The audit objective was to determine the adequacy of BEP's pricing methodology to (1) cover all costs of manufacturing products and services performed, (2) provide for acquisition of capital equipment, and (3) provide for working capital needs. In general, we considered BEP's financial operations and pricing data for FY 1998 through FY 2004.

We reviewed the pertinent provisions of Public Law 81-656 and Public Law 95-81. We visited BEP Headquarters and interviewed the Chief (OFM) and members of his staff. We also spoke with the CFO about capital acquisition policies, and with the Federal Reserve's liaison at BEP regarding the role of his organization in the currency billing process.

We reviewed and analyzed cost data provided by BEP personnel to ensure that all direct and indirect costs as well as administrative expenses were included in determining currency billing rates. We evaluated the basis upon which BEP established the amount of working capital required to meet its financial obligations and responsibilities. We also evaluated BEP's procedures regarding the submission, approval, and funding of capital projects.

We analyzed monthly cash balances for the period October 2001 through February 2004, and reviewed current and long-term liabilities as presented on the audited annual financial statements. We sampled various components of cost data, and confirmed that the costing data and procedures reviewed conformed to BEP's *Financial Management Policy Manual*. We also reviewed summaries and audit step results, dealing with verification of costs, which were prepared by independent auditors.

We conducted our audit between March 2004 and July 2004 in accordance with generally accepted government auditing standards.

The term *revenue enhancement* is an action recommended in an OIG audit report that would, if implemented, enhance the General Fund receipts of the Federal Government, usually without having any budgetary impact on any of the Department of the Treasury's appropriations. The implementation of the following recommendation in this report involves a revenue enhancement. The related amount, as shown in the table below, will be recorded in JAMES and included in the statistical reporting in the next OIG Semiannual Report to the Congress.

Table 2. Computation of Revenue Enhancement

| **Recommendation Number** | **Revenue Enhancement** |
|---|---|
| Finding 2 – Recommendation 3 | $ 29.4 million |
| **Total:** | **$ 29.4 million** |

The funds associated with Recommendation 3 represent an estimate of the amount that may be paid by OPM for post-retirement benefits for 3 years. The estimated amount is based on an assumption that the benefits paid by OPM will at least equal the $9.8 million that OPM paid for FY 2004, and is computed by multiplying the $9.8 million by three.

It is management's responsibility to record the actual monetary benefits realized as a result of its implementation of the recommendation in JAMES.

DEPARTMENT OF THE TREASURY
BUREAU OF ENGRAVING AND PRINTING
WASHINGTON, D.C. 20228

October 21, 2005

MEMORANDUM FOR MARLA A. FREEDMAN
ASSISTANT INSPECTOR GENERAL FOR AUDIT
OFFICE OF INSPECTOR GENERAL

FROM: Gregory D. Carper *Gregory D. Carper*
Chief Financial Officer

SUBJECT: Draft Audit Report: BILL AND COIN MANUFACTURING: The Bureau of Engraving and Printing Should Ensure That Its Currency Billing Rates Include All Costs and That Excess Working Capital Is Deposited in the General Fund

Thank you for the opportunity to review the Office of Inspector General's (OIG) draft audit report "BILL AND COIN MANUFACTURING: The Bureau of Engraving and Printing Should Ensure That Its Currency Billing Rates Include All Costs and That Excess Working Capital Is Deposited in the General Fund." The Bureau of Engraving and Printing (BEP) offers the following comments on the draft report:

Recommendation 1.

The BEP Director should, to improve transparency in BEP financial operations and reporting, and absent a compelling reason for its current practice, ensure that excess working capital is returned to the Treasury general fund directly by BEP.

Comment

In setting prices, BEP projects both capital and operating expenses and allocates them to products. BEP reserves the right to adjust prices upward if actual expenses exceed planned expenses. Conversely, when capital and/or operating expenses are less than anticipated, this money is returned to the customer through a pricing adjustment or retained if needed for future requirements.

While BEP has the authority to retroactively classify such funds as reserved for future capital expenditures, our preference has been to return them to the Federal Reserve. This is because future years' depreciation expense can be used to fund planned capital investment, and the Federal Reserve can put the funds to better use in the short term because they have investment authority, which BEP lacks. In addition, the Federal Reserve transfers its surplus to Treasury weekly, which provides the funds to Treasury sooner than an annual reimbursement from BEP would. Based on the foregoing, BEP does not intend to take further action on this recommendation.

Recommendation 2.

The BEP Director should enhance the discussion in its annual *Chief Financial Officer Performance and Accountability Report* to include BEP management's rationale and methodology for setting its currency prices.

Comment

BEP concurs with this recommendation. Additional discussion related to the pricing methodology will be added to BEP's future Chief Financial Officer Performance and Accountability Reports.

Recommendation 3.

The BEP Director should ensure that currency billing rates consider the full cost of operations, including imputed costs such as the imputed cost of employee benefits paid by the Office of Personnel Management. To the extent the currency rates result in excess monies to the BEP revolving fund, they should be deposited as miscellaneous receipts to the Treasury general fund.

Comment

The issue regarding charging for imputed costs for post-retirement benefits is government-wide and is best addressed by the Office of Management and Budget or the government-wide CFO Council. BEP has not been able to identify any entity or fund that is including such costs in its billing rates. This may be due to the fact that Federal Accounting Standards provide for the recognition of imputed revenue as a financing source to offset the imputed costs. As a result, these imputed costs are non-cash expenses to the entities, financing is provided (imputed), and there is no charge or cost to reimburse. In addition, charging these costs to the Federal Reserve will not result in any increase in funding to Treasury. Because the Federal Reserve provides weekly cash transfers to Treasury, having BEP charge for these costs would only serve to lessen this weekly reimbursement and replace them with an annual reimbursement from BEP.

While these imputed costs are being allocated to entities across the government, there is no traceability for the cost allocation or any charge-back. That is, the costs being allocated for post-retirement benefits to BEP are not traceable to any BEP retiree or any service provided to BEP. This has been an issue at the U.S. Postal Service that the Government Accountability Office has been unable to satisfactorily resolve for more than a decade. BEP feels strongly, and has stated in the past, that the post-retirement expenses for retirees should be traceable and once traceable, charged to the responsible entity and reimbursed. Also, including these post-retirement costs in BEP's billing rates will not in any manner impact the funding situation for these costs/liabilities if such reimbursement is classified as a miscellaneous receipt to Treasury. If any reimbursement were made for these costs it should go to the paying office, the Office of Personnel Management, and their appropriation reduced accordingly. Further, in our opinion, the use of imputed costs and revenues does not improve the financial statement presentation. Based on the foregoing, BEP does not intend to take further action on this recommendation.

Recommendation 4.

The Director should require that policies and procedures be written and implemented that document the process for determining currency billing rates. These should outline the process by which BEP determines how each component of the billing rates is determined. The policies and procedures should also require evidence that the process and its results were properly documented, reviewed, and approved by BEP management.

Comment

BEP concurs with this recommendation and will document existing policies and procedures used to determine currency billing rates. We plan to have the policies and procedures prepared by June 2006.

Recommendation 5.

The Director should require the Chief Financial Officer (CFO) to document that excess working capital funds earmarked to reduce currency billing rates are not needed to fund current and future capital projects. In addition, the BEP Director and the CFO should document that they are satisfied that the excess funds are not needed to address BEP's capital needs.

Comment

BEP will continue to review and revise billing rates annually as needed to maintain working capital and provide for capital investment. Billing rates for currency, which are revised each calendar year, will be completed and approved by the Director by December 1st.

**Department of the Treasury**

Office of Strategic Planning and Performance Management
Office of Accounting and Internal Control

**Bureau of Engraving and Printing**

Director
Associate Director (Chief Financial Officer)

**Office of Management and Budget**

OIG Budget Examiner