Audit Report

OIG-13-024

Audit of the Bureau of Engraving and Printing's Fiscal Years 2012 and 2011 Financial Statements

December 17, 2012

Office of Inspector General

Department of the Treasury

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

OFFICE OF
INSPECTOR GENERAL

December 17, 2012

**MEMORANDUM FOR LARRY R. FELIX, DIRECTOR
BUREAU OF ENGRAVING AND PRINTING**

FROM: Michael Fitzgerald
Director, Financial Audits

SUBJECT: Audit of the Bureau of Engraving and Printing's
Fiscal Years 2012 and 2011 Financial Statements

I am pleased to transmit the attached audited Bureau of Engraving and Printing (BEP) financial statements for fiscal years 2012 and 2011. Under a contract monitored by the Office of Inspector General, KPMG LLP, an independent certified public accounting firm, performed an audit of the financial statements of BEP as of September 30, 2012 and 2011 and for the years then ended. The contract required that the audit be performed in accordance with generally accepted government auditing standards; applicable provisions of Office of Management and Budget Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements,* as amended*;* and the *GAO/PCIE Financial Audit Manual*.

The following reports, prepared by KPMG LLP, are incorporated in the attachment:

- Independent Auditors' Report;
- Independent Auditors' Report on Internal Control Over Financial Reporting; and
- Independent Auditors' Report on Compliance and Other Matters

In its audit, KPMG LLP found that the financial statements were fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles. However, KPMG LLP identified certain control deficiencies related to the implementation of the Oracle Operating System that were considered collectively to be a significant deficiency. Further, KPMG LLP found no instances of reportable noncompliance with laws and regulations tested.

KPMG LLP also issued a management letter dated December 14, 2012 discussing certain matters involving internal control over financial reporting and its operation that were identified during the audit but were not required to be included in the auditors' reports. This letter will be transmitted separately.

In connection with the contract, we reviewed KPMG LLP's reports and related documentation and inquired of its representatives. Our review, as differentiated from an audit in accordance with generally accepted government auditing standards, was not intended to enable us to express, and we do not express, an opinion on BEP's financial statements or conclusions about the effectiveness of internal control or compliance with laws and regulations. KPMG LLP is responsible for the attached auditors' reports dated December 14, 2012 and the conclusions expressed in the reports. However, our review disclosed no instances where KPMG LLP did not comply, in all material respects, with generally accepted government auditing standards.

Should you have any questions, please contact me at (202) 927-5789, or a member of your staff may contact Shiela Michel, Manager, Financial Audits at (202) 927-5407.

Attachment

THE DEPARTMENT OF THE TREASURY
BUREAU OF ENGRAVING AND PRINTING

Financial Statements

Years ended September 30, 2012 and 2011

(With Independent Auditors' Reports Thereon)

THE DEPARTMENT OF THE TREASURY
BUREAU OF ENGRAVING AND PRINTING
FINANCIAL STATEMENTS
FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

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KPMG LLP
Suite 12000
1801 K Street, NW
Washington, DC 20006

Independent Auditors' Report

The Inspector General, Department of the Treasury and
The Director of the Bureau of Engraving and Printing, Department of the Treasury:

We have audited the accompanying balance sheets of the Bureau of Engraving and Printing (the Bureau) as of September 30, 2012 and 2011, and the related statements of operations and cumulative results of operations, and cash flows (hereinafter referred to as "financial statements") for the years then ended. These financial statements are the responsibility of the Bureau's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Bureau of Engraving and Printing as of September 30, 2012 and 2011, and the results of its operations, and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our reports dated December 14, 2012, on our consideration of the Bureau's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts, and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in assessing the results of our fiscal year 2012 audit.

KPMG LLP

December 14, 2012

THE DEPARTMENT OF THE TREASURY
BUREAU OF ENGRAVING AND PRINTING

Balance Sheets

As of September 30, 2012 and 2011

	2012	2011
	(In Thousands)	
ASSETS		
Current assets		
Cash (Note 3)	$ 117,993	$ 130,178
Accounts receivable (Note 10)	54,355	38,436
Inventories, net (Note 4)	144,676	148,826
Prepaid expenses	4,743	3,698
Total current assets	321,767	321,138
Property and equipment, net (Note 5)	416,350	381,507
Other assets, net (Note 6)	19,606	20,220
Total assets	$ 757,723	$ 722,865
LIABILITIES AND EQUITY		
Liabilities		
Current liabilities (Notes 7 and 8)		
Accounts payable	$ 18,980	$ 33,683
Accrued liabilities	34,668	35,949
Advances	5,011	8,460
Total current liabilities	58,659	78,092
Workers' compensation liability (Note 8)	63,039	62,423
Total liabilities	121,698	140,515
Contingencies and commitments (Notes 12 and 13)		
Equity		
Invested capital	32,435	32,435
Cumulative results of operations	603,590	549,915
Total equity	636,025	582,350
Total liabilities and equity	$ 757,723	$ 722,865

See accompanying notes to the financial statements.

THE DEPARTMENT OF THE TREASURY
BUREAU OF ENGRAVING AND PRINTING

Statements of Operations and
Cumulative Results of Operations

For the Years Ended September 30, 2012 and 2011

	2012	2011
	(In Thousands)	
Revenue from sales (Note 10)	$ 735,797	$ 548,094
Cost of goods sold	564,669	442,769
Gross margin	171,128	105,325
Operating costs:		
General and administrative expenses	108,326	80,433
Research and development	9,127	8,314
	117,453	88,747
Excess of revenues over expenses	53,675	16,578
Cumulative results of operations at beginning of year	549,915	533,337
Cumulative results of operations at end of year	$ 603,590	$ 549,915

See accompanying notes to the financial statements.

THE DEPARTMENT OF THE TREASURY
BUREAU OF ENGRAVING AND PRINTING

Statements of Cash Flows

For the Years Ended September 30, 2012 and 2011

	2012	2011
	(In Thousands)	
Cash flows from operating activities		
Excess of revenues over expenses	$ 53,675	$ 16,578
Adjustments to reconcile excess of revenues over expenses to net cash provided by operating activities:		
Depreciation	40,812	32,566
(Gain) Loss from obsolescence	(175)	720
Loss from disposal of property and equipment	-	53
Changes in assets and liabilities		
Increase in accounts receivable	(15,919)	(9,814)
(Increase) decrease in inventories	5,102	(8,729)
(Increase) decrease in prepaid expenses	(1,045)	210
Increase in other assets	(163)	(4,102)
Increase (decrease) in accounts payable	(14,703)	13,639
Increase (decrease) in accrued liabilities	(1,281)	2,436
Decrease in advances	(3,449)	(2,861)
Increase in workers' compensation liability	616	3,588
Net cash provided by operating activities	63,470	44,284
Cash flows from investing activities		
Purchases of property and equipment	(75,655)	(67,768)
Net cash used in investing activities	(75,655)	(67,768)
Net decrease in cash	(12,185)	(23,484)
Cash at beginning of year	130,178	153,662
Cash at end of year	$ 117,993	$ 130,178

See accompanying notes to the financial statements.

1. Reporting Entity

The Bureau of Engraving and Printing (Bureau), a component of the United States (U.S.) Department of the Treasury, is the U.S. Government's security printer. The Bureau designs and produces U.S. currency. The Bureau also advises and assists federal agencies in the design and production of other U.S. Government documents requiring counterfeit deterrence or secure production.

The Bureau operates under basic authorities conferred by the Act of July 11, 1862, (12 Stat. 532; also, 31 U.S.C. 5114) and other laws and regulations. In accordance with the provisions of Public Law 81-656, effective August 4, 1950, the operations of the Bureau are financed by means of a revolving fund. This fund is reimbursed through billings to the Bureau's customers for products delivered. Public Law 95-81 authorized the Bureau to include in its product prices an amount to provide funding for the acquisition of capital equipment and future working capital. Invested capital represents the historical value of the initial contribution made by the Federal Government.

The financial statements represent the consolidation of two federal revolving funds. The majority of all financial transactions are contained in the Bureau of Engraving and Printing Revolving Fund, which finances Bureau operations. The other revolving fund, the Mutilated Currency Revolving Fund, is used to redeem damaged paper currency received from the public. All significant balances and transactions between the funds have been eliminated in consolidation.

2. Summary of Significant Accounting Policies

Basis of Accounting

The Bureau has historically prepared its financial statements in conformity with U.S. generally accepted accounting principles (GAAP), based on accounting standards issued by the Financial Accounting Standards Board (FASB), the private-sector standards-setting body. Under such standards, the Bureau prepares its financial statements using the full accrual basis of accounting under which revenues are recognized when earned and expenses are recognized as incurred, regardless of when cash is exchanged.

The Federal Accounting Standards Advisory Board (FASAB) has been designated by the American Institute of Certified Public Accountants as the standards-setting body for financial statements of Federal Government entities, with respect to the establishment of GAAP. FASAB has indicated, however, that financial statements prepared based upon accounting standards published by the FASB may also be regarded as in conformity with GAAP for those federal agencies, such as the Bureau, that have issued financial statements based upon FASB accounting standards in the past. Accordingly, consistent with historical reporting, the Bureau’s financial statements are presented in accordance with accounting standards published by the FASB.

Estimates

The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and related revenues and expenses. Those estimates most significant to the Bureau's financial statements are the actuarial estimates made by the Department of Labor (DOL) in arriving at the liabilities for workers' compensation, allowances for obsolescence, the useful lives of property and equipment, the likelihood of losses associated with contingent liabilities, and certain accrued expenses at the date of the financial statements. Such estimates and assumptions could change in the future as more information becomes known, which could impact the amounts reported and disclosed herein.

Cash

Cash represents the aggregate amount of the Bureau's funds held on deposit with the U.S. Treasury and are available to pay liabilities.

Inventories

Raw material and supply inventories are stated at standard cost, except for one advanced counterfeit deterrent material, which is valued using the first-in-first-out (FIFO) method. Finished goods inventories are stated at weighted average unit cost. All methods approximate actual cost. Cost elements included in work-in-process and finished goods inventories are direct materials, direct labor, manufacturing overhead and manufacturing support.

Any raw materials inventory determined to be obsolete will be immediately expensed resulting in no allowance for inventory obsolescence for raw materials.

Property and Equipment

Property and equipment are recorded at cost. Major alterations and renovations are capitalized, while maintenance and repair costs are charged to expense as incurred. The capitalization threshold is $50,000. The Bureau capitalizes all cost associated with new construction and building improvements.

The Bureau occupies and uses buildings and land owned by the Department of the Treasury. The Bureau is not charged for the use of the buildings or land, but is responsible for maintenance and repair of all buildings and land improvements. The land and building shell for the Bureau's Western Currency Facility were donated by the City of Fort Worth, Texas to the Department of the Treasury (See Note 5).

Depreciation of property and equipment is calculated using the straight-line method over the following estimated useful lives:

Machinery and equipment	3 - 15 years
Building improvements	3 - 40 years
Information technology (IT) equipment and software	3 - 5 years
Office machines	5 - 10 years

Furniture and fixtures	5 - 10 years
Motor vehicles	3 - 9 years

Other Assets

Other assets consist principally of machine repair parts and tools, which are used in the production of the Bureau's products. Other assets are stated at standard cost, which approximates actual cost, net of a reserve for obsolescence.

Employee Retirement Plans

Bureau employees participate in the contributory Civil Service Retirement System (CSRS) or Federal Employees' Retirement System (FERS), to which the Bureau and employees make contributions according to plan requirements. Consistent with reporting under multi-employer pension plans, the Bureau does not report CSRS and FERS assets, accumulated plan benefits or future liabilities, if any, applicable to its employees. This data is reported for plan participants by the Office of Personnel Management (OPM).

Postretirement Benefits Other than Pensions

Postretirement benefits for former Bureau employees, specifically health care costs and life insurance, are administered and paid by OPM through appropriations received from the U.S. Government. The Bureau does not reimburse OPM for these payments. The Bureau's financial statements do not include the cost of employee postretirement benefits paid by OPM, or the actuarial liability for such benefits.

Workers' Compensation Costs

The Federal Employee Compensation Act (FECA) provides income and medical cost protection to covered federal civilian employees injured on the job, employees who have incurred a work-related occupational disease and beneficiaries of employees whose death is attributable to a job-related injury or occupational disease. Claims incurred for benefits for the Bureau's employees under FECA are administered by DOL and are ultimately paid by the Bureau.

The FECA liability consists of two components. The first component, the accrued FECA liability, is based on actual claims paid by DOL but not reimbursed by the Bureau. The Bureau reimburses DOL for the amount of actual claims normally within one to two years after payment is made by DOL. As a result, the Bureau recognizes a current and non-current liability for actual claims paid by DOL, to be reimbursed by the Bureau.

The second component, the actuarial FECA liability, is the estimated liability for future benefit payments. These future workers' compensation estimates were generated from an application of actuarial procedures developed to estimate the liability for future FECA benefits. The actuarial liability for future worker's compensation benefits includes the expected liability for death, disability, medical and miscellaneous costs for approved compensation cases, plus a component for incurred but not reported claims. The liability is determined using a method that utilizes historical benefit payment patterns related to a specific incurred period to predict the ultimate payments related to that period. These annual benefit payments have been discounted to present value using the Office of Management and Budget's (OMB) economic assumptions for 10-year Treasury notes and bonds, which resulted in discount rates as of September 30, 2012 and 2011, of 2.29% and 3.54% in year one and 3.14% and 4.03% thereafter. The Department of the Treasury allocated the overall liability to Treasury components based on past claims paid information provided by DOL.

Annual, Sick, and Other Leave

Annual leave is accrued as a liability when earned and the accrual is reduced as leave is taken. The balance in this accrued liability account reflects current pay rates.

Sick leave and other types of non-vested leave are expensed as the leave is taken.

Revenue Recognition

Revenue from sales to the Federal Reserve Board is recognized when finished goods satisfactorily pass all Bureau quality control standards and are delivered to the on-site Federal Reserve Depository vaults. Finished goods are released for shipment in accordance with customer requirements. Revenue from the sale of uncut currency to the public is recognized at the time the product is shipped. The Bureau does not record an allowance for returns because of a historically negligible return rate.

Research and Development Costs and Public Education (Advertising) Costs

Research and development costs and public education costs are expensed as incurred. Public education costs, which are reported in cost of goods sold, amounted to $0 and $3.1 million in the years ended September 30, 2012 and 2011, respectively.

Tax Status

The Bureau is a federal entity, and therefore is not subject to federal, state, or local income taxes. Accordingly, no provision for income taxes is made in the accompanying financial statements.

Contingencies

Liabilities from loss contingencies arising from claims, assessments, litigation, fines and penalties, and other sources, are recorded when it is probable that a liability has been incurred and the amount of the assessment and/or remediation cost can be reasonably estimated. Loss contingencies that do not meet these criteria, but are reasonably possible and estimable are not accrued, but are disclosed in Note 12.

Fair Value Measurements

ASC 820-10, *Fair Value Measurements and Disclosures*, establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The Bureau's financial instruments are comprised of cash, accounts receivable, accounts payable, accrued liabilities, and advances as of September 30, 2012 and 2011, respectively. The carrying amounts of these financial instruments approximate fair value because of the short-term nature of these instruments. The Bureau holds no financial instruments that are required by ASC 825-10 to be valued at, reported, or disclosed at fair value as of September 30, 2012 or 2011.

3. Cash

The year-end cash balances by fund are as follows as of September 30, 2012 and 2011:

	(In Thousands)	
	2012	**2011**
Bureau of Engraving and Printing Revolving Fund	$ 113,076	$ 126,264
Mutilated Currency Revolving Fund	4,917	3,914
Total	$ 117,993	$ 130,178

The balance in the mutilated currency revolving fund, consisting of processed claims for mutilated currency submitted by the public for redemption, is offset by a liability to the public which is included in advances on the balance sheets as of September 30, 2012 and 2011, respectively (See Note 7).

4. Inventories, net

Inventories consist of the following as of September 30, 2012 and 2011:

	(In Thousands)	
	2012	**2011**
Raw material and supplies	$ 75,418	$ 46,429
Work-in-process	41,736	40,203
Finished goods - currency	7,302	48,270
Finished goods - uncut currency	20,220	13,924
Total	$ 144,676	$ 148,826

The allowance for inventory obsolescence was $0 and $952 thousand, at September 30, 2012 and 2011, respectively.

5. Property and Equipment, net

Property and equipment consist of the following as of September 30, 2012 and 2011:

	(In Thousands) 2012	2011
Machinery and equipment	$ 494,201	$ 477,455
Building and land improvements	251,335	234,314
IT equipment and software	94,603	56,821
Office machines	2,791	2,791
Furniture and fixtures	1,277	1,272
Donated assets - art work	125	125
Motor vehicles	212	212
	844,544	772,990
Less accumulated depreciation	553,642	512,831
	290,902	260,159
Construction-in-progress	125,448	121,348
Net property and equipment	$ 416,350	$ 381,507

Depreciation expense for the years ended September 30, 2012 and 2011 was $40.8 million and $32.6 million, respectively.

The Bureau occupies and uses buildings and land owned by the Department of the Treasury. The land and building shell for the Fort Worth, Texas facility were donated by the City of Fort Worth to the Department of the Treasury in 1987, which holds the title thereto. At the time of donation, the land had an appraised value of $1.5 million and the building shell cost was $5.6 million. In accordance with the provisions of Public Law 81-656, Bureau financial statements include only the costs to build out the facility.

6. Other Assets, net

Other assets consist principally of machine repair parts and tools. The allowance for obsolescence for these parts and tools for the years ended September 30, 2012 and 2011 was $6.7 million and $5.9 million, respectively.

7. Current Liabilities

All current liabilities are funded and consist of the following as of September 30, 2012 and 2011:

	(In Thousands) 2012	2011
Intragovernmental	$ 5,843	$ 15,354
With the public	52,816	62,738
Total	$ 58,659	$ 78,092

Accrued current liabilities consist of the following as of September 30, 2012 and 2011:

	(In Thousands) 2012	2011
Payroll	$ 16,506	$ 17,591
Annual leave	11,628	11,591
Workers' compensation	5,595	5,270
Other	939	1,497
Total	$ 34,668	$ 35,949

Advances consist of the following as of September 30, 2012 and 2011:

	(In Thousands) 2012	2011
Other Federal Agencies	$ 58	$ 4,513
Mutilated Currency	4,917	3,914
Public sales	36	33
Total	$ 5,011	$ 8,460

8. Workers' Compensation Liability

Claims incurred and paid by DOL as of September 30, 2012 and 2011, but not yet reimbursed to DOL by the Bureau, are approximately $11.8 million and $12.3 million, of which approximately $5.6 million and $5.3 million represent a current liability, as of September 30, 2012 and 2011, respectively. The Bureau will reimburse DOL for these claims in the next two years. The Bureau's estimated non-current, actuarially derived future workers' compensation liability was approximately $56.8 million and $55.4 million as of September 30, 2012 and 2011, respectively. The Bureau's estimated, undiscounted, non-current, actuarially derived future workers' compensation liability was approximately $81.9 million and $87.5 million as of September 30, 2012 and 2011, respectively.

9. Employee Retirement Plans and Postretirement Benefits Other than Pensions

Employer contributions to the retirement plans were $18.3 million and $17.9 million for 2012 and 2011, respectively. The CSRS employer contribution rate for fiscal years 2012 and 2011 was 7.0%. The FERS agency contribution rate was 11.9% and 11.7% for fiscal years 2012 and 2011, respectively. The cost of providing the CSRS and FERS benefits is more than the amounts contributed by the Bureau and the employees to OPM. The additional cost of providing benefits, including the cost financed by OPM, which is not included in the Bureau's Statements of Operations, totaled $25.7 million and $26.5 million in 2012 and 2011, respectively.

OPM paid costs totaling $10.7 million and $11.2 million for the Federal Employees Health Benefits Program (FEHBP) and Federal Employees Group Life Insurance (FEGLI) programs in 2012 and 2011, respectively. These costs are not included in the Bureau's Statements of Operations. The Bureau paid costs totaling $14.6 million and $14.1 million for the FEHBP and FEGLI programs in 2012 and 2011, respectively.

10. Concentration of Revenue

The Bureau’s principal customers are other federal and quasi-federal governmental organizations. During 2012 and 2011, the Bureau’s sales revenue from these organizations as well as the outstanding amounts due from them as of September 30, 2012 and 2011, are reflected in the following table:

	Revenue (In Thousands)		**Accounts Receivable** (In Thousands)	
	2012	**2011**	**2012**	**2011**
Federal Reserve Board:				
Currency Production	$ 723,436	$ 523,009	$ 52,954	$ 36,993
Mutilated Currency	3,277	3,472	804	873
Other Federal Agencies	1,974	3,291	92	126
	728,687	529,772	53,850	37,992
Public sales	6,809	18,320	1	56
Other	301	2	504	388
	7,110	18,322	505	444
Total	$ 735,797	$ 548,094	$ 54,355	$ 38,436

Revenues from other federal agencies are derived principally from the sale of security printing products to U.S. Government agencies and related fees charged.

Substantially all products are sold on a fixed price basis. When the revenue from such pricing is not sufficient to cover all costs and provide for necessary working capital the Bureau will negotiate with the Federal Reserve Board for an additional surcharge. The required surcharge totaled approximately $0 and $97.8 million in 2012 and 2011, respectively. This amount is included in Revenue on the Statement of Operations.

11. Principal Suppliers

The Bureau is dependent upon sole suppliers for distinctive currency paper and several advanced counterfeit deterrent materials.

12. Commitments and Contingencies

The Bureau is a party in various administrative proceedings, legal actions, and claims brought against the Federal Government by employees, contractors, and other parties. As of September 30, 2012 and 2011, there are no contingencies for litigation involving the Bureau, where the risk of loss is probable. Contingencies, where the risk of loss is reasonably possible, are approximately $3.4 million and $4.0 million as of September 30, 2012 and 2011, respectively. Since the risk of loss for these litigations is not probable, the Bureau did not record any liability. Management believes that the ultimate resolution of these litigations will not have a material impact on the reported financial position, results of operations, and cash flows.

In 2007, a judge ruled that the current U.S. currency design violates Section 504 of the Rehabilitation Act. The Court awarded no monetary damages. However, the Bureau is required to provide meaningful access to United States currency for blind and other visually impaired persons as part of the next currency redesign. The cost of currency changes necessary to provide meaningful access will be incorporated into future currency redesign costs. No costs related to the Court ruling have been accrued in the accompanying financial statements as of September 30, 2012 and 2011.

The Bureau has contracted to purchase three large finishing presses, incorporating automated inspection and packaging capability, costing approximately $53.0 million. As of September 30, 2012, the Bureau has made cumulative payments of $41.9 million and the remaining commitment outstanding is $11.1 million. Delivery of the presses will be determined upon successful completion of final factory inspection tests. Progress payments related to the above contract is included in construction-in-progress within Property and Equipment on the balance sheets as of September 30, 2012 and 2011, respectively.

The Bureau does not carry commercial insurance on its physical assets because by law the Federal Government is self-insured.

13. Operating Lease

In 2002, the Bureau entered into a cancelable operating lease for warehouse space that expired in 2012. The operating lease for warehouse space was renewed in 2011 for an additional 10 years and will expire in 2022.

Rental expense for the years ended September 30, 2012 and 2011 was $2.5 million and $1.9 million, respectively.

Future minimum payments under the lease as of September 30, 2012, are (in thousands):

For the years ending September 30:	Amount
2013	$ 3,039
2014	3,051
2015	3,064
2016	3,077
2017	3,090
Thereafter	14,068
Total	$ 29,389

14. Subsequent Events

The Bureau has evaluated subsequent events through December 14, 2012, the date which the financial statements were available to be issued. There were no material events that required additional accruals or disclosures.

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Independent Auditors' Report on Internal Control Over Financial Reporting

To the Inspector General, Department of the Treasury, and
The Director of the Bureau of Engraving and Printing, Department of the Treasury:

We have audited the balance sheets of the Bureau of Engraving and Printing (the Bureau) as of September 30, 2012 and 2011 and the related statements of operations and cumulative results of operations, and cash flows (hereinafter referred to as "financial statements") for the years then ended, and have issued our report thereon dated December 14, 2012.

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

The management of the Bureau is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our fiscal year 2012 audit, we considered the Bureau's internal control over financial reporting by obtaining an understanding of the design effectiveness of the Bureau's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Bureau's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Bureau's internal control over financial reporting. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*.

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.

Our consideration of internal control over financial reporting was for the limited purpose described in the third paragraph of this report and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. In our fiscal year 2012 audit, we did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over financial reporting described in Exhibit I that we consider collectively to be a significant deficiency in internal control over financial reporting. 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.

The Bureau's written response to the significant deficiency identified in our audit and presented in Exhibit I was not subjected to the auditing procedures applied in the audit of the Bureau's financial statements and, accordingly, we express no opinion on it.

Exhibit II presents the status of the prior year significant deficiency.

We noted certain additional matters that we have reported to management of the Bureau in a separate letter dated December 14, 2012.

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

KPMG LLP

December 14, 2012

Exhibit I

Bureau of Engraving and Printing
Independent Auditors' Report on Internal Control Over Financial Reporting
Status of Prior Years' Significant Deficiency

Deficiencies Identified Related to the Implementation of the Oracle Operating System

In fiscal year 2010, the Bureau introduced a multi-phase approach for upgrading its manufacturing and data management systems titled, Bureau of Engraving and Printing Enterprise (BEN). The roadmap to complete BEN included a series of manufacturing and data management system releases executed over a span of two years. On April 1, 2011, the Bureau issued a manufacturing support system release within the Office of Financial Management. This release was the first step in a full financial system conversion from BEP's legacy system, Bureau of Engraving and Printing Management Information System (BEPMIS), to a new system, Oracle-On-Demand and encompassed the conversion of the general ledger, the fixed assets sub-ledger, and the accounts receivable sub-ledger in fiscal year 2011. The remaining modules within BEN (which made up the bulk of the modules and included additional financial system components) were converted through a second release on October 2, 2011. Further upgrades to BEN in fiscal year 2012 were issued through Releases 3 (January 2012) and 4 (May 2012).

We noted several control deficiencies, related to the financial reporting process and associated with the Oracle implementation, which follow:

- The recording of Public Sales became automated through the Oracle system on May 31, 2012. Bureau management did not perform a reconciliation of the cash receipts report to the sales activity reflected in the items shipped report for the months of June through September 2012 until October, 2012 due to a system error in the recording of sales returns and certain sales transactions. BEN uses the items shipped information to record revenue earned in the general ledger, as a result, the Bureau was unable to reconcile cash received with revenue earned during those months noted above.

- A control gap exists in that the acquisitions department does not perform a monthly review of open Purchase Orders relating to Stock and Materials Requirements Planning (MRP) Orders to determine the reason an order is in open status because of insufficient staff and an inability to obtain the information from the system.

- Oracle Purchasing automatically records accrued liabilities as goods and services are received. From October 2011 through May 2012, because of an incorrect system preference selected, BEP did not have a control in place to ensure invoices that only required a two-way match and related to purchase orders that were migrated into Oracle during the conversion were properly recorded.

- The Bureau did not perform a reconciliation of the Work-In-Process Inventory (WIP) sub-ledger to the general ledger until July 2012. As such, no reconciliations were performed for the months of October 2011 through June 2012. BEP management noted that machine hours from the shop floor were not properly transferring from the sub-ledger to the general ledger during the month of October 2011. Furthermore, Oracle was not properly measuring the actual costs of raw materials in order to generate standard costs until May 1, 2012. Both of these issues contributed to the improper valuation of WIP until May 2012. The reconciliations were subsequently performed biweekly during the months of August and September 2012.

Exhibit I

Bureau of Engraving and Printing
Independent Auditors' Report on Internal Control Over Financial Reporting
Status of Prior Years' Significant Deficiency

OMB Circular A-123 states, "Management is responsible for developing and maintaining effective internal control. Effective internal control provides assurance that significant weaknesses in the design or operation of internal control, that could adversely affect the agency's ability to meet its objectives, would be prevented or detected in a timely manner."

A failure to properly reconcile account sub ledgers to the general ledger or properly accrue liabilities could result in a misstatement of the related items on the financial statements. The Bureau determined that inventory was understated by $2.1 million and public sales revenue was overstated by $140 thousand based on the issues noted. A failure to review open purchase orders affects the ability of the Bureau to ensure that orders are processed promptly and correctly. This could allow the possibility of unmatched receiving documents or invoices to exist that are not being properly accrued.

We recommend the Bureau (1) review transaction and posting models within each sub-ledger of BEN to ensure that the system is correctly set up and that underlying transactions in each sub-ledger are being accurately reflected in the general ledger; (2) ensure that timely reconciliations of sub-ledgers to the general ledger are performed throughout the year, and (3) design and implement a control to perform a timely review of open purchase orders.

Management Response:

Management concurs with the recommendations and will take the necessary steps to implement policies and procedures to ensure the timely and accurate review of reconciliations performed.

Exhibit II

Bureau of Engraving and Printing
Independent Auditors' Report on Internal Control Over Financial Reporting
Status of Prior Years' Significant Deficiency

Finding and Recommendations	Status
Internal Control Over Year End Liability Accruals Needs Improvement	
We recommend the Bureau (1) develop and implement policies and procedures to improve the reliability of reviews over significant and unusual accounting transactions and reconciliations by individuals most knowledgeable of the subject matter, (2) ensure policies and procedures are followed to verify all significant and unusual accounting transactions and reconciliations were performed properly, (3) require supporting documentation be provided with, and be examined as part of, the Bureau's review of year end specific item accounts payable estimates, and (4) ensure all year end specific item accounts payable estimates are adequately supported and properly accrued.	No control deficiencies related to the recording and review of Accounts Payable were indentified in current year testing. We consider this finding closed.

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Independent Auditors' Report on Compliance and Other Matters

The Inspector General, Department of the Treasury and
The Director of the Bureau of Engraving and Printing, Department of the Treasury:

We have audited the balance sheets of the Bureau of Engraving and Printing (the Bureau) as of September 30, 2012 and 2011, and the related statements of operations and cumulative results of operations and cash flows (hereinafter referred to as "financial statements") for the years then ended, and have issued our report thereon dated December 14, 2012.

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

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

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

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

KPMG LLP

December 14, 2012