Alcohol and Tobacco Tax and Trade Bureau

ANNUAL REPORT

FISCAL YEAR 2016

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Introduction

Within its FY 2016 Annual Report, the U.S. Department of the Treasury's Alcohol and Tobacco Tax and Trade Bureau (TTB) combines program performance with financial data to demonstrate how effectively the Bureau translates its program dollars into effective consumer protection and increased tax revenue.

Each year, as part of the performance and budget cycle, TTB issues this report to inform its stakeholders of the Bureau's accomplishments and explain any challenges. The report defines the Bureau's mission, strategic goals, and major programs, and summarizes its progress in meeting the objectives outlined in the TTB strategic plan. TTB also presents financial information that depicts how TTB expended its budget according to its major programs and accounted for tax collections from the alcohol, tobacco, firearms, and ammunition industries.

This report presents this information in four parts:

Part I – Management's Discussion and Analysis. This section provides an overview of the Bureau, including its mission and programs, and highlights of program performance and financial operations.

Part II – Program Performance Results. This section provides a discussion of results achieved for each performance measure related to the Collect the Revenue and Protect the Public strategic goals and an overview of the Bureau's accomplishments under its Management and Organizational Excellence goal.

Part III – Financial Results, Position, Condition and Auditors' Reports. In this section, TTB presents audited balance sheets, statements of net cost, changes in net position, budgetary resources, and custodial activity as of and for the years ending September 30, 2016, and September 30, 2015, and the Independent Auditors' Report on these financial statements. Also included is a report on the Bureau's internal controls over financial reporting and a report on TTB's compliance with laws and regulations. This section also includes a discussion of budget activities for each of the Bureau's seven major programs and supplemental information, such as a history of federal excise tax collections for the past decade.

Part IV – Appendices. This section includes a list of TTB's principal officers, an organization chart, and strategic plan information that demonstrates the relationship between TTB's plan and the Department of the Treasury's mission and goals.

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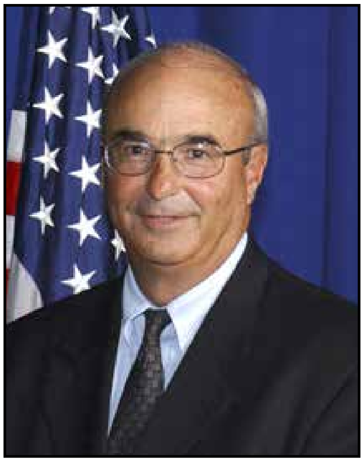
Message from the Administrator



All too often, the phrase "good enough for government" is said with derision, implying that lackluster results are acceptable, and perhaps expected, from government agencies. This does not reflect the culture that we cultivate at TTB. Instead, in keeping with the origins of the phrase, we set high standards and aggressive performance targets, striving for improvement based on a keen understanding of the importance of our work to the industries who rely on us.

In facing our challenges, we continue to adopt the best management principles of private industry and apply them to the public model, creating a results-driven culture that is evident in every program area. In our service areas, we improved label performance significantly this year, using a data-driven approach to evaluate and understand the bottlenecks and barriers to timely processing, and developing strategic solutions to address them. With these efforts, we ended the year with the majority of label and formula applications at our service standards, and we are well-positioned to further improve service times in FY 2017 to facilitate the operations of the growing alcohol beverage industries.

Conversely, we have seen service levels degrade in the permitting area, with existing resources strained to keep up with the continued increase in prospective breweries, wineries, and distilleries applying for a federal permit. We are taking a similar tack to address these issues, basing planned system updates and industry guidance on the findings of a review of our workflow and the frequent application errors that have compounded processing delays. As we roll out these changes in FY 2017, including a major redesign of the Permits Online electronic filing system, we expect to curb the declining service levels that stand in the way of healthy small business growth.

As these industries expand, our role in enforcement to maintain a level playing field is more important than ever. Whether through ensuring compliance with trade practice laws to address anti-competitive business practices, or effectively enforcing the tax code, we continue to address the unlawful conduct that stifles fair competition and deprives the government of revenue to fund national priorities.

While the progress this year has been mixed, I look forward with confidence to the year ahead. Our organization has never been more committed to achieving results, and through the combined talents and engagement of our people, we are on track to implement strategic solutions for sustained performance improvement.

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

John J. Manfreda

John J. Manfreda

Administrator

Vision, Mission, and Values

Vision

Our vision is to be the world's authority in the regulation, taxation, and science of alcohol and tobacco products and a model for next generation government.

Mission

Our mission is to collect the taxes on alcohol, tobacco, firearms, and ammunition; protect the consumer by ensuring the integrity of alcohol products; and prevent unfair and unlawful market activity for alcohol and tobacco products.

Values

We value:

- **People.** We empower our people through trust, respect, and teamwork.
- **Results.** We take pride in accomplishing meaningful results for the American public.
- **Accessibility.** We are available to the public and our colleagues through collaboration, communication, and partnership.
- **Innovation.** We explore new and better methods of conducting business, take manageable risks to improve our operations, and evolve based on results.
- **Service.** We are professionals dedicated to public service.

TTB Strategic Goals and Objectives

Strategic Goal: Collect the Revenue

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

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

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

Strategic Goal: Protect the Public

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

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

Product Integrity. Ensure that alcohol beverage products comply with federal production, labeling, and advertising requirements

Market Integrity. Ensure fair trade practices throughout the alcohol beverage marketplace

Strategic Goal: Management and Organizational Excellence

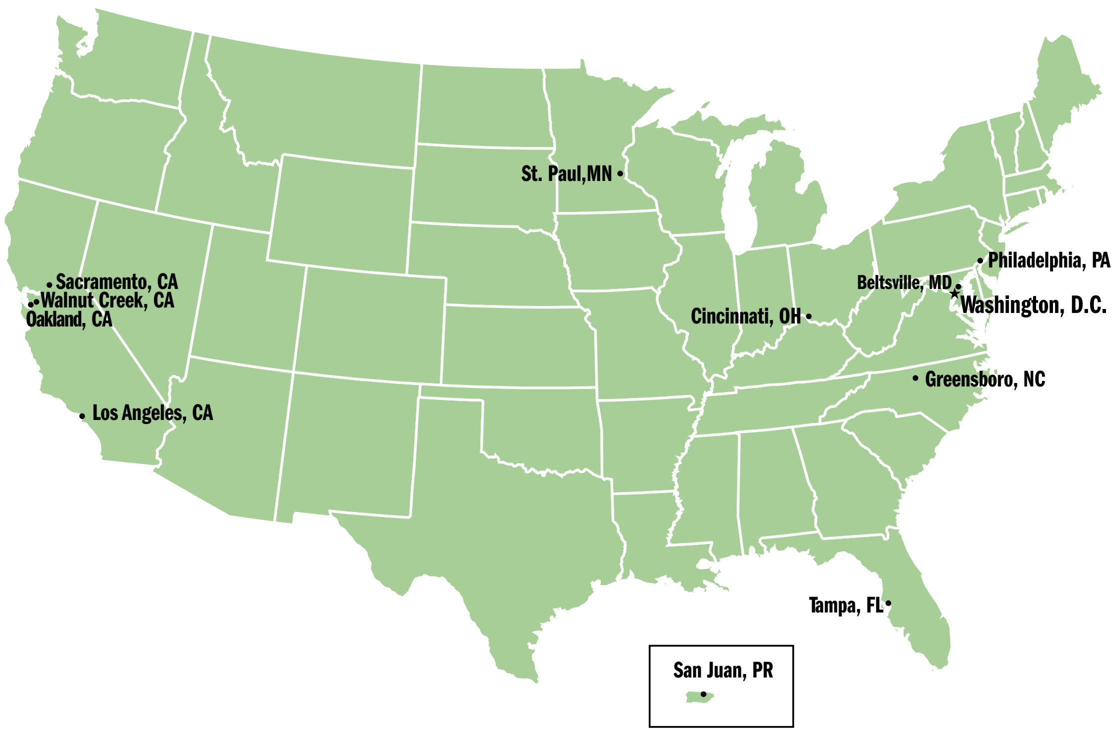
Effectively managed resources and human capital for maximum performance, efficiency, and program results

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

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

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

TTB Office Locations



Industry at a Glance	FY 2016	FY 2015
Total TTB Permittees	82,391	76,341
TTB Permittees by Industry Type		
Alcohol	97%	97%
Tobacco	1%	1%
Firearms	2%	2%
TTB Taxpayers	12,941	11,689

TTB at a Glance	FY 2016	FY 2015
Employees	494	473
Office Locations	12	12
Budget Authority	$106 Million	$100 Million
Revenue Collected	$22.1 Billion	$22.3 Billion
Permits Applications Received	8,554	8,337
Certificate of Label Approval Applications Received	161,477	153,867

*TTB has some offices co-located in larger cities.

Part I: Management's Discussion and Analysis

Profile of a Bureau

Supporting the nation's economic vitality is at the core of the work performed by the Alcohol and Tobacco Tax and Trade Bureau (TTB). The Bureau's role in permitting, regulating, and taxing the alcohol and tobacco industries ensures a fair marketplace, compliant commerce, and a level playing field for those engaged in the manufacture and trade of these commodities.

TTB is staffed with approximately 490 employees, most of whom report to either the headquarters office in Washington, D.C., or the National Revenue Center in Cincinnati, Ohio. For its auditors, investigators, and agents to most effectively operate in the field, TTB maintains a minimal physical footprint, with 10 offices in cities across the United States and Puerto Rico. These small, strategically located offices place the Bureau in close proximity to centers of trade and industry activity, and provide effective launch points for TTB's investigative and audit teams. Additionally, the Bureau has two laboratory facilities in Walnut Creek, California and Beltsville, Maryland. See Part IV of this report for a chart outlining the TTB organizational structure.

The Bureau was formed in January 2003, under the Homeland Security Act of 2002, but its history began more than 200 years ago as one of the earliest federal tax collection agencies. Today, TTB operates under the authorities of the Internal Revenue Code of 1986 (IRC)[1], the Federal Alcohol Administration Act (FAA Act),[2] the Alcoholic Beverage Labeling Act of 1988 (ABLA),[3] and the Webb-Kenyon Act.[4] These laws put in place strict requirements and controls related to alcohol and tobacco products and place restrictions on who can make, sell, and distribute these commodities.

In essence, TTB administers its jurisdiction according to two core mission areas—"Collect the Revenue" and "Protect the Public"—both of which serve to support economic growth and stability by ensuring that the federal government has the resources needed to fund national priorities and that lawful U.S. alcohol businesses are competitive and thriving in the global marketplace.

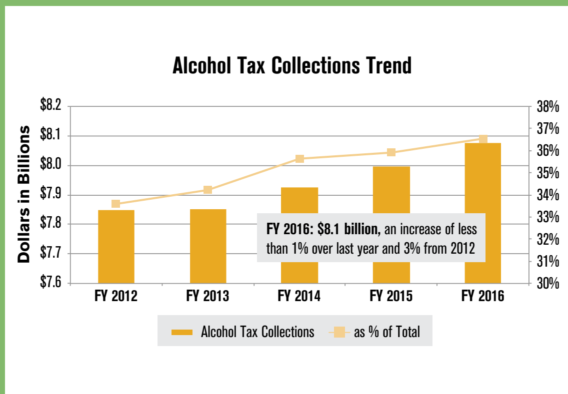
1 Chapters 51 and 52 of the IRC provide for excise taxation and authorize operations of alcohol and tobacco producers and related industries, and IRC sections 4181 and 4182 provide for excise taxes for firearms and ammunition.

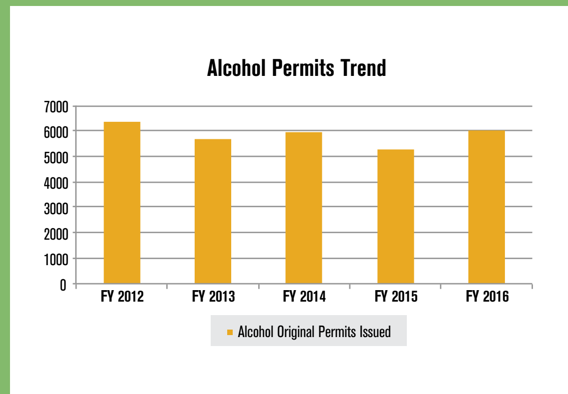
2 The FAA Act provides for regulation of those engaged in the alcohol beverage industry and for protection of consumers through certain requirements regarding the labeling and advertising of alcohol beverages. The FAA Act also includes provisions to preclude unfair trade practices that serve as barriers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

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

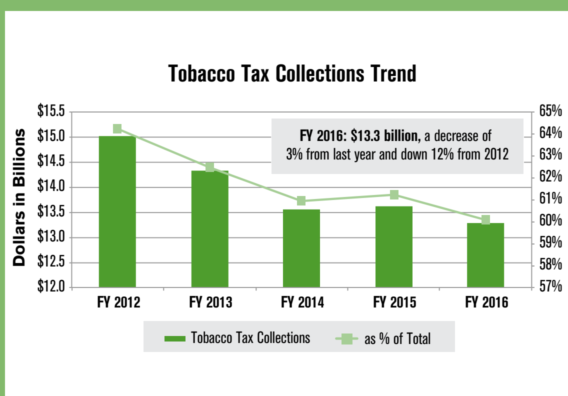
4 The Webb-Kenyon Act prohibits the shipment of alcohol beverages into a state in violation of that state's laws.

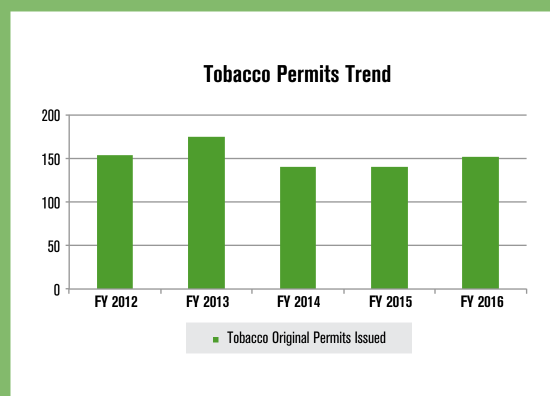
Alcohol Industry Snapshot



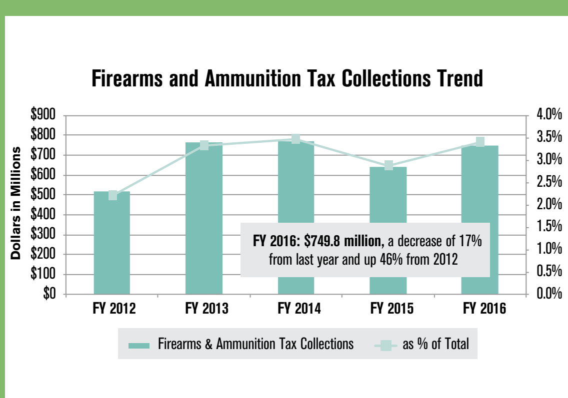


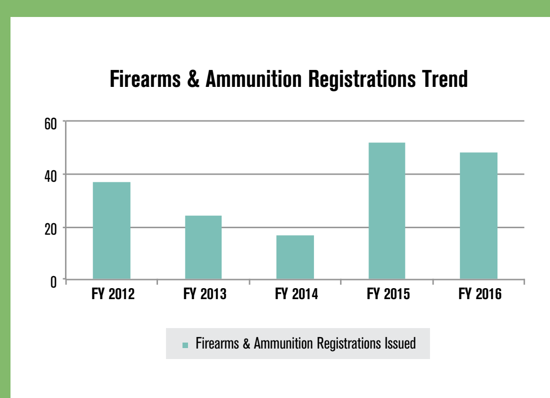
Tobacco Industry Snapshot





Firearms & Ammunition Industry Snapshot

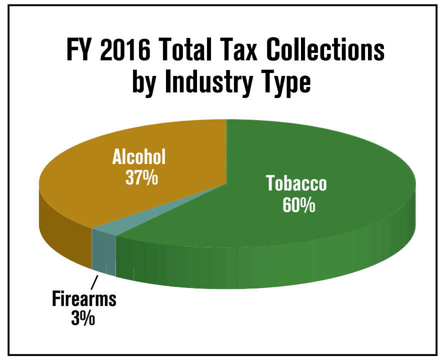




Performance Highlights

Collect the Revenue

TTB is the third largest tax collection agency in the U.S. government, behind the Internal Revenue Service (IRS) and U.S. Customs and Border Protection (CBP). Annual revenues from the alcohol, tobacco, firearms, and ammunition industries are approximately $22 billion. TTB excise tax collections reached an historic high of nearly $24 billion in FY 2010, principally due to increased receipts from the tobacco industry. Today, tobacco revenues comprise 60 percent of TTB's total excise tax collections.



In FY 2016, TTB collected more than $13 billion in tobacco tax revenue. As forecasted, tobacco revenues have generally declined since FY 2010, the first full year of collections following the 2009 federal tobacco tax rate increase. Higher prices on tobacco products have historically resulted in decreased consumption and increased illicit trade, which indicates that tobacco revenue will continue to decline. Further, recent analysis of tobacco collections has shown significant market shifts for tobacco products since 2009. The 2009 tax rate change introduced large federal excise tax disparities among tobacco products, which created opportunities for tax avoidance and led manufacturers and price-sensitive consumers to shift toward lower-taxed products. The growing popularity of electronic nicotine products, such as e-cigarettes, which are not subject to federal excise tax unless they contain tobacco, could contribute to declining tobacco revenue in the future. TTB will continue to exercise its jurisdiction to support tax compliance and deter illicit trade.

The alcohol beverage industry in the United States accounts for approximately 37 percent of the excise tax revenue collected by TTB. In FY 2016, TTB collected approximately $8 billion in revenue from U.S. wineries, breweries, and distilleries. Although economic forecasts predict continued modest growth in the U.S. alcohol industry as a whole, excise tax collections will likely remain relatively constant due to a number of variables, including increasing volumes in imports, for which CBP collects the tax; increasing volumes of exports, on which no tax is due; and declining sales by volume from the country's largest brewers, who account for approximately 90 percent of the beer sold in the U.S. The rapid expansion of small wineries, breweries, and distilleries will not entirely offset the declines in sales and tax payments by large companies as small beer and wine producers are eligible for reduced tax rates or tax credits based on their production volume. This trend is expected to continue through FY 2018.

TTB also collects the federal excise taxes on firearms and ammunition. These taxes are remitted to the Fish and Wildlife Restoration Fund for wildlife restoration and research and hunter education programs. Firearms and ammunition excise tax (FAET) collections have increased from $288 million in FY 2007 to $750 million in FY 2016, an increase of $462 million over the past decade, or a 160 percent growth in tax revenue. Historically, increases in reported FAET revenue can be attributed to growth in sales due to external factors as well as TTB's enforcement presence, which increases collections and promotes voluntary compliance.

Civil Tax Enforcement

Tax Classification

The tax rate on alcohol and tobacco products depends on a variety of factors, including product type (i.e., wine, distilled spirits, or beer) as well as characteristics of the products themselves, such as composition and weight. A critical first step in tax enforcement is the assignment of a tax class to alcohol and tobacco products based on federal statutory and regulatory standards. TTB conducts product evaluations during audits to check for proper tax classification based on the characteristics of the product as defined by statute.

Shifting Tobacco Market Trends due to Tax Rates

The significant differences in the federal excise tax rates on cigarettes and other tobacco products highlight the importance of TTB's tax classification activities. Since the new federal excise tax rates on tobacco products took effect in April 2009, TTB has identified and monitored significant market shifts toward lower-taxed tobacco products by manufacturers and price-sensitive consumers, contributing to declines in tax revenue.

In the past six years, TTB data indicates a near complete reversal in the market shares for pipe and roll-your-own tobacco in response to the lower tax rate on pipe tobacco.[5] Because the two products can be similar (and even interchangeable), and because the tax on roll-your-own tobacco was significantly increased, a portion of the roll-your-own tobacco market has switched to pipe tobacco, resulting in a dramatic shift in the volume of pipe tobacco and roll-your-own tobacco reported as removed by domestic manufacturers.

Due to the lack of clear standards in the tax code to differentiate pipe tobacco from roll-your-own tobacco, TTB has initiated rulemaking to establish objective standards that would provide a basis for differentiating between these two products for tax purposes. At the same time, in support of this rulemaking, the TTB Tobacco Laboratory has been evaluating proposed methods and standards. The goal is to set forth objective criteria, based on physical characteristics of the products, to distinguish between pipe tobacco and roll-your-own for tax purposes. TTB intends to publish subsequent rulemaking in this area.

The market shares for small cigars and large cigars, which were relatively equal prior to the 2009 tax rate revisions, have also starkly shifted toward large cigars following the increase in the small cigar tax rate. Large cigars are subject to an *ad valorem* tax and may have a significantly lower tax than a small cigar depending on the sale price of the cigar.[6]

The incentive to avoid tax is reflected in the overall decrease in the average taxable sale price for large cigars in the past five years. Large cigar manufacturers may be lowering their taxable sale price in a number of ways in order to realize net savings, including through legitimately adding weight to small

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5 Prior to 2009, the tax rates on pipe tobacco and roll-your-own tobacco were the same at just under $1.10 per pound. Beginning in 2009, the tax on pipe tobacco was increased to just over $2.83 per pound, while the tax on roll-your-own tobacco was increased to $24.78 per pound.

6 Large cigars are the only tobacco product for which the excise tax is based on the manufacturer or importer's sale price, up to a maximum amount; all other tobacco products are taxed at a flat rate based either on the number of units or the weight of the product. As a result, since the tax increase on small cigars, TTB has found that manufacturers and importers are increasing the weight of products that had been classified as small cigars prior to 2009 so that they meet the statutory definition of a large cigar.

cigars to qualify them for the large cigar tax rate. Another common scenario is to "layer" sales transactions to avoid taxes, which can involve inserting an intermediate sale into the distribution chain to lower the taxable sale price of the cigar. This activity and others, which could represent legal tax avoidance or illegal tax evasion depending on the circumstances of the case, present an ongoing enforcement challenge for TTB.

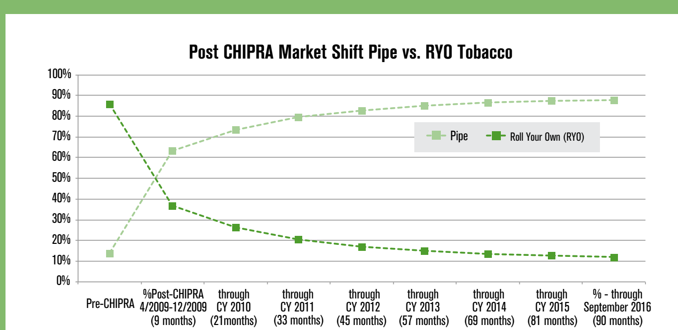
Supporting Global Alcohol and Tobacco Tax Administration

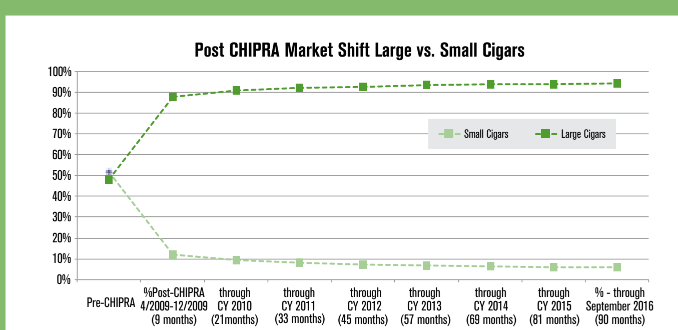
TTB supports effective global excise tax enforcement through technical collaborations with domestic partners and foreign counterparts. TTB's expertise extends from alcohol and tobacco excise tax administration to advanced analytical techniques in the testing of these products to support lawful and compliant trade.

During FY 2016, TTB hosted delegations from India to provide information on the U.S. framework for alcohol and tobacco regulation, including tax administration, enforcement methods, and export-related requirements. TTB also hosted meetings with officials from Norway, Ireland, and Chile regarding U.S. rules and regulations relative to specific products of geographic significance.

Further, in FY 2016, TTB took over the role as Chair of the Interagency Working Group to Combat Illicit Tobacco, a group created by the U.S. Department of State to facilitate collaboration between agencies on reducing the domestic and international illicit tobacco trade. The group's recent work includes a State Department publication, "The Global Illicit Trade in Tobacco: A Threat to National Security." Participants include CBP, the Immigration and Customs Enforcement Homeland Security Investigations (HSI), the Bureau of Alcohol, Tobacco, Firearms and Explosives, and Federal Bureau of Investigation,

Market Shifts in Tobacco Products





Significant shifts in the tobacco industry have developed since Congress revised the federal tax rates on tobacco products effective April 2009, particularly for small and large cigars and pipe and roll-your-own tobacco. An independent review by the Government Accountability Office (GAO) examined the market shifts in smoking tobacco products and federal revenue losses (GAO-12-475), which range in the billions. TTB has taken steps to respond to these market shifts, including its efforts to differentiate between roll-your-own and pipe tobacco for tax collection purposes. However, given limited enforcement remedies, GAO has recommended that Congress consider equalizing tax rates on roll-your-own and pipe tobacco and, in consultation with the Department of the Treasury, consider options for reducing tax avoidance due to tax differentials between small and large cigars.

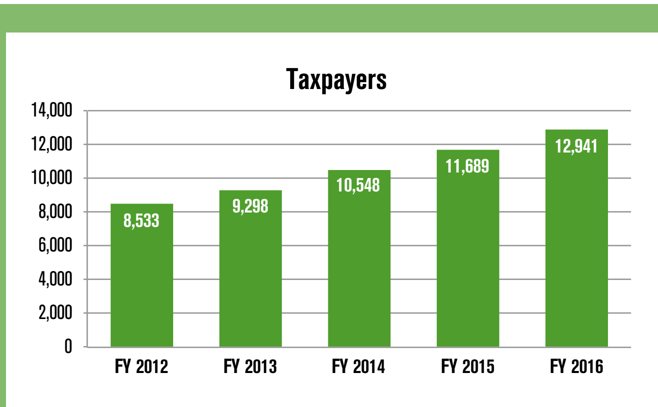
and the Food and Drug Administration, as well as foreign counterpart agencies in Australia, Canada, Germany, and the United Kingdom.

TTB also continued its efforts to advance tobacco science through the development of methods and protocols to identify physical and chemical characteristics of tobacco products for regulatory and tax enforcement purposes. In FY 2016, TTB's Tobacco Laboratory continued its partnership with the FDA's Center for Tobacco Products to develop and validate an analytical method for polyphenols in tobacco leaves and tobacco products to support rulemaking and enforcement efforts by both agencies. TTB chemists presented the research findings at the Cooperation Centre for Scientific Research Relative to Tobacco (CORESTA) Conference in Berlin, Germany, in support of international cooperation in tobacco science. TTB also continued its efforts to validate a method for the analysis of emerging products that claim to be tobacco-free, such as e-cigarettes and e-liquid, which could assist TTB in determining if these products are subject to its jurisdiction.

In FY 2016, TTB also hosted an international wine technical forum, which provided an opportunity for TTB to address emerging technical issues and encourage scientific collaboration between TTB, industry scientists, and other wine regulators. Participants at this year's forum included representatives from TTB and the Wine Institute as well as officials from key wine-producing and importing economies, such as Australia, Canada, China, and Mexico, as well as new attendees from Argentina, Chile, Georgia, Indonesia, Japan, Malaysia, Peru, Thailand, and Vietnam. The technical principles discussed during the international forum support a multi-year project to promote coherence in wine regulation throughout the Asia-Pacific region.

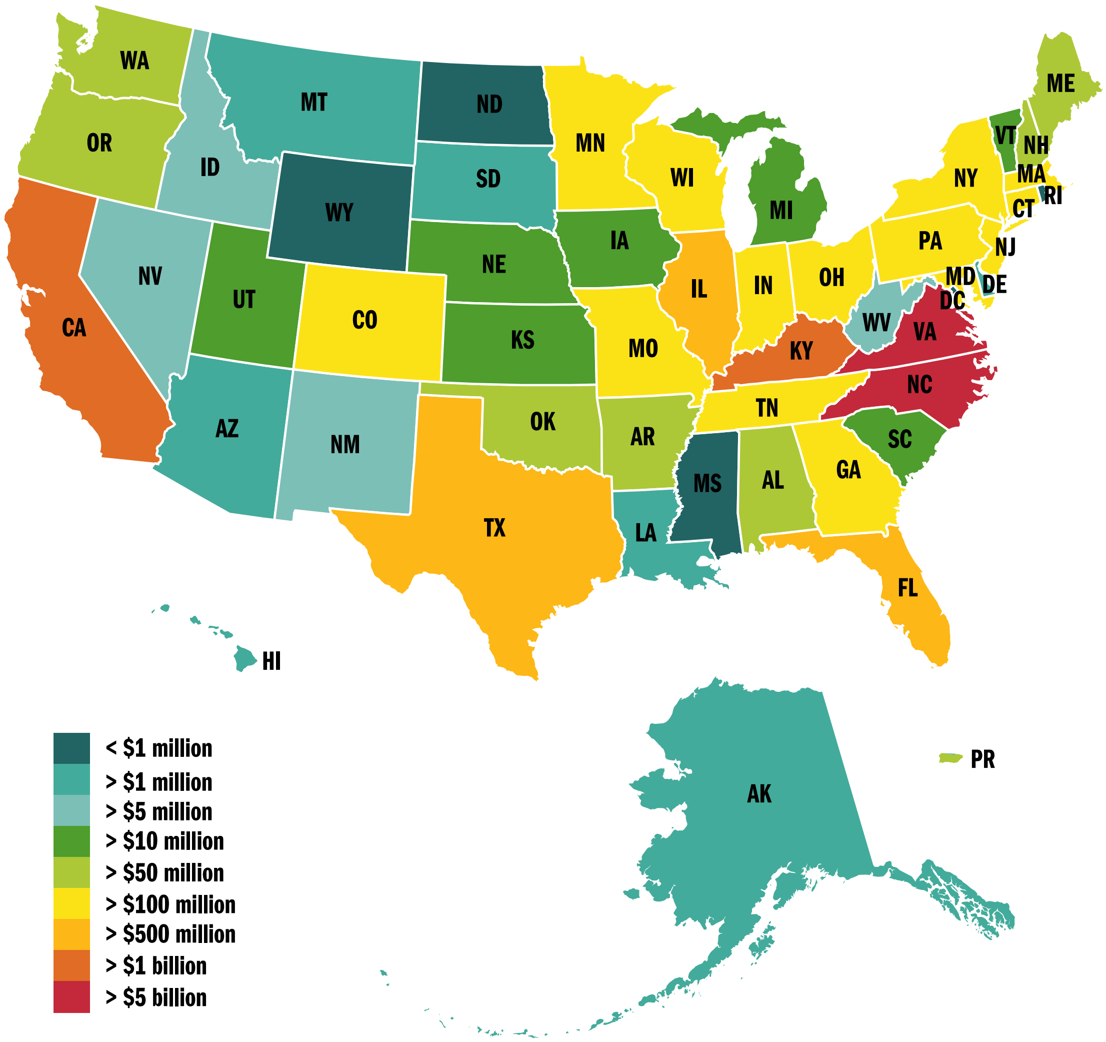
Tax Verification

In effecting its revenue mission, TTB uses a strategic risk-based approach to verify that industry members remit the excise taxes due on the alcohol, tobacco, firearms, and ammunition products sold to U.S. consumers. This strategy enables TTB to cover a wide universe of taxpayers and establish an identifiable enforcement presence to deter industry members and others from engaging in diversion activity. Through a combination of risk modeling and data analytics, TTB continues to focus on identifying the highest risk activity for audits and investigations. Continuous refinements to these models and sound intelligence enable TTB to efficiently deploy its enforcement resources to address the most serious revenue threats.



TTB regulates approximately 82,000 permittees, but only a subset file a return and pay taxes to TTB in a given fiscal year. The largest segment of TTB permit holders–alcohol importers and wholesalers–do not pay taxes to TTB. Explosive growth in alcohol beverage producers, beginning in 2010, has contributed to a significant increase in TTB taxpayers. Since 2012, the number of taxpayers has increased more than 50 percent, with the TTB tax base growing by approximately 10 percent or more in FY 2016 for the fifth consecutive fiscal year.

FY 2016 Tax Collections by State



Addressing Revenue Threat from Cigarette-Making Machines

Any person who makes a cigarette-making machine available to consumers for commercial purposes is considered a tobacco product manufacturer under federal law and is required to obtain a TTB permit and pay the applicable taxes. These machines began to increase in popularity in 2009, as consumers responded to the increased tax rate on cigarettes and roll-your-own tobacco by substituting a lower-taxed alternative, pipe tobacco, in the machines. Further, the 2009 tax rate change coincided with technological advances in cigarette-making machines, some of which could make cigarettes from either pipe tobacco or roll-your-own tobacco at a much quicker rate, taking only eight minutes to produce a carton of 200 cigarettes as compared to the three hours needed to produce a carton using older model machines.

The use of these machines continues to create enforcement challenges and strain TTB enforcement resources given the number of locations and the relative tax exposure involved in each case. TTB partners with states to identify establishments operating cigarette-making machines and take enforcement action. In FY 2016, TTB continued its enforcement efforts at retail establishments, which, to date, have resulted in the identification of $11.6 million in tax liabilities. Going forward, TTB will continue to engage its law enforcement partners and collect additional intelligence on locations with these machines to identify and collect unpaid tax liabilities from unpermitted manufacturers shirking their tax responsibilities.

Enforcing Compliance in the Import and Export Trade

According to TTB data, non-taxpaid removals of alcohol and tobacco products from bonded premises for export present an annual excise tax exposure of about $400 million and $1 billion, respectively.[7] Due to the known revenue risk in the import and export trade in alcohol and tobacco products, in FY 2016, TTB continued to focus its enforcement on this high-risk activity. TTB's efforts, in collaboration with CBP and HSI, have helped to maintain an even playing field in the international trade of alcohol and tobacco.

Exports pose a significant revenue threat because alcohol and tobacco products intended for export may be placed in a customs bonded warehouse, foreign trade zone, or tobacco export warehouse without payment of tax because they are not intended for the U.S. market. Some tax evasion schemes involve diversion of these products into domestic commerce to evade federal excise taxes.

In FY 2016, TTB examined suspected tax fraud and diversion at customs bonded warehouses, foreign trade zones, and tobacco export warehouses, following the transfers of alcohol and tobacco products to verify the exportation of these non-taxpaid products. To date, investigations in these areas have yielded approximately $50 million in identified tax liabilities as well as criminal referrals.

In addition, specifically with regard to diversion risk associated with the importation and exportation of alcohol and tobacco products, TTB has been working with CBP on cooperative enforcement efforts, including the development and implementation of the International Trade Data System (ITDS). As explained in Executive Order (E.O. 13659), the purpose of ITDS is to provide a "single window" through which importers and exporters may submit electronically the data required by federal government agencies for clearing imports or exports. Significant progress was made in FY 2016, with the completion of a successful system pilot for importers and the publication of a final rule to fully implement ITDS for all TTB-permitted importers on track for publication in December 2016. TTB intends to make similar

7 Represents the estimated tax liability for all exported bottled distilled spirits and cigarettes in calendar year 2015.

progress in the export area in FY 2107. This cooperative system and the transactional trade data that it will provide are expected to factor prominently in TTB's tax enforcement strategy going forward. In addition to more timely information on imports and exports for enforcement purposes, TTB expects that this effort will improve communication and coordination between CBP, TTB, and other participating agencies on tax and trade issues.

Addressing the Revenue Risk from Processed Tobacco

Manufacturers and importers of processed tobacco distribute millions of pounds of processed tobacco annually to a myriad of brokers, manufacturers, and other tobacco processors for use in cigarettes and other taxable tobacco products. These entities must obtain a TTB permit and report to TTB on the first removal, transfer, or sale of processed tobacco. As processed tobacco is not subject to tax, the transfer or sale of this product for use in the illegal manufacture of cigarettes or other tobacco products poses a significant revenue risk, and TTB continues to face enforcement challenges due to the unrestricted sale of processed tobacco.[8]

In FY 2015, the last complete year of data examined, nearly 17 percent of the roughly one billion pounds of processed tobacco removals reported to TTB were shipped to entities that do not hold a federal permit with TTB.[9] Although some of these removals represent sales to brokers, who may resell processed tobacco to a TTB-permitted manufacturer of tobacco products, other removals may be ultimately destined for illicit production. Given the revenue risk, TTB continues to review its reporting requirements to improve TTB's ability to monitor transfers and sales of processed tobacco in order to improve its tax enforcement capabilities.

Criminal Enforcement

TTB is the federal agency responsible for detecting and addressing federal excise tax evasion in relation to alcohol, tobacco, firearms, and ammunition products. Under its criminal enforcement authority, TTB is charged with identifying any gaps in tax payment from entities and individuals manufacturing or selling these products illegally. The diversion of products into domestic commerce without the payment of taxes threatens federal revenues, undermines fair competition, and provides a well-established source of funding for criminal enterprises.

Increases in federal and state tobacco tax rates have further increased the profit incentive to engage in cigarette trafficking, which has resulted in a proliferation of tobacco diversion schemes. A Government Accountability Office report found that there is a wide range of schemes used to evade tobacco excise taxes and fees and described the scope of diversion activity.[10] However, the diversion of products to evade federal excise tax is not limited to tobacco. Enforcement experience also indicates that there is criminal activity in the alcohol trade, with non-taxpaid product removals, illegal imports, and fraudulent labeling just a few of the schemes used to evade taxes, defraud American consumers, and undermine the legitimate alcohol trade. TTB has also initiated criminal investigations related to firearms and ammunition excise tax evasion.

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8 The Administration proposed legislative amendments in the FY 2014, FY 2015, and FY 2016 President's Budgets that would tax processed tobacco when it is removed by the manufacturer or importer for delivery to any non-permitted domestic entity.

9 Reported volume excludes exports.

10 "Illicit Tobacco: Various Schemes are Used to Evade Taxes and Fees," U.S. Government Accountability Office, GAO-11-313, March 2011.

Achieving Criminal Enforcement Results

TTB's criminal enforcement program is critical to the Bureau's ability to effectively curtail current illicit operations and deter others from engaging in diversion activity. With a small cadre of special agents, obtained through an interagency agreement with the Internal Revenue Service Criminal Investigation Division, TTB's criminal enforcement program has exhibited notable results. Since 2011, TTB has opened a total of 105 cases, with identified liabilities of over $591 million in estimated alcohol, tobacco, firearms, and ammunition excise taxes and approximately $124 million in criminal seizures. To date, approximately 97 percent of the cases presented to the U.S. Attorney's Office have been accepted for further investigation, demonstrating both the merit and magnitude of these cases. Further, TTB has maintained a 100 percent conviction rate on cases fully resolved through the legal system. TTB's criminal enforcement program is also building key relationships with other federal and state law enforcement agencies, generating referrals for additional cases and opportunities for partnering in future cases and investigations.

Protect the Public

TTB's public protection mission includes a wide range of activities that directly impact American consumers and the U.S. economy. TTB's role in regulating the trade of alcohol and tobacco products ensures not only consumer confidence in the integrity of the products manufactured in the U.S., but also that businesses are operating on a level playing field—key outcomes that promote job growth and a strong economy. TTB's work in this mission area aligns under three main programs: 1) Permits and Business Assurance; 2) Trade Facilitation; and 3) Advertising, Labeling, and Product Safety.

Business Integrity

TTB facilitates growth in the U.S. economy by ensuring that only qualified applicants enter business as an alcohol producer, wholesaler, or importer, or as a tobacco products manufacturer, importer, or exporter. The FAA Act includes provisions that require a permit for alcohol beverage producers, importers, or wholesalers; the IRC includes similar permitting requirements for tobacco manufacturers, importers, and export warehouses, as well as some alcohol industry members. Each year, TTB receives more than 8,000 applications for an original permit or registration. Today, the Bureau regulates more than 82,000 industry members.

Under its statutory authority, TTB evaluates applications prior to issuing a permit to ensure that only qualified persons operate within the TTB-regulated industries. Through this process and other activities under its Permits and Business Assurance Program, TTB protects federal revenues by preventing prohibited persons from commencing operations and potentially diverting products from legitimate commercial channels to fund illicit activity.

Efficiency in permit processing is equally critical to support economic opportunities for U.S. businesses. Prompt turnaround times for permit application processing enables those who are qualified to hold a federal permit to begin their operations sooner, facilitating U.S. economic growth in a fair marketplace.

Improving Service in Permit Processing

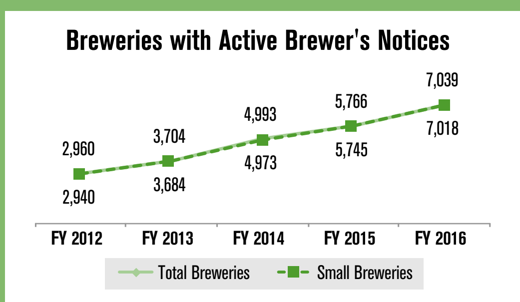
TTB processes applications for 23 types of permits or registrations for the alcohol, tobacco, firearms, and ammunition industries. In FY 2016, TTB processed approximately 8,000 applications for a federal permit

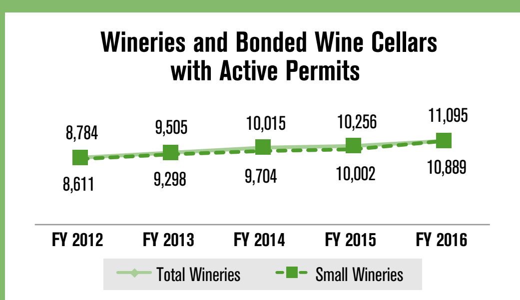
Growth in Alcohol Producers

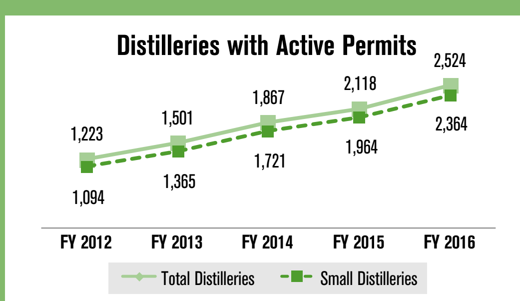
The number of U.S. wineries, breweries, and distilleries continues to increase. Since 2012, the number of wineries has grown nearly 30 percent, with small wineries producing less than 250,000 wine gallons annually driving the increase.

U.S. breweries increased dramatically in the same time period, increasing nearly 140 percent overall. TTB data indicates that this growth is attributed to the small brewer segment, defined as those who produce less than 2 million barrels annually.

There has also been significant growth in the number of distillers, which increased over 100 percent since 2012. This growth is driven by a boom in small distillers, defined as distilled spirits producers that taxpaid less than 100,000 proof gallons annually. This segment has increased by 116 percent in 5 years. This data reflects all permits with potential activity.







or registration, and qualified approximately 6,250 new business operations. These are predominantly small businesses, which contribute to local job opportunities and often lead the industry in product innovation.

The Permits Online electronic filing system has helped TTB manage the influx of applications resulting from sustained industry growth. However, even as electronic filing rates reached 84 percent, the average processing time for a new permit application increased from 94 days in FY 2015 to 122 days in FY 2016. Although the electronic filing system provides certain efficiencies, including more timely and effective industry correspondence, it does not diminish the time needed by TTB to review each application. Since TTB launched Permits Online in FY 2011, applications have increased more than 50 percent, and TTB resources have not kept up with this level of demand for its services.

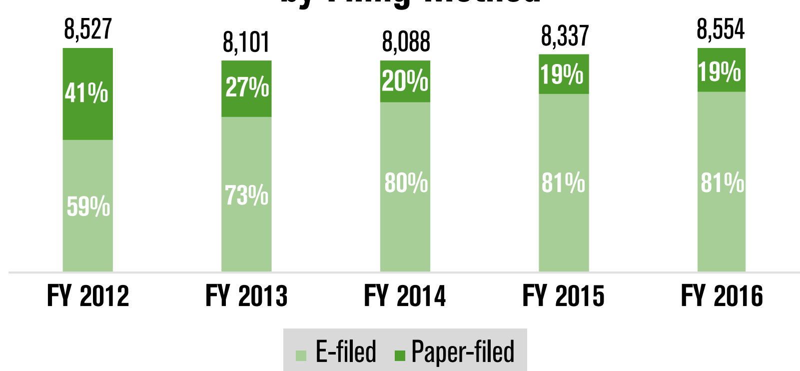
Significantly, industry growth in the number of alcohol beverage producers, driven by a boom in small breweries, distilleries, and wineries, has also contributed to delays in permit processing times. These application types are among the most complex, requiring extensive documentation and review, and are often submitted incomplete or with errors that require follow up and reprocessing, adding further strain to limited staffing resources. In FY 2016, more than 80 percent of new permit applications were returned to applicants for correction or additional information.

TTB is working to meet these challenges through its priority project to improve its business qualification process, including through enhancements to its electronic filing and processing environment. In FY 2016, TTB continued to make steady progress in the development of a redesigned version of Permits Online. The new design will enhance usability for industry members and improve the compliance rate of submissions, reducing resubmitted applications and the overall workload volume that are contributing to delays. The redesigned system will also improve the ease of amendment filing for existing Permits Online users and enable the approximately 60,000 TTB permittees who originally filed a paper permit application to file for amendments to their permit through Permits Online. As TTB receives approximately 20,000 permit amendments annually, this project will result in efficiencies for both TTB and improved processing times for the businesses it serves.

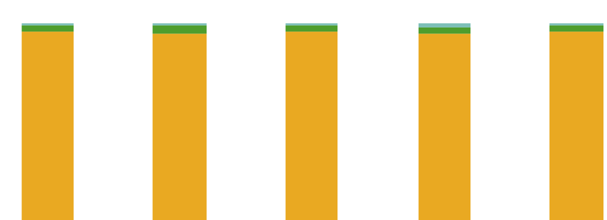
TTB also will continue to update its procedures used to screen permit applicants, adding new data sources to its risk models and improving the risk criteria used to vet applicants for suitability to hold a federal permit in the alcohol and tobacco industries. Increased focus on risk modeling and statistical sampling will help to ensure that TTB is permitting only qualified applicants, while also managing workloads and improving service delivery. With these efforts, TTB will be positioned to achieve performance improvements in FY 2018.

Permitting Stats

Original Permits or Registrations Received by Filing Method



Original Permits Issued by TTB



	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
Firearms	37	24	17	52	48
Tobacco	153	174	140	140	151
Alcohol	6,384	5,660	5,959	5,261	6,050

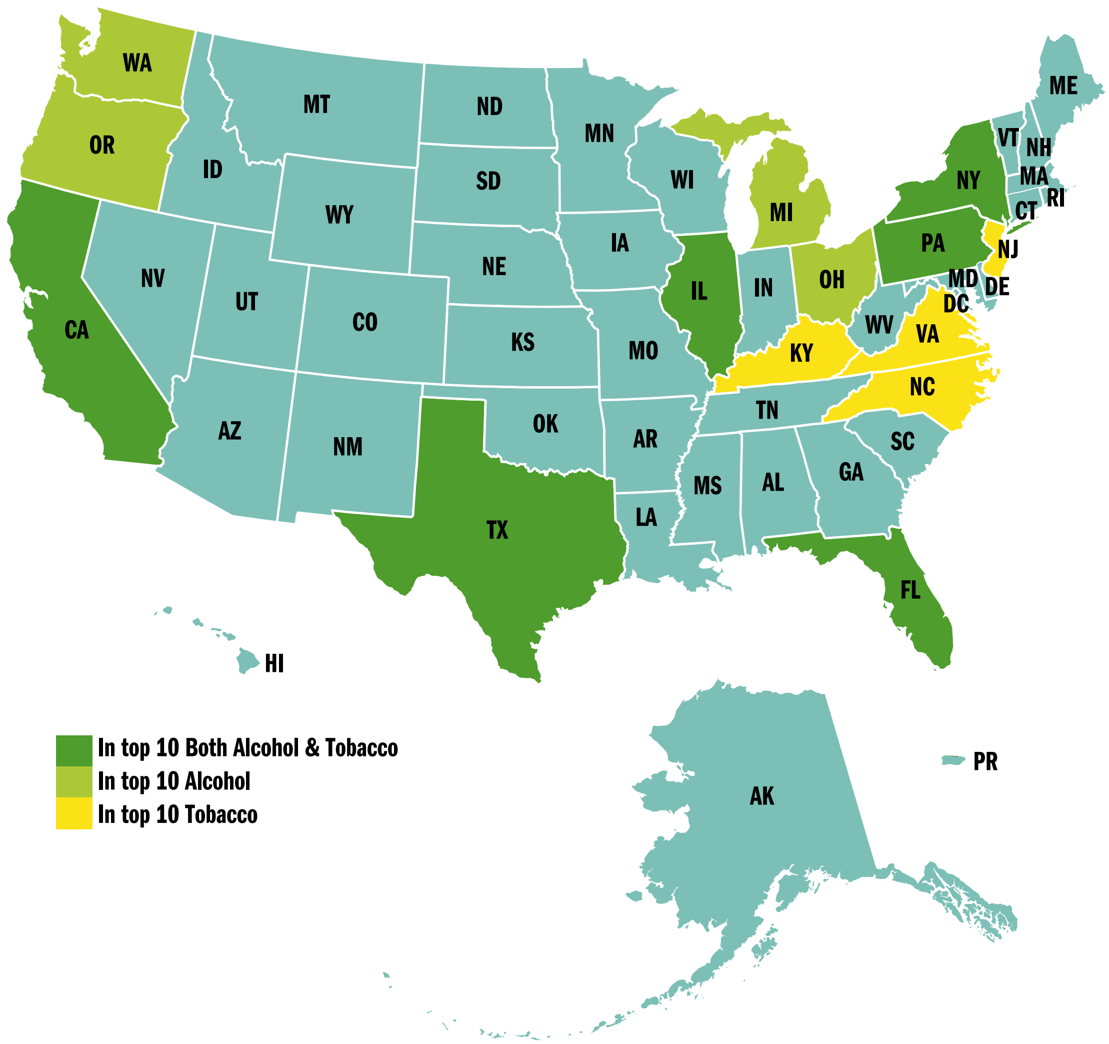
Since FY 2012, TTB has received more than 8,000 permit applications or registrations. Alcohol wholesaler permit applications spiked in FY 2012 due to a change in Washington State law, and have since decreased. Growth continues in the number of small wineries, breweries, and distilleries.

In FY 2016, TTB issued nearly 6,250 permits and registrations, primarily to new alcohol beverage producers, importers, and wholesalers.

Electronic filing rates remain high, holding at over 80 percent for the second consecutive year. TTB expects the electronic filing rate to increase following the next release of the Permits Online in FY 2017.

Note: Data for original permits received revised based on error in source data.

FY 2016 Permittees by State



Top 10 States by Number of Alcohol Permits	
State	**# Permit Holders**
California	7,254
Washington	1,911
New York	1,887
Texas	1,473
Pennsylvania	1,335
Oregon	1,245
Michigan	1,240
Ohio	1,078
Illinois	979
Florida	964

Top 10 States by Number of Tobacco Permits	
State	**# Permit Holders**
Florida	226
California	91
North Carolina	71
New York	69
Virginia	41
Texas	39
New Jersey	33
Pennsylvania	33
Kentucky	24
Illinois	23

Product Integrity

Consumer confidence is essential to ensuring that U.S. and world economies perform at their full economic potential. TTB is the federal agency responsible for carrying out provisions of the FAA Act that ensure that labeling and advertising of alcohol beverages provide adequate information to consumers concerning the identity and quality of products. This authority also calls for TTB to prevent misleading labeling or advertising that may result in consumer deception regarding alcohol beverage products.

This consumer protection function falls under TTB's Advertising, Labeling, and Product Safety Program. Before an alcohol beverage product subject to the FAA Act can be sold in the United States, TTB reviews the product label to ensure that it contains all mandatory information, including the health warning statement, and does not mislead the consumer. The approved label application is called a Certificate of Label Approval (COLA).

Prior to label approval, TTB also evaluates the formulation of certain domestic and imported alcohol beverages to support the accurate labeling and appropriate tax classification of those products. Formulas may require statements of process, laboratory analyses, and pre-import letters, all of which also help to ensure that U.S. consumers have full and accurate information about the products they purchase.

TTB confirms compliance with federal product and labeling regulations by reviewing production records through its product integrity investigations and by conducting marketplace sampling to test products for safety as well as container content and label compliance. TTB also reviews advertisements for alcohol beverage products from television, radio, the Internet, and other sources for compliance with federal regulations.

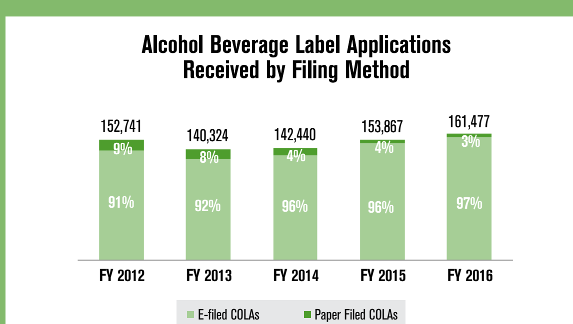
In the event that a food safety or other product integrity issue occurs, TTB responds by working directly with the responsible parties and, as appropriate, shares its findings with other regulatory and enforcement agencies to work in partnership to timely resolve issues.

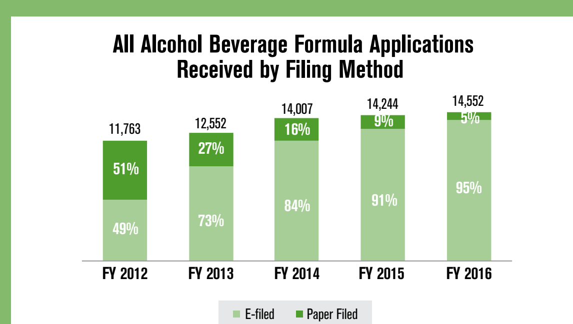
Label and Formula Electronic Filing Rates

Electronic filing rates for label and formula applications continued to increase in FY 2016. Electronic filing has many benefits, particularly to industry members, who generally experience faster response times compared to paper filers.

Electronic filing, however, does not decrease the time required for TTB to review an application, and with the high volume of submissions, TTB has implemented program and system changes to meet the demand for service.

These changes include improved guidance and system validations for common application errors, which will decrease the total processing workload and support improved service. Together with additional staffing resources, TTB expects to reach and maintain new service standards of 10 days for label and formula applications by the end of FY 2017.





Volume of Label and Formula Submissions by Commodity

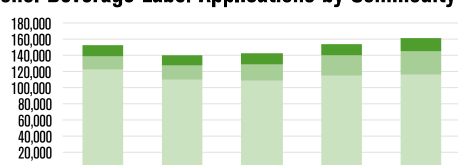
Since 2012, the total number of alcohol beverage label applications has increased approximately 5 percent. This moderate growth in submissions during a period of industry expansion can be attributed in large part to TTB's successful intervention strategies to reduce filing requirements in certain low-risk areas. Without these policy changes, TTB was on track to receive more than 185,000 label applications in FY 2016.

The 5 percent increase in total label applications this year compared to FY 2015 was driven by increases in both malt beverage and spirits label applications of greater than 15 percent.

Over the same period, the total number of alcohol beverage formula applications increased nearly 40 percent. Product innovation and growth in the number of small brewers and distillers, which have historically been the highest volume filers, contributed to the overall increase in formula submissions. The policy changes implemented by TTB in fiscal years 2015 and 2016 successfully curbed the growth in malt beverage formulas, decreasing submissions by 40 percent compared to the high watermark in FY 2014; however, market trends in spirits and wine, including significant growth in flavored wine and hard cider, have offset these reductions.

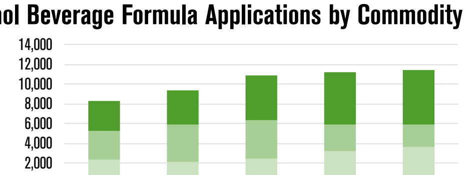
Note: Data does not include pre-import or laboratory and hard cider, have offset these reductions.

Alcohol Beverage Label Applications by Commodity



	2012	2013	2014	2015	2016
Distilled Spirits	13,873	12,389	12,984	12,986	15,107
Malt Beverage	16,425	17,602	20,629	25,398	29,798
Wine	122,443	110,330	108,827	115,483	116,126

Alcohol Beverage Formula Applications by Commodity



	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
Distilled Spirits	3,004	3,459	4,539	5,271	5,521
Malt Beverages	2,919	3,733	3,861	2,759	2,302
Wine	2,347	2,183	2,512	3,203	3,629

Modernizing the Alcohol Beverage Label Program

In FY 2016, TTB received more than 161,000 label applications and more than 14,500 formula applications. The rapid expansion of the alcohol beverage industry, combined with market trends toward formulated products, have contributed to the high volume of applications. TTB has implemented policy changes since FY 2012 to reduce label and formula applications, issuing guidance to exempt certain malt beverage products from the requirement to obtain a formula approval and expanding the number of changes that industry may make to an alcohol beverage label without a new approval.

These policy changes successfully reduced the volume of label and formula submissions in the short-term without compromising TTB's consumer protection role; however, industry trends have resulted in increased submissions that have offset these reductions. Specifically, efforts to remove label approval requirements reduced the volume of submissions in fiscal years 2013 and 2014, but filings began to trend up again in FY 2015. Since last year, label applications increased another 5 percent, reaching a new historic high.

TTB initiated similar efforts in the formula area in FY 2014, and made significant progress this year with the publication of three rulings that eliminate the formula requirement for products that present a low-risk to consumers or the revenue. The malt beverage ruling, published in December 2015, expanded the list of exempted ingredients and processes used in the production of beer, resulting in a nearly 40 percent reduction in malt beverage formula submissions. However, increases in formula submissions from the spirits and wine industries offset these reductions, causing overall submissions to increase in FY 2016. TTB anticipates that two additional rulings, published in September 2016, for spirits and wine products will help to curb the volume of submissions and ensure industry can bring their products to market without undue delays. Additional policy changes may require rulemaking, which TTB plans to evaluate in FY 2017.

Additionally, industry members often require extensive assistance during the label approval process and frequently submit applications that require correction, both of which add to processing times. In FY 2016, approximately 40 percent of label and formula applications were submitted incomplete or with errors. Given these error rates and the resulting reprocessing of submissions, TTB processed more than 250,000 label and more than 25,000 formula applications in FY 2016, compounding processing delays.

Even with these workload challenges, TTB made progress in improving its service to U.S. malt beverage, wine, and spirits producers and importers, effectively using an infusion of resources in its FY 2016 budget to accelerate processing times for labels and formulas. By investing in a combination of staff and system upgrades, TTB ended FY 2016 with 83 percent of label applications meeting its 30-day service standard and 95 percent of formula applications meeting its 45-day standard, essentially at or above the annual target. Throughout FY 2016, TTB deployed system enhancements to COLAs Online and Formulas Online, focusing its efforts on enhancing its compliance validations and guidance to target the most frequent application errors, with the goal of improving initial application compliance by up to 20 percent. The combined impact of the phased releases is anticipated in FY 2017. Further, once new staff is onboard and trained, TTB is targeting substantial service improvements and expects to meet a new 10-day standard for 85 percent of label and formula applications by the end of FY 2017. Achieving these targets will be supported through updates to federal labeling regulations and ongoing improvements to online guidance and filing systems.

Market Review of Label and Product Compliance

After alcohol beverages enter the marketplace, TTB monitors labeling compliance through the Alcohol Beverage Sampling Program (ABSP). The ABSP is a random survey of products in the marketplace to help TTB evaluate marketplace compliance and determine where issues may exist. The Bureau's continued monitoring of product and label compliance through the ABSP assists TTB in evaluating the integrity of U.S. alcohol beverage products, both in the view of U.S. consumers and TTB's international counterparts, which is critical to gaining foreign market access for U.S. exporters.

For each product evaluated under the ABSP, TTB determines if they are fully and accurately labeled (i.e., whether the label accurately reflects the content of the bottle) by reviewing their labels and contents. In reviewing the label, TTB checks for all required information and determines if there is a valid COLA. TTB also sends the products to its laboratories to undergo chemical analyses to evaluate whether the label information accurately reflects the content of the container.

TTB uses the ABSP results to address compliance problems for products that are currently in the marketplace. In most cases, TTB notifies the industry member about a violation and works with them to bring the product into compliance. For more significant violations, however, the Bureau conducts field investigations and ensures that corrective action is taken on the part of industry members. The most frequent violations in FY 2016 related to discrepancies between the actual alcohol content of certain wine, spirits, and malt beverage products and the alcohol content stated on the label of those products. The complete results of the ABSP are available on TTB.gov.

Ensuring Accurate Product Information for Consumers

TTB worked with its domestic and international counterpart regulators in FY 2015 to resolve several incidents related to mislabeled alcohol beverages that had potential health and safety consequences for U.S. consumers.

In FY 2016, TTB also effectively leveraged its global network of regulators in its efforts to protect consumers and promptly address compliance issues in the international trade of alcohol beverages. In FY 2016, TTB was contacted by the Embassy of Italy over the potential misuse of the "Prosecco" designation on certain imported wine and in certain advertisements. Prosecco is an Italian appellation of origin and is recognized in the European Union as a protected designation of origin, which guarantees the origin and the quality of such wine produced in a defined geographical area according to specific viticulture and vinification rules. The Embassy claimed that certain wine being sold in the U.S. was labeled with Prosecco as the appellation of origin and Italy as the country of origin, when in fact the wine was not produced in Italy. TTB initiated an investigation and is taking the appropriate action. TTB also addressed several advertising issues that were raised by the Embassy, ensuring that the advertisements were in compliance with TTB regulations and did not contain misleading information about the origin of the wine.

Further, TTB continued to monitor kombucha products in the marketplace that, in some instances, are not properly labeled as an alcohol beverage. The term "kombucha" generally refers to a fermented beverage produced from a mixture of steeped tea and sugar, combined with a culture of yeast strains and bacteria. TTB's prior market sampling indicated that a number of kombucha products contain 0.5 percent or more alcohol by volume, rendering the product an alcohol beverage under federal law. In FY 2016, TTB addressed these findings by working with each producer to ensure that the kombucha is either manufactured in a way that prevents it from reaching an alcohol content level of 0.5 percent or more, or if it does reach that alcohol level, that the product is labeled appropriately and the company is properly permitted. TTB also continued its outreach and education to kombucha producers, in cooperation with the FDA, to explain statutory requirements and potential tax payment and permitting requirements.

Protecting Consumers from Adulterated and Contaminated Products

In administering the Advertising, Labeling, and Product Safety Program, TTB conducts analyses of alcohol beverage products in the marketplace for ingredients or materials whose presence is prohibited or limited. TTB also works with its counterpart U.S. and international agencies to evaluate and address incidents involving potential health hazards related to alcohol beverage products, including the FDA. TTB considers an alcohol beverage found by FDA to be adulterated under the federal Food, Drug, and Cosmetic Act to be mislabeled under federal alcohol beverage labeling laws.

In FY 2016, TTB responded to 16 incidents of potential contaminated, adulterated, or counterfeit alcohol products to ensure that these products had not been exported to the United States. TTB also worked with industry members on the voluntary recall of several domestic and imported alcohol beverage products, including a malt beverage with glass particles that had fractured from the bottle and a rum that was found to have elevated levels of lead. Through these efforts, TTB was able to protect U.S. consumers from potential health hazards.

Market Integrity

TTB is charged with ensuring that the alcohol marketplace is free from practices that would stifle competition and act as a barrier to trade. TTB meets this mandate through a variety of activities under its Trade Facilitation program, ranging from investigations of industry trade practices to engaging foreign counterparts to keep the channels of commerce open and operating in compliance with U.S. and international laws.

Promoting Fair Competition in the U.S. Marketplace

As part of its Trade Facilitation Program, TTB's FAA Act trade practices program investigates acts that violate federal law relating to alcohol beverage marketing practices. Regulated trade practices include restrictions on exclusive outlets, tied house arrangements, commercial bribery, and consignment sales. Given the many new, often small, businesses entering the market, TTB's enforcement of trade practice laws ensures that industry members can compete in a fair and open marketplace.

In FY 2016, TTB issued general guidance to address the legality of common promotional activities associated with category management programs. TTB found that industry would benefit from specific guidance to clarify whether certain activities are lawful following a nationwide investigation that found that a number of the nation's top alcohol beverage producers are providing shelf space and category management services to the top 50 chain-retail establishments. Services being provided far exceed those contemplated under the shelf plans and schematics exception in the TTB regulations and often include the producers being directly involved in the day-to-day operations of these retailers, including the selection and placement of products in the commodity category. TTB has found that the value of such services can range into the millions of dollars per year, and results in a highly anti-competitive environment for other producers. In response to industry requests for clarification of what is considered an unlawful inducement under the FAA Act,[11] TTB published Ruling 2016-1, The Shelf Plan and Shelf Schematic Exception to the "Tied House" Prohibition, and Activities Outside Such Exception, in February 2016, and a set of FAQs on shelf plans and schematics to accompany the ruling. In FY 2017, TTB will monitor the marketplace to ensure industry compliance with the new guidance.

TTB also reached a $300,000 settlement with Anheuser-Busch, LLC for alleged consignment sales violations under the FAA Act stemming from an end of season buy-back program. Under this program, the Bureau alleges that Anheuser-Busch sold more than 540,000 cases with the agreement to buy back unsold and out-of-date product from participating wholesalers and distributors in violation of federal and state law. Under the consignment sales provisions, the FAA Act prohibits the sale or purchase of alcohol beverage products with the privilege of return. TTB previously issued guidance in 2012 to address this type of program arrangement through TTB Ruling 2012-4, Freshness Dating and Allowable Returns of Malt Beverages under the FAA Act.

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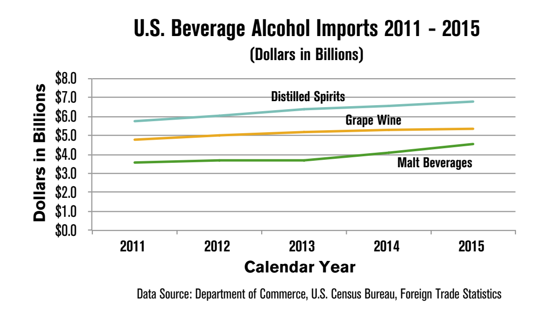
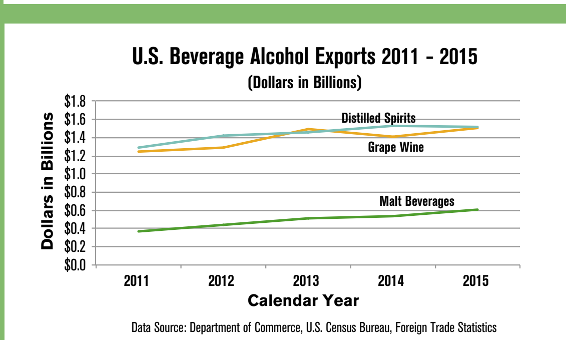
11 Examples of activities that are considered unlawful inducements under the FAA Act include furnishing, giving, renting, lending, or selling to the retailer any equipment, fixtures, signs, supplies, money, services, or other things of value. The regulatory exceptions to this provision are limited to certain promotional support items, such as product displays.

Alcohol Beverage Imports and Exports





The value of U.S. import trade in 2015, the most recent full year of data available, increased 4 percent over 2014 to a total of $16.6 billion. Both wine and distilled spirits experienced moderate increases, while the malt beverage category continued to expand, increasing by 10 percent for the second consecutive year. The five-year trend indicates continued U.S. demand for imported products.

Overseas demand for the products TTB regulates remains high. The value of U.S. exports of all alcohol beverages totaled approximately $3.6 billion in 2015, an increase of 5 percent over the prior year. U.S. exports of distilled spirits totaled more than $1.5 billion, consistent with 2014 totals. Over the same period, U.S. exports of beer also increased by 14 percent, to $613 million. Meanwhile, U.S. exports of wine increased by 7 percent, to $1.5 billion.

TTB has undertaken a variety of efforts to directly influence this trend through its partnership with USTR. These include facilitating the reduction of export certification requirements imposed by foreign countries, providing technical advice for trade agreements that facilitate trade and suspend trade barriers, and educating industry on U.S. import and export-related requirements.

Facilitating U.S. Penetration into Foreign Markets

TTB has been actively engaged with U.S. trade officials in facilitating fair and open trade in alcohol beverages to support new opportunities for U.S. businesses in overseas markets. U.S. exports of alcohol beverages totaled approximately $3.6 billion in 2015, the most recent full year of data available. In line with increases in overall export volume, alcohol beverage exports increased approximately 25 percent since 2011. The majority of these exports are spirits and wine products, although growth has also been notable for malt beverages in recent years.

As the technical expert in these commodities, TTB seeks to promote U.S. exports by facilitating industry compliance with foreign requirements and by working with foreign regulators to address barriers that block market access for U.S. products. For example, many major markets abroad require export certifications to accompany shipments of alcohol beverages before a product may enter foreign commerce.

TTB's workload in processing export certificates increased by 73 percent between fiscal years 2009 and 2013, reflecting increased overseas demand for U.S. spirits and wine, and was on track to double by FY 2014. Continuous efforts by TTB to eliminate and reduce burdensome certification requirements, however, led to an agreement with Chinese authorities that year, in which three required certificates for U.S. wine to China were combined into a single export document. As a result, TTB reduced the number of certifications issued to approximately 12,000 in FY 2015, as compared to more than 15,000 just three years ago. This declining trend has continued, with TTB issuing approximately 11,300 certificates in FY 2016.

Toward this end, TTB also led the development of a model wine export certificate to replace several existing export certificates currently required by Asia-Pacific Economic Cooperation (APEC) economies for imported wine products. Given that 62 percent of the wine export certificates issued by TTB in FY 2016 were for exports intended for APEC economies, this effort will significantly reduce trade barriers and the associated costs of trade, in addition to reducing the workload related to issuing these certificates. TTB is now undertaking active efforts to encourage the voluntary implementation of this certificate among these economies.

Preventing and Addressing Barriers to Trade

The TTB Trade Facilitation Program also includes identifying and addressing barriers to trade in the international marketplace. TTB is the principal technical expert for the Office of the United States Trade Representative (USTR) and other federal agencies in the administration of U.S. alcohol laws, regulations, and policies, and coordinates with these agencies as appropriate in responding to alcohol beverage trade issues. TTB provides expert reviews of foreign regulatory proposals affecting the alcohol trade to identify and assess the impact of potential trade barriers for U.S. alcohol exporters. The USTR estimates that, in any given year, up to 20 percent of new barriers to trade relate to alcohol beverages. TTB plays a crucial role in the early identification and resolution of these issues.

Specifically, in FY 2016, TTB continued its efforts to prevent new non-tariff trade barriers related to alcohol beverages by participating in the World Trade Organization process for reviewing proposed, new, and amended technical regulations. In FY 2016, TTB addressed 26 issues related to alcohol beverage regulations or standards proposed by various governments, including major markets for U.S. products, such as China, Mexico, India, Taiwan, and Brazil. Notably, TTB is leading the U.S. government response to China's new food safety law (Decree 145) with regard to wine, which requires the registration of foreign manufacturers of imported foods. Wine, seafood, and dairy products are among the first commodities that will be required to register in China under the new law.

In addition, TTB continued to participate in the U.S. delegation to the Codex Alimentarius Commission (Codex) committee meetings to protect U.S. interests as other countries and organizations seek to initiate or adopt standards and guidelines that could prove burdensome and unnecessary for U.S. producers of alcohol beverages. Codex is a United Nations organization that develops international food standards and guidelines. TTB continued its engagement on key issues under consideration by Codex committees, including establishing standards for the labeling of alcohol beverages, e.g. regarding date marking.

TTB also continued its efforts through Codex to add common winemaking additives to the General Standards for Food Additives (GSFA). Many developing countries look to the GSFA to set national legislation and do not allow the use of additives that are not listed in the GSFA. This reliance on the GSFA can result in trade barriers for U.S. alcohol beverages entering certain markets, and TTB's work in this area will help to ensure export markets remain open to U.S. businesses.

Supporting International Trade Agreements for Alcohol Beverages

TTB also works to address barriers in the international marketplace by participating with other federal agencies in the negotiation of international trade agreements related to alcohol beverages on behalf of the U.S. government. Highlights in FY 2016 include:

TTB Participates In International Wine Trade Meetings

In November 2015, TTB was part of the U.S. delegation that participated in the World Wine Trade Group (WWTG) and the Asia-Pacific Economic Cooperation Wine Regulatory Forum (APEC-WRF) meetings held in Adelaide, Australia.

Other U.S. government agencies in attendance included Office of the United States Trade Representative, United States Departments of Commerce, Agriculture, and State.

The WWTG (Argentina, Australia, Canada, Chile, Georgia, New Zealand, South Africa, and the United States) meeting covered a number of wine trade issues including a round table discussion on new wine trade developments, observer status at international organizations, a draft potential agreement on counterfeit products, and consideration of "good regulatory principles for wine production" as listed in the "Tbilisi Statement on Analytical Methodology and Regulatory Limits."

The WRF meeting was the largest gathering to date, in which government officials and industry representatives from 17 economies participated; these included Australia, Canada, Chile, China, Hong Kong, Japan, Malaysia, Mexico, New Zealand, Papua New Guinea, Peru, Philippines, Russia, Chinese Taipei, Thailand, United States, and Vietnam; Argentina and South Africa participated as observers.

The WRF seeks to eliminate non-science based testing and certification requirements in an effort to increase wine production, to expand trade, and to create jobs in the APEC region.

- Promoted U.S. export trade in wine through the APEC Wine Regulatory Forum. TTB played a significant role in advancing the goals of five public-private working groups formed to reduce export certificates in the APEC region, increase transparency of regulatory requirements, improve product testing and risk controls, promote good regulatory practices, and establish pesticide maximum residue levels. In addition to working to develop a model wine export certificate, TTB contributed to progress in the working groups' efforts to: 1) establish a searchable, online compendia of wine regulatory requirements for APEC economies, 2) conduct the second iteration of a laboratory ring test to promote consistency and accuracy in analytical testing of key wine characteristics, 3) develop a guideline for the harmonization of pesticide maximum residue levels in imported foods within APEC economies, and 4) develop a guide on the development of wine standards that align with widely accepted international regulatory practices. Next steps in each area will be determined at the March 2017 APEC WRF meeting.

- Provided technical advice on the Wine and Spirits Annex to the chapter of the Trans-Pacific Partnership Agreement (TPP) related to technical barriers to trade. The Annex aims to reduce barriers to trade in the regulation of wine and spirits.

- Contributed to the negotiations of the Transatlantic Trade and Investment Partnership (TTIP), a comprehensive free trade agreement between the U.S. and the EU. The EU is the top export market for U.S. wine, and it is the largest source of imported wine in the United States. As a result, maintaining a free flow of trade between the two economies is vital to U.S. economic growth. USTR sought TTB's technical advice on a variety of alcohol beverage topics in FY 2016, and TTB will continue to assist the USTR on TTIP in FY 2017.

- Participated in the World Wine Trade Group (WWTG) meeting in November 2015, which reviewed topics such as the WWTG's status in international standards organizations and a draft agreement on information exchange and counterfeit products. TTB will continue to work with USTR and its WWTG counterparts in FY 2017 to further the group's key objectives, including outreach to strategic markets and the minimization of technical trade barriers.

Voluntary Compliance

In its Collect the Revenue and Protect the Public programs, TTB promotes voluntary compliance by providing clearer regulatory standards and guidance, encouraging use of its e-Gov filing systems, and supporting industry members through education and outreach efforts. TTB employees also provide industry members and states with direct assistance on specific needs or guidance on broader issues affecting the regulated commodities.

Supporting Compliance through Industry Outreach

The industries regulated by TTB are growing, and obtaining voluntary compliance requires that TTB educate both new and existing industry members on federal requirements. TTB has reshaped its approach to outreach in recent years to operate a voluntary compliance program with limited resources by taking advantage of technological advances. Although TTB continues to attend select industry-sponsored seminars and workshops to provide information and answer questions on federal laws and regulations, TTB increasingly relies on online training to reach industry members.

In FY 2016, TTB improved TTB.gov and Formulas Online to support the new rulings that eliminate the formula requirement for certain malt beverage, wine, and spirits products and further reduce the number of submissions through industry education. The improvements include creating a webpage called "Do I need a formula?" and updates to the formula web-based tool, which industry members may use to determine if their product needs a formula. Formulas Online now provides links to this webpage on key screens within the system, making the web-based tool more accessible. By giving industry members the ability to easily determine whether a formula is required, the volume of applications submitted to TTB that do not actually require a formula approval should decrease. Recent research within Formulas Online indicates that industry members are submitting a large quantity of formulas that do not require TTB approval—up to 50 percent of all formulas for some classes/types of products—therefore, developing tools, such as this, to educate industry members may have the highest impact on reducing the number of formula submissions in the future.

Using Data to Direct Improved Guidance

TTB regularly surveys its TTB.gov users to measure visitor satisfaction and uses this data, as well as other Web analytics, to develop enhancements to help improve industry understanding of TTB's tax and regulatory requirements. In FY 2016, TTB augmented this information with data derived from its help desks to improve the information provided on TTB.gov. This analysis resulted in updates to online content, including updated information regarding funding sources for prospective businesses who must supply this information when applying for a federal permit. TTB plans to improve its call and email management software in FY 2017 to enhance the consistency and quality of customer support. This software will enable TTB to derive additional insights on areas for future guidance.

TTB also issued its third annual Web-based customer survey to garner feedback from industry members on several areas, including the quality and availability of guidance. Approximately 5,000 industry members responded to the survey, with some notable findings relating to the complexity of TTB's regulations and industry dissatisfaction with processing times. In FY 2017, TTB intends to use this data in developing initiatives to improve overall compliance and customer interactions with TTB.

Streamlining Regulations to Reduce the Compliance Burden

TTB also seeks to promote voluntary compliance through clear and unambiguous regulations and guidance. TTB has an ongoing regulations modernization effort underway to ensure that its regulations and enforcement strategies keep up with changes in the industries that it regulates. In FY 2016, TTB made progress in updating its regulations to implement statutory mandates, reflect current industry practices, and achieve efficiencies for the industry and TTB.

On December 18, 2015, the President signed into law the Protecting Americans from Tax Hikes Act of 2015 (the "PATH Act"). The PATH Act benefits small industry members by allowing for quarterly or annual filing, depending on the taxes paid during the prior calendar year (or expected to be paid during the upcoming year), and eliminating the bond requirement for those industry members. These provisions are expected to decrease compliance burdens on both industry as well as TTB. In addition, the PATH Act expanded the universe of cider products eligible for the reduced hard cider tax rate. TTB is currently working on two separate rulemaking projects as well as accompanying system and guidance updates to implement these changes, which take effect in January 2017.

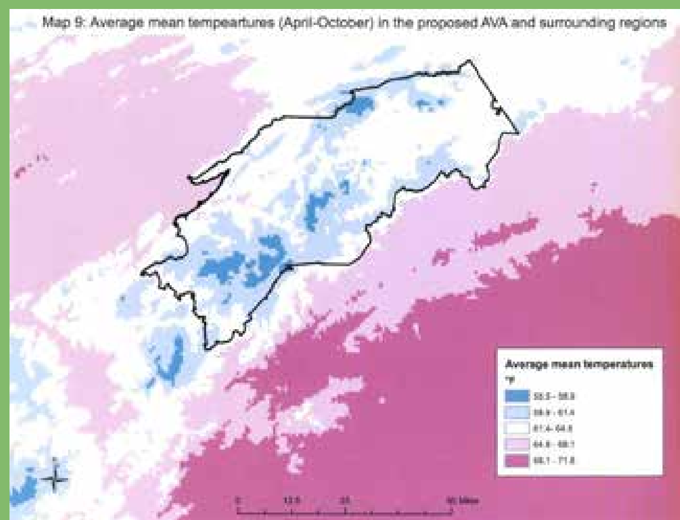
In August 2016, TTB issued a final rule to revise the specially denatured alcohol (SDA) and completely denatured alcohol (CDA) formula regulations to remove unnecessary regulatory burdens and update the regulations to align them with current industry practice. SDA and CDA are widely used in the U.S. fuel, medical, and manufacturing sectors. The industrial alcohol industry is far larger than the beverage alcohol industry in both size and scope, and it continues to grow in the U.S. The final rule eliminates outdated SDA formulas from the regulations, reclassifies some SDA formulas as CDA, and issues new general-use formulas for products made with SDA to reduce the number of products that require pre-approval by TTB. TTB estimates that this effort will decrease the number of formula submissions required from industry by roughly 80 percent.

TTB is also currently engaged in rulemaking to consolidate the required distilled spirits plant (DSP) monthly operations reports. TTB is preparing to issue a supplemental proposed rulemaking that will propose to consolidate the current four operational report forms, which would be filed on a monthly or quarterly basis. TTB undertook this project to address the interest in improved reporting by distilled spirits industry members and to achieve efficiencies by reducing the number of monthly plant operations reports that DSPs must complete and file, and that TTB must process. TTB intends to continue this rulemaking project in FY 2017.

Finally, TTB intends to pursue rulemaking to incorporate formula standards for nonbeverage products into the regulations to decrease burdens for industry and TTB, which should result in improved approval times for industry. The proposed amendments would streamline TTB's process for approving nonbeverage product formulas, which is designed to ensure that approved products are unfit for use as alcohol beverages, by eliminating the requirement for certain nonbeverage formula submissions and approvals.

American Viticultural Areas

During FY 2016, TTB published 14 AVA-related rulemaking documents. Of these 14 documents, 10 were final rules: one final rule established a new AVA in Idaho (Eagle Foothills); two final rules established individual AVAs in California (Los Olivos District and Lamorinda); one final rule established a new multi-State AVA that covers portions of western Iowa and northwestern Missouri (Loess Hills District); one final rule expanded an existing AVA in Oregon (Willamette Valley); one final rule established a new multi-State AVA that covers portions of southeastern Washington and northwestern Idaho and realigned an existing AVA in Washington (Lewis-Clark Valley and realignment of Columbia Valley); one final rule established a new AVA in Michigan (Tip of the Mitt); one final rule expanded an existing AVA in California (Sta. Rita Hills expansion); one final rule established a new AVA in New York (Champlain Valley of New York); and one final rule established a new AVA in Arizona (Willcox).



Map of the average mean temperature in the proposed Appalachian High Country AVA in North Carolina proposed in FY 2016.

As a result of these final rules, at the end of FY 2016, TTB and its predecessor agency, the Bureau of Alcohol, Tobacco and Firearms, have established a total of 238 AVAs.

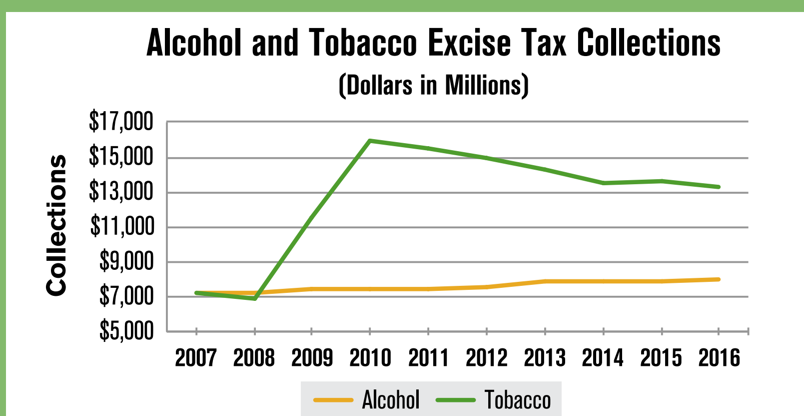
Financial Highlights

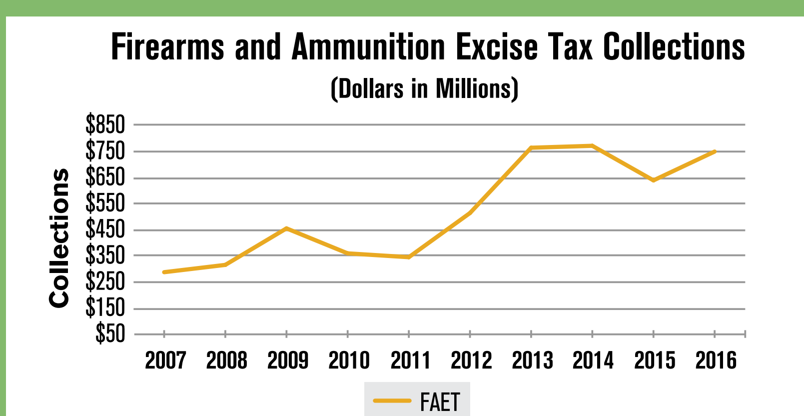
Federal Excise Tax Collections

TTB collects excise taxes from the alcohol, tobacco, firearms, and ammunition industries. In addition, the Bureau collects Special Occupational Tax (SOT) from certain tobacco businesses. During FY 2016, TTB collected $22.1 billion in taxes, interest, and other revenues.

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

FY 2016 Excise Tax Collections	
Alcohol	$8,075,476,000
Tobacco	$13,274,371,000
FAET	$749,789,000
SOT	$258,000
FST	$245,000
Other	$505,000
Total	**$22,100,644,000**





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

Tobacco tax revenues in FY 2016 decreased in line with consumption patterns and consumer trends toward lower taxed alternative products.

Revenue for firearms and ammunition excise taxes increased by 17 percent from the prior year. Since TTB assumed the responsibility for administering FAET in 2003, collections have increased from $193,414,000 to $749,789,000, a 288 percent increase.

Refunds and Other Payments

During FY 2016, TTB issued $815 million in tax refunds, cover-over payments, and drawback payments on taxes paid by manufacturers of nonbeverage products (MNBPs).

Cover-over Payments

Federal excise taxes are collected under the Internal Revenue Code of 1986 on certain articles produced in Puerto Rico and the U.S. Virgin Islands (USVI) that are brought or imported into the United States. In accordance with 26 U.S.C. 7652, taxes collected on rum imported into the U.S. are "covered over," or paid into, the treasuries of Puerto Rico and USVI, less the collection expenses incurred by TTB. TTB also issues cover-over payments to Puerto Rico and USVI for "other rum," which is rum imported into the United States from other than Puerto Rico or the USVI.[12]

During FY 2016, cover-over payments totaled $425 million, with $417 million paid to Puerto Rico and $8 million paid to USVI. Year-to-year, cover-over payments can vary depending on the rate of payments, which is established by statute. The Department of the Interior also issues cover-over payments for imported USVI rum to the USVI.

Drawback Payments

Under current law (26 U.S.C. 5114), MNBPs may be eligible to claim a refund of taxes paid on distilled spirits used in their products. During FY 2016, drawback payments totaled $356 million.

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

FY 2016 Excise Tax Refunds	
Alcohol and Tobacco Excise Tax Refunds	$34,799,000
Cover-over Payments , Puerto Rico	$416,815,000
Cover-over Payments , Virgin Islands	$7,975,000
Drawbacks on MNBP Claims	$355,668,000
Interest and Other Payments	$162,000
Total	**$815,419,000**

12 The cover-over payments made to Puerto Rico and the Virgin Islands based on taxes collected on "other rum" is distributed between the territories based on a formula set forth in 27 CFR 26.31.

FY 2016 Bureau Budget

Direct Appropriations (Salaries & Expense Account)

The 2016 Consolidated Appropriations Act (Public Law 114-113) authorized $106.4 million and 494 full-time equivalent (FTE) positions for TTB's programs. This amount included $5 million in directed funding to accelerate the processing of formula and label applications. In general, the additional $5 million allowed TTB to recruit, hire, and train additional staff; invest in enhancements to the online filing systems for label and formula applications; and proceed with initiatives to update industry guidance, rulemaking, and policies to improve program performance.

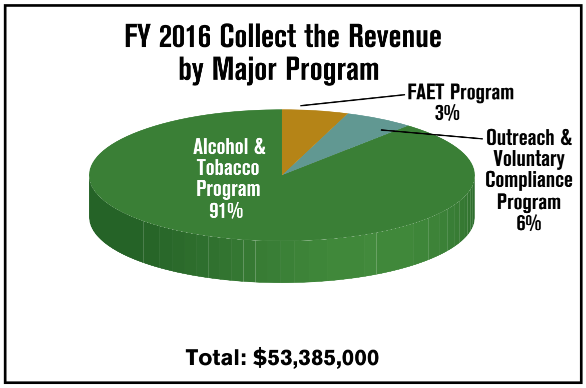
Offsetting Collections and Reimbursables

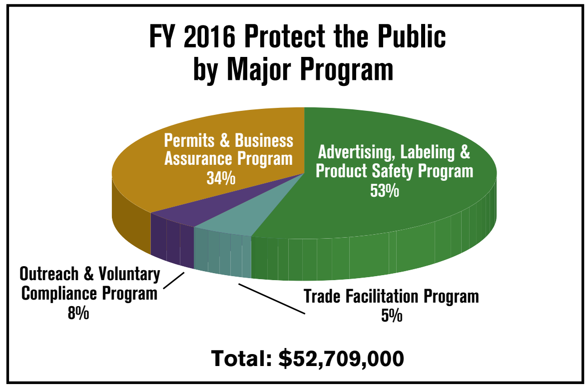
During FY 2016, TTB had $7.1 million in current year spending authority from offsetting collections and reimbursable activity. Of that amount, TTB incurred obligations and expenditures of $5.7 million. The funds originated from multiple sources, including:

- Recoveries from the operation of the cover-over program and other enforcement activities in Puerto Rico;
- Reimbursement from the Community Development Financial Institutions Fund (CDFI) for information technology support services;
- Funding from the Department of the Treasury's Executive Office for Asset Forfeiture (TEOAF) mandatory account to cover investigative expenses;
- Reimbursement from the FDA for laboratory services;
- Reimbursement from Treasury Departmental Offices (DO) for a TTB detailee to the Office of Intelligence and Analysis; and
- Reimbursement from the U.S. Department of Agriculture (USDA) for technical assistance.

FY 2016 Offsetting Collections and Reimbursables		
	Authority	**Actuals**
Offsetting Collections		
Puerto Rico Cover Over	$3,242,000	$3,007,817
Reimbursables		
Community Development Financial Institutions Fund (CDFI)	$3,000,000	$2,193,931
Treasury Executive Office for Asset Forfeiture - Mandatory Account	$600,000	$383,362
U.S. Food and Drug Administration (FDA)	$105,000	$46,686
Treasury Departmental Offices (DO)	$58,000	$38,239
U.S. Department of Agriculture (USDA)	$50,000	$49,491
Department of Justice, Bureau of Alcohol,Tobacco, Firearms and Explosives (ATFE)	$12,000	$-
FY 2016 Offsetting Collections and Reimbursables	**$7,067,000**	**$5,719,526**

Obligations and Expenditures by TTB Program





Audit of TTB's FY 2016 Financial Statements

The Department of the Treasury is one of 24 federal agencies that are required by law to produce annual audited financial statements. TTB's financial activities are an integral part of the information reported on by the Treasury Department.

TTB's Annual Report includes audited FY 2015 and FY 2016 financial statements; the Independent Auditors' Report addresses these financial statements and reports on the Bureau's internal controls over financial reporting and compliance with laws and regulations.

Management Assurances

TTB received an unmodified audit opinion following the independent, full-scope financial statement audit that was conducted for FY 2016. TTB provides reasonable assurance that the objectives of the Federal Managers' Financial Integrity Act were achieved in FY 2016, and that the Bureau's financial management systems are in substantial compliance with the Federal Financial Management Improvement Act. This overall determination is based on past and current practices, an improved internal controls environment, scrutiny by external audit sources, internal evaluations, and administrative and fiscal accounting system enhancements.

During FY 2016, TTB also applied its custom risk management tools to its Revenue Accounting Section to identify risks in the accounting and tracking of TTB's annual federal excise tax collections and to the National Revenue Center, with a focus on its key business processes. Based on these tools, TTB has determined that adequate internal controls are in place to mitigate risk to those operations, and the overall risk of fraud, waste, and abuse is "low."

Bureau Challenges

TTB plans to revisit the vulnerability and risk management tools that are used each year to monitor the internal controls over tax collections to ensure these documents reflect the key business processes in operation at the National Revenue Center and fully support our internal controls program at the Bureau. As systems and businesses processes change, it is important that TTB update the tools used to monitor its tax processing activities.

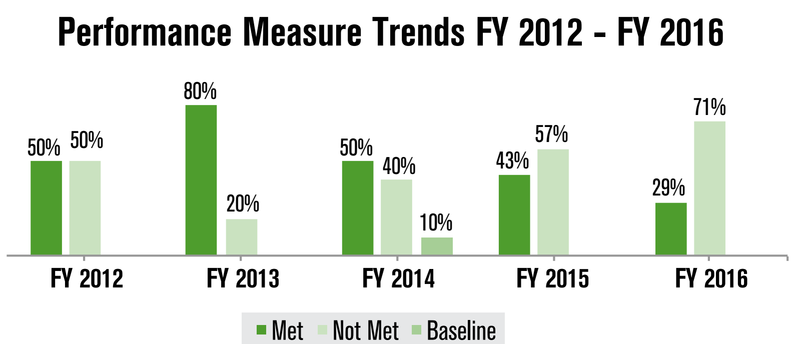
Part II:
Program Performance Results

Performance Overview

TTB reports its performance through a suite of key performance measures that represent its ability to effectively administer the tax code and facilitate commerce through prompt, reliable service delivery. In FY 2016, TTB met or exceeded the performance targets for two of its seven measures. In two of the five measures where TTB's results fell short, performance neared the annual target, with TTB achieving more than 90 percent of its targeted performance level.

Based on external factors and the results achieved this fiscal year, TTB reviewed its performance goals and set FY 2017 targets that reflect workload projections, resource constraints, planned business process improvements, and anticipated impacts from technology enhancements. To meet its performance goals in FY 2017, TTB will implement an aggressive strategic agenda that integrates new technology, streamlining initiatives, and targeted efforts in both outreach and enforcement. All performance results are subject to management review and periodic audit by the Department of the Treasury.

FY 2016 Performance Measure Status	
Performance Targets Met	2
Performance Targets Not Met	5
Total Performance Measures	**7**



Summary of Collect the Revenue Performance

Measure	FY 2012 Actual	FY 2013 Actual	FY 2014 Actual	FY 2015 Actual	FY 2016 Actual	FY 2016 Target	FY 2017 Target	FY 2016 Target Met?	% of Target Reached
Amount of Revenue Collected Per Program Dollar	449	457	457	437	414	400	400	Y	104%
Percent of Voluntary Compliance from Large Taxpayers in Filing Tax Payments Timely (In Terms of Revenue)	92	92	90	88	87	92	90	N	95%

Performance Discussion

In FY 2016, TTB met one of its two annual targets for the performance measures under the Collect the Revenue mission. Taken together, TTB's measures of the Amount of Revenue Collected per Program Dollar and the Percent of Voluntary Compliance from Large Taxpayers in Filing Payments Timely demonstrate the effectiveness and efficiency with which TTB operates its revenue collection function. TTB's strategies for achieving results for both measures include applying technology to streamline internal and external processes and leveraging data sources to direct our outreach and enforcement efforts.

Improve Efficiency of Tax Collection

The Amount of Revenue Collected per Program Dollar measure uses annual collections figures and the actual expenditures and obligations for collection activities to quantify the efficiency of the TTB tax collection program. In FY 2016, TTB achieved a return on investment of $414 for every program dollar spent on collection activities, which exceeded its annual performance target of $400. TTB sets its performance target based on historical trends and other predictors that influence consumer behaviors. The year-to-year decline in performance represents continued declines in tobacco revenue that, after peaking in FY 2010 following the significant tax rate increases enacted in 2009, have steadily declined in line with shifts in consumption patterns, product manufacturing, and trade.

Effective enforcement combined with process improvements and streamlining efforts should result in ongoing positive returns on the investment in TTB, contributing to Treasury's goal of a modern and effective tax system. In FY 2017, to meet its performance target of $400, TTB will continue to improve efficiencies and results in its tax enforcement program by improving its systems and processes related to tax verification. On the front end, TTB will continue to evaluate and develop options to increase automation in the detection, notification, assessment, and collection of excise taxes due to preserve staff time for substantive tax analysis. On the back end, TTB will continue to use data analytics and other intelligence to efficiently deploy its limited enforcement resources. A primary focus for TTB tax enforcement continues to be exported alcohol and tobacco products. In FY 2016, TTB made significant inroads into identifying tax evasion schemes that involve the diversion of non-taxpaid products intended for export. TTB's enforcement efforts into the export trade, including tobacco export warehouses that are permitted by TTB, have identified over $50 million in additional liabilities to date as well as numerous criminal cases. Going forward, TTB will continue to develop and build risk models based on multiple data sources to identify high-risk activity or taxpayers for audit and investigation.

Increase Voluntary Compliance from Taxpayers

Fostering voluntary compliance among taxpayers is a primary tax administration strategy for TTB. The Percent of Voluntary Compliance from Large Taxpayers in Filing Tax Payments Timely is a key performance metric that shows the rate of compliance by large taxpayers (i.e., those that pay more than $50,000 in annual taxes) in voluntarily filing their tax payments on or before the scheduled due date. In FY 2016, TTB achieved a compliance rate of 87 percent from its large taxpayers, which fell below the performance target of 92 percent. The declining compliance rate in recent years is due to improvements in TTB's tax reconciliation and enforcement functions related to identifying late, missing, and erroneous tax returns and payments. These efforts often result in the late filing of tax returns that otherwise would have remained unfiled. The additional late-filed returns have the effect of reducing the reported voluntary compliance rate. TTB anticipates that taxpayers targeted by enforcement efforts, in addition to planned enhancements to online guidance, will begin filing timely returns in future years, and that, over time, reported voluntary compliance rates will increase.

Summary of Protect the Public Performance

Measure	FY 2012 Actual	FY 2013 Actual	FY 2014 Actual	FY 2015 Actual	FY 2016		FY 2017 Target	FY 2016 Target Met?	% of Target Reached
					Target	Actual			
Percent of Electronically Filed Permit Applications 1/	59	73	80	81	81	87	82	N	93%
Percentage of Permit Applications Processed within Service Standards	61	50	58	47	32	85	85	N	38%
Average Number of Days to Process an Original Permit Application for a New Alcohol or Tobacco Business	69	81	84	DISC	DISC	n/a	n/a	n/a	n/a
Customer Satisfaction Rate with TTB Permitting Process	n/a	n/a	BASE	76	71	80	80	N	89%
Percent of Electronically Filed Label and Formula Applications	88	90	93	94	97	95	95	Y	102%
Percentage of Alcohol Beverage Label and Formula Applications Processed within Service Standards	83	49	67	75	75	85	85	N	88%
Percent of Electronically Filed Certificate of Label Approval Applications	91	92	94	DISC	DISC	n/a	n/a	n/a	n/a
Percentage of Importers Identified by TTB as Operating without a Federal Permit	13	11	15	DISC	DISC	n/a	n/a	n/a	n/a

Key: DISC - Discontinued and BASE - Baseline

1/ Reported results revised for FY12 - FY15 due to an error identified in the source data for paper-filed original permit applications.

Performance Discussion

In FY 2016, TTB met one of its five annual targets for the performance measures under its Protect the Public mission. TTB reports on its success in meeting the Department's objective to facilitate lawful commerce and TTB's goal to ensure consumer protection through five principal performance measures. These measures help TTB monitor the degree to which it is meeting the service standards it establishes for permit, label, and formula applications; the impact that electronic filing initiatives are having on improved service delivery; and the level of satisfaction that prospective industry members have with TTB's permitting process. TTB's strategies to achieve its performance targets for these measures include a combination of streamlining internal processes, implementing enhancements to online filing systems, modernizing filing requirements, and providing clearer guidance to industry members.

Improve Efficiency and Effectiveness of Permitting Process

TTB protects consumers by screening permit applicants to ensure only qualified persons engage in the alcohol, tobacco, firearms, and ammunition industries. For this purpose, in FY 2016, TTB processed more than 8,500 original permit applications, performing investigations into high-risk applicants to meet TTB's business integrity objective. TTB monitors its timeliness in processing permit applications through its measure of the Percentage of Permit Applications Processed within Service Standards. As businesses rely on accurate information related to TTB service delivery in their operational planning, this measure provides important data related to a key outcome for TTB and its stakeholders. In FY 2016, TTB met its 75-day service standard for 32 percent of original permit applications, a significant year-to-year decline and well below the 85 percent performance target. The increased volume of submissions, particularly in the more complex alcohol manufacturing application types, has caused processing times to increase. Processing times are expected to worsen as the backlog of applications continues to grow, with particular challenges resulting from stagnant resource levels that have not kept up with industry expansion. Going forward, TTB intends to review its service standards to more accurately represent its current processing times, and will strive to meet this new standard for 85 percent of permit applications through a combination of internal workflow changes, industry education efforts, and ongoing enhancements to Permits Online.

According to its measure of the Percent of Electronically Filed Permit Applications, which tracks the e-filing rate for new business applications, TTB has generally reached a plateau in performance, with approximately 81 percent of permit applications received via Permits Online. Although trending up slightly, this rate reflects marginal gains achieved over the past three years. TTB is reviewing its strategies to increase the benefits associated with electronic filing, including faster processing times and improved application compliance, and expects improvement on both fronts as part of a major system release planned for the latter half of FY 2017. These system changes, combined with effective outreach and training, will support TTB in achieving its targeted electronic filing rate of 82 percent in FY 2017, with more significant gains anticipated in FY 2018.

Increase Customer Satisfaction with TTB Service Delivery

TTB also measures its performance in its permitting function by surveying the businesses that apply for a TTB permit. TTB monitors the Customer Satisfaction Rate with TTB's Permitting Process by using an e-mail survey to assess how satisfied businesses are when applying for a permit through Permits Online.

Satisfaction rates in FY 2016 were below the annual target of 80 percent, with 71 percent of applicants filing for an original permit satisfied with the application process, including the level of service received and timeliness of TTB's response. Satisfaction rates have declined year-to-year as processing times have lengthened, and they are expected to remain below target until service improves. In FY 2017, to achieve its performance target of 80 percent, TTB will continue to implement internal workflow improvements to reduce processing times and, by year-end, will release a new version of Permits Online that is intended to improve online guidance as well as overall customer experience with the system. TTB will also seek to improve the level of service provided to customers seeking live assistance with the permit application process via TTB's call center.

Improve Efficiency and Effectiveness of Alcohol Beverage Label Processing

TTB protects U.S. consumers by ensuring that the alcohol beverage products sold at retail outlets are properly labeled and comply with federal production standards. In FY 2016, TTB received more than 161,000 label applications and more than 14,500 formula applications, an increase in submissions that reflects the ongoing expansion of the alcohol beverage industry. Given the importance of timely TTB approvals and the negative impact that delays have on U.S. businesses, TTB monitors its ability to provide timely and consistent service through its measure of the Percentage of Alcohol Beverage Label and Formula Applications Processed within Service Standards. TTB combines label and formula applications in this measure given the interdependent nature of these approvals. In FY 2016, TTB met its service standards of 30 days for a label approval and 45 days for a formula approval approximately 75 percent of the time, with new businesses waiting three months on average from the time they filed for a formula approval to being able to bottle and distribute a new product. While overall performance remained flat, TTB made significant progress in meeting its service standard for formula approvals, with TTB meeting its 45-day service standard 63 percent of the time, compared to just 15 percent last fiscal year. Performance in labeling declined slightly to 76 percent of label approvals meeting the 30-day service standard compared to 80 percent achieved last year.

Recent policy changes intended to reduce label and formula applications without compromising TTB's consumer protection role successfully reduced the volume of label and formula submissions in the short-term; however, industry growth combined with market trends toward formulated products have resulted in increased submissions that have offset these reductions. These workload challenges have prevented TTB from making sustained service delivery improvements in this area to date.

In the year ahead, TTB expects to make significant progress to accelerate label and formula processing, through a combination of guidance and system enhancements, as well as additional staff hired in FY 2016 with directed funding to support performance improvements in the labeling program. For FY 2017, TTB will maintain its established target of 85 percent for the percentage of label and formula applications that meet the established service standards; however, TTB expects to adjust its service standards to reflect its goal of achieving a 10-day turnaround for label and formula applications by FY 2018. To meet the performance target for this new service standard, TTB will continue to focus on improving its system-based checks and online guidance to facilitate the compliance of initial applications, thus reducing the overall submission volume. This strategy is critical to managing the total workload associated with label and formula applications, which will be necessary to achieve and sustain reduced processing times. TTB also intends to proceed with its labeling modernization project, which will update and streamline the labeling regulations to reflect current TTB policy and modern industry practices.

Further, TTB will continue to employ its strategy to increase electronic filing to manage workloads and reduce processing times. These efforts include improving online guidance, enhancing the help features in TTB's online systems, and implementing system upgrades intended to increase the compliance of initial submissions. In FY 2016, TTB exceeded its target by achieving a combined electronic filing rate of 97 percent, as tracked by its measure of Percent of Electronically Filed Label and Formula Applications. TTB expects that these planned improvements will help TTB continue to attract users to its online systems and maintain performance above its 95 percent target in FY 2017.

Summary of Management and Organizational Excellence Performance

Effectively and efficiently administering the Bureau's revenue collection and public protection missions requires that TTB create the conditions necessary for programs to reach and sustain excellence. In all aspects of performing its mission, TTB aims to ensure that its programs operate efficiently and effectively, and with full accountability. TTB accomplishes this through its objectives in the area of Management and Organizational Excellence, which aim to provide program offices with the high-quality support needed in the areas of human capital, financial management, and information technology to achieve the Bureau's mission.

Human Capital Management

In FY 2016, TTB continued efforts to align workforce needs with the strategic direction of the Bureau, taking into account the overall business and cultural vision for TTB. Through strategic workforce planning, the Bureau continues to build capacity and address workforce trends by identifying and closing competency gaps for occupations deemed critical to current and future success, including cybersecurity and data analytics positions.

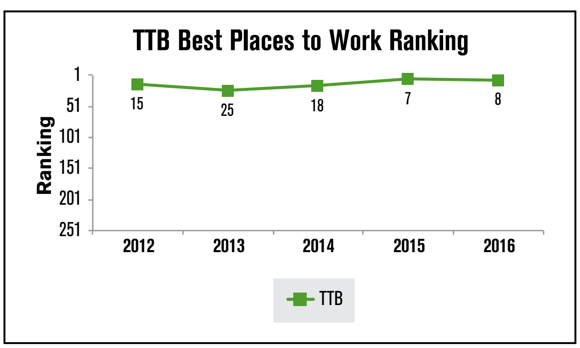
Significantly, like many government agencies, TTB is facing a potential retirement wave, with nearly 20 percent of the TTB workforce eligible to retire as of September 2016; within the next three years, another 30 percent will be retirement eligible. TTB intends to continue its proactive approach to addressing this mission risk by using a variety of human capital policies and programs, such as:

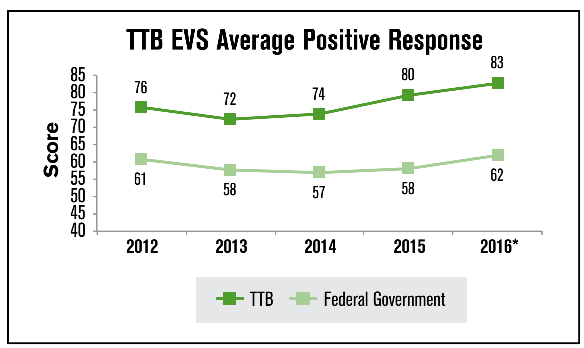
- Flexible work schedules and telework to promote a positive work/life balance to retain experienced staff;
- Hiring reemployed annuitants and developing specialized training to retain critical job knowledge;
- Partnering with a diverse range of universities, community organizations, and professional associations; and
- Expanding the use of special hiring authorities, including those for veterans and persons with disabilities.

TTB will also continue to develop its next generation of leaders through its Emerging Leaders Program. This leadership development initiative offers three unique certificate programs for non-supervisors, first-level supervisors, and second-level managers at TTB. The three-year program supports TTB's workforce planning strategies and prepares participants for leadership by developing the competencies critical for higher levels of responsibility. In FY 2017, TTB is using participant feedback to expand the program to include an experiential learning opportunity to put classroom skills into effect and broaden the exposure of program participants to other areas of the Bureau's operations.

Employee engagement and satisfaction are equally critical to a productive workplace. Each year, the Office of Personnel Management (OPM) administers the Federal Employee Viewpoint Survey (FEVS) to measure the satisfaction of the federal workforce. Based on this survey data, the Partnership for Public Service determines rankings for federal agencies. TTB uses these results to develop an annual Employee Engagement Action Plan to target areas for improvement, with these efforts resulting in a positive performance trend. Even as government-wide performance has remained relatively flat, TTB has successfully improved its workforce satisfaction over the past five years, reaching its highest positive response rate of 83 percent in FY 2016. TTB ranks 8th out of 305 sub-component agencies in the Best Places to Work in Federal Government.

In FY 2107, TTB will continue to focus on the areas with the greatest opportunity for improvement, including training and internal communications, to maintain its status as an employer of choice in the federal government. Notably, in FY 2016, TTB conducted a workforce survey to better understand employee feedback on the FEVS related to current training and professional development opportunities. As a result, TTB established a priority initiative to revitalize its training programs, including through an improved onboarding program for new hires and the development of TTB-specific curricula across job series at both introductory and advanced levels. Further, in the area of communication, TTB will continue its series of "TTB twenty5s,"a new monthly videoconference offered to all employees on Bureau priorities, programs, and emerging issues. In FY 2017, TTB also will hold its first virtual awards ceremony to bring together its dispersed workforce to recognize the recipients of TTB's meritorious awards.





The reported scores indicate the average of three survey items related to job and organization satisfaction that identify overall employee satisfaction. This data was revised to represent the Partnership for Public Service method.

Financial Management

TTB established and monitored key performance standards to ensure that its business activities covering financial accounting and reporting operate in a highly effective and efficient manner. In FY 2016, TTB achieved all of its financial management performance metrics, in collaboration with its shared service provider, the Bureau of the Fiscal Service Administrative Resource Center (BFS ARC).

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

- Paying vendor invoices on time (Prompt Payment Rate) greater than 99.5 percent;
- Ensuring a Proper Payments Rate of greater than 99.5 percent;
- Processing Budget Reprogramming Documents within 2 business days;
- Completing timely entry of budget and financial data in the OMB MAX reporting system;
- Reconciling Fund Balance with Treasury by the 20th calendar day of the month;
- Ensuring prompt deposits and recording of tax collections; and
- Providing timely and useful financial management data.

TTB also met established due dates to ensure timely submission of reports required by BFS ARC. Monthly closing of financial data was completed within three business days, and payroll information was downloaded into the core accounting system within three working days of receipt from the National Finance Center.

In addition, joint reviews of payroll activity were conducted to obtain reliable projections of payroll costs relative to on-board staffing levels. The payroll projection system has proven to be a valuable tool as it enables TTB to extract information from the core accounting system and make sound payroll projections, providing reliable and accurate financial information for TTB management to use in executing the budget.

In FY 2016, the Bureau was also able to conduct timely reviews of financial information so that program offices were provided with the data necessary to make efficient use of the Bureau's annual appropriation and fulfill TTB's tax collection and regulatory responsibilities, as outlined in its budget plan. By closely monitoring the Bureau's financial status, TTB was successful in making a number of key investments to support its mission. These financial reviews were not limited to the current year's appropriation. TTB also conducted a review of FY 2015 obligations to recover up to 50 percent of unobligated funds, which may be accessed for critical and/or unforeseen investments with appropriate authorization. In FY 2016, TTB received authorization for $340 thousand from unobligated FY 2015 funds to invest in scientific laboratory equipment.

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

Expansion of Technology Solutions

TTB aligns its business and technical strategies to maximize the use of technology to enable the Bureau to meet its objectives in the most efficient and cost-effective manner. In FY 2016, TTB made significant progress in each of its four IT strategic goals:

- **Modernize IT Systems** to reduce costs, streamline operations, and improve customer satisfaction.
- **Increase TTB Workforce Effectiveness** to enhance systems that focus on decision support and analysis and mobility of the TTB workforce.
- **Increase IT Cost Efficiency** by leveraging strategic sourcing solutions, optimizing IT contracts, and reducing costs through innovations.
- **Strengthen IT Security** to ensure that security vulnerabilities are addressed and patches are installed while allowing appropriate access to information and applications.

With regard to its first goal, TTB continues to focus on automating manual business processes and improving the accuracy and completeness of filings by industry. In FY 2016, more than 60 percent of system releases automated manual business processes, freeing TTB resources to perform mission-essential activities. These releases included enhancements to COLAs Online and Formulas Online designed to increase the accuracy and completeness of applications by improving user help features, system navigation, and system-based application checks to guide users in filing correctly the first time. These changes targeted high frequency application errors and, with the most significant changes released in September 2016, are expected to result in improved application compliance rates beginning in early FY 2017. Thus far, these enhancements have increased industry member satisfaction rates to 74 percent with COLAs Online, an increase of 3 percent compared to last year, and to 58 percent for Formulas Online, a remarkable 10 percent improvement in just one year. Further, TTB made significant progress towards its multi-year initiative to redesign Permits Online to improve the filing and processing of original and amended permit applications. These system changes will improve the ease of amendment filing for existing Permits Online users and enable the approximately 60,000 TTB permittees who originally filed a paper permit application to file for amendments to their permit through Permits Online. As TTB receives approximately 20,000 permit amendments annually, this project will result in efficiencies for both TTB and the businesses it serves through increasing the rate of electronic filing by industry and improving processing times.

In FY 2016, TTB also made progress in its goal to increase TTB workforce effectiveness. TTB improved its capabilities in data-driven decision making by improving its analytics environment through new tools and infrastructure. In addition to supporting dynamic analysis and more timely reporting, these new capabilities enable TTB to retire legacy reporting tools that have hindered TTB's data transparency initiatives on Data.gov. In addition, TTB continues to expand its fraud detection capabilities, effectively using data from TTB, other government agencies, and commercial sources to detect and address tax fraud and other compliance violations.

In FY 2016, toward its goal to increase IT cost efficiency, TTB continued its efforts to transition IT infrastructure from proprietary hardware to more common, lower-cost commodity hardware and to shift away from proprietary software platforms to Open Source platforms. These efforts will lower the costs for hardware, software, and IT support and, at the same time, include enhanced features to support seamless updates to TTB's online systems and reduced downtime required for system maintenance. Additionally, TTB further consolidated and optimized over 40 percent of its IT contracts to more efficiently support the annual renewal of licenses and support for office automation products used daily by TTB personnel. Going forward, TTB will continue to seek efficiencies through implementing Open Source and cloud-based solutions, optimizing IT contracts, and leveraging Treasury strategic sourcing solutions.

Maintaining the security of TTB's IT systems remains a top priority and, in FY 2016, TTB made significant progress to improve its capacity to combat cybersecurity threats through advanced technology and employee education. TTB improved its malware detection to both prevent and enhance the reporting and monitoring of malicious e-mails, all of which have reduced security response time and increased efficiencies. In the coming year, TTB will continue to strengthen its security posture to best protect the sensitive information the Bureau collects and uses to achieve its mission responsibilities.

Message from the Chief Financial Officer

TTB faced a multitude of fiscal and programmatic challenges this year by continuing its proven approach to data-driven decision-making and investing in its workforce to ensure that we fulfill our diverse mission of consumer protection and revenue collection.

TTB once again obtained an unmodified (clean) audit opinion on its financial statements from an independent public accounting firm, demonstrating our commitment to financial reporting excellence. Our strong internal controls and sound management practices ensure the collection and verification of more than $22 billion in annual excise tax collections from the alcohol, tobacco, firearms, and ammunition industries.

Performance in our core lines of business, however, has been significantly challenged by staffing levels that have not kept up with a growing demand for TTB's services. Relative to its essential mission, TTB is a lean organization, and each position carries vital responsibilities and makes significant contributions to our performance goals. Staff turnover, particularly in mission-critical positions, combined with lengthy hiring times has caused performance in many key programs to fluctuate and deteriorate. TTB placed significant focus on staffing in FY 2016, which resulted in the hiring of 46 new employees, more than double the previous year and equivalent to nearly 10 percent of the TTB workforce. Once fully trained, these new employees are expected to support performance improvements in the year ahead, particularly with nearly half of the hires dedicated to meeting the Congressional mandate to accelerate the processing of alcohol beverage label and formula approvals.

TTB also made investments in employee training and development to ensure the workforce is skilled and able to meet the challenges ahead. TTB issued a Bureau-wide training survey to better understand the successes of the current training and professional development programs, as well as areas for improvement. Using a cross-section of experts and volunteers from around the Bureau, we developed and initiated an action plan to increase training satisfaction and effectiveness across TTB, focusing on the needs of both new and existing employees, as well as organizational needs to develop emerging leaders.

We will continue to face the uncertainties and challenges ahead by relying on our Balanced Scorecard to integrate our strategic plan with our management and investment decisions. This tool, in addition to open dialogue, ensures that we remain focused on the critical issues and opportunities to improve our operations, our workplace, and our performance.

Cheri D. Mitchell

Cheri D. Mitchell

Assistant Administrator, Management/CFO

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Part III: Financial Results, Position, Condition, and Auditors' Reports

Budget Highlights by Fund Account

This section highlights the TTB program activity in FY 2016 under the annual Salaries and Expenses appropriations account. The Bureau's financial statements include all financial transactions in both the current year accounts and the expired accounts for the previous five years.

FY 2016 Salaries and Expenses	
Fund Source	
Salaries & Expenses FY 2016 Appropriation (P.L. 114-113 Consolidated Appropriations Act, 2016) 1/	**$106,439,000**
Obligations Incurred in FY 2016 from Current Year Appropriations	$106,094,241
Salaries & Expenses FY 2015/16 **(50% Prior Year Recovery)2/**	**$340,000**
Obligations Incurred in FY 2016 from Current Year Appropriations	$339,961

1/ The 2016 Consolidated Appropriations Act included $5 million in funding for TTB to use for the costs of accelerating the processing of formula and label applications.

2/ General Provisions of the appropriations bill provide that 50 percent of the unobligated balances remaining available at the end of Fiscal Year 2015 shall remain available through September 30, 2016.

In FY 2016, TTB received $106.4 million in discretionary appropriations under the FY 2016 Consolidated Appropriations Act and authorized 494 full-time equivalent (FTE) staffing level. This amount included $5 million for the costs of accelerating the processing of formula and label applications.

The Bureau obligated or expended more than 99 percent of the $106.4 million in FY 2016 of discretionary funding from its one-year Salaries and Expenses appropriation.

TTB also received Congressional authorization in FY 2016 to use an additional $340 thousand from the prior year account of unobligated available balances (also referred to as the 50 percent account) to replace obsolete scientific laboratory equipment.

Offsetting Collections and Reimbursable Accounts

During FY 2016, the Bureau realized $5.7 million in spending from offsetting collections and reimbursable accounts. The primary sources of reimbursable funding were collections from the cover-over program and enforcement activity in Puerto Rico, investigative expenses and data systems from TEOAF; reimbursement from the Community Development Financial Institution Fund (CDFI) for information technology services; reimbursement for Technical Assistance for Specialty Crops (TASC) program with the USDA; and reimbursement for laboratory services from the Food and Drug Administration and the Bureau of Alcohol, Tobacco, Firearms, and Explosives.

Puerto Rico Cover Over and Enforcement Activities

All costs associated with the functioning and support of TTB's Puerto Rico office are paid from the cover-over program, which is offset from cover-over taxes collected in the United States on products originating in Puerto Rico ($417 million) and the U.S. Virgin Islands ($8 million).

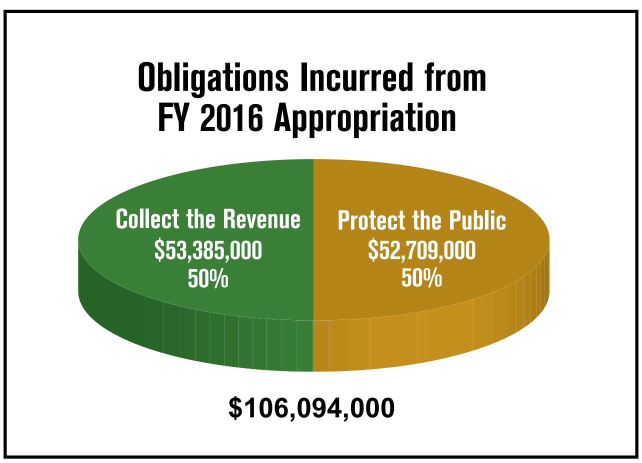
In Puerto Rico, TTB conducts annual audits and investigations of industry members regarding the collection of revenue, application processing, and product integrity. TTB conducts revenue inspections on producers of alcohol and tobacco. These examinations are integral to TTB's fulfillment of its obligations to verify tax compliance and ensure the payment of all cover-over amounts due to the government of Puerto Rico.

Additionally, as a result of the Caribbean Basin Economic Recovery Act, taxes collected on rum imported into the United States from other than Puerto Rico or USVI ("other rum") are also covered into the treasuries of Puerto Rico and USVI. The USVI also receives direct reimbursement for rum it produces and transports to the U.S. through the Department of the Interior.

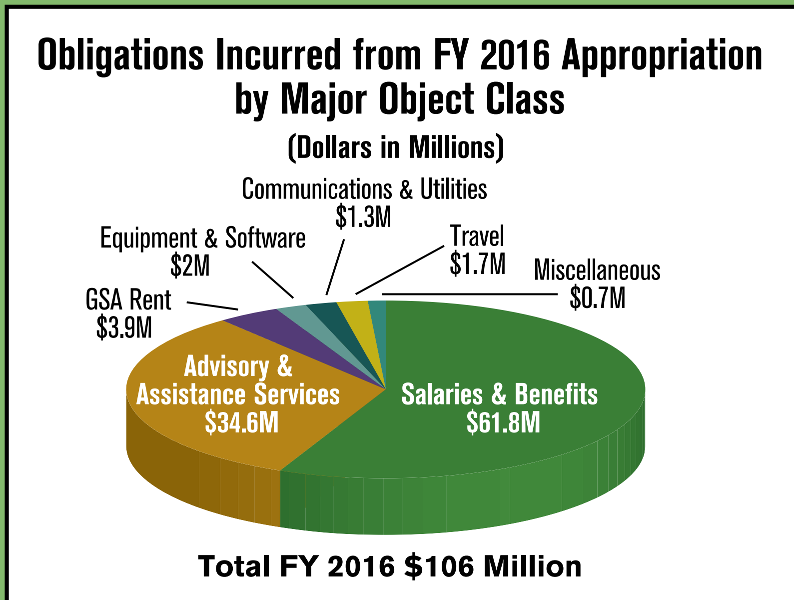
Linking Budget and Program Spending

TTB has two primary budget activities that directly align to its mission and strategic goals: Collect the Revenue and Protect the Public. TTB uses an account code structure that provides a direct link from the Bureau budget to specific programs and project activities. To ascertain the full costs of each of these budget activities, overhead costs were allocated and combined with the direct program costs.

An analysis of the FY 2016 data stemming from the account code structure shows that TTB incurred obligations of $106,094,000 of its salaries and expenses appropriation, of which 50 percent was spent on the Collect the Revenue budget activity and 50 percent was spent on Protect the Public budget activity.



Spending by Major Object Class



TTB presents its obligations incurred by budget activity and program in its Annual Report to explain the cost of delivering the services that support TTB's mission. TTB also presents specific data regarding the purchase of goods and services by major object class that support its program activities. The majority of TTB's incurred obligations (91 percent) fall into two principal major object classes: Salaries & Benefits and Advisory & Assistance Services (Contracts).

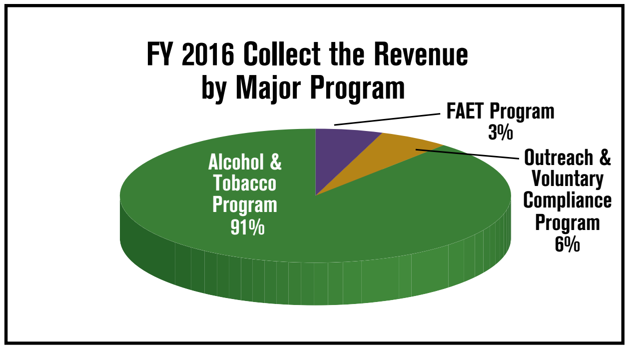
Salaries & Benefits comprise 58 percent of total obligations incurred by object class, and cover the cost of TTB's roughly 470 onboard positions in FY 2016. The Advisory & Assistance Services object class constitutes 33 percent of FY 2016 incurred obligations, and covers the cost of both commercial and intra-governmental services. The commercial contracts category is predominantly IT contracts in support of engineering, infrastructure, and support services. This category includes other commercial contracts for services such as the scanning and imaging of label applications and tax forms, lab maintenance, and Web site development.

Intra-governmental services include administrative support services provided by our shared service provider for human resources, accounting, travel, and procurement. Other intra-governmental services include budget items such as the costs for special agent support, background investigations, Federal Protective Services and Departmental franchise services.

In FY 2016, the Bureau's travel costs were primarily related to core mission activities for audits and investigations. The remaining object classes that cover the FY 2016 obligations incurred include cost categories for rent, communications, equipment, and other miscellaneous categories.

Obligations Incurred from FY 2016 Appropriations by Budget Activity

Collect the Revenue….. $53,385,000



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

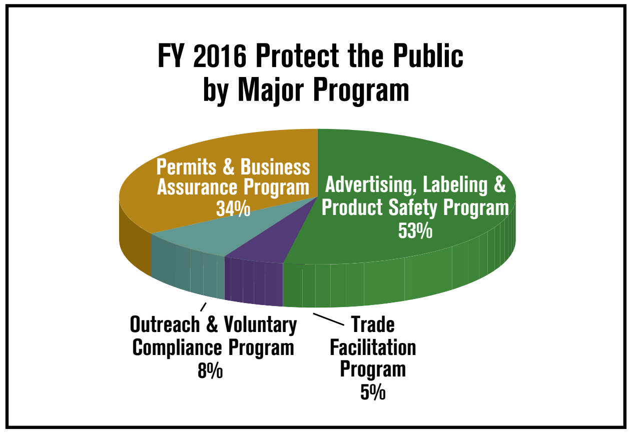
Under the Collect the Revenue activity, TTB administers three programs: 1) Alcohol and Tobacco Tax; 2) Firearms and Ammunitions Excise Tax (FAET); and 3) Outreach and Voluntary Compliance.

In FY 2016, TTB expended 91 percent of its Collect the Revenue resources in collecting federal excise taxes from the alcohol and tobacco industries and 3 percent in collecting FAET. These costs include projects relating to the processing of tax returns and operational reports at the National Revenue Center and the audits and investigations conducted on alcohol, tobacco and firearms industry members.

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

Protect the Public….. $52,709,000

The Protect the Public budget activity encompasses TTB's strategy to ensure industry compliance with laws and regulations designed to protect the consumers of alcohol beverages, which TTB accomplishes by ensuring the integrity of the people who operate these businesses, of the products themselves, and of the marketplace in which they are traded.



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

An analysis of the financial data from FY 2016 reveals that TTB spent the preponderance of its Protect the Public resources on two programs: Permits and Business Assurance (34 percent), and Labeling, Advertising, and Product Safety (53 percent).

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

The Labeling, Advertising, and Product Safety Program includes activities designed to ensure that beverage alcohol labels fully and accurately describe the products upon which they appear and are not misleading. It also encompasses activities relating to verifying that alcohol advertisements contain all mandatory information and do not mislead consumers. The Product Safety component involves all investigative and laboratory activities, including domestic and imported product analyses.

The remainder of the Protect the Public resources were divided between the Trade Facilitation Program (5 percent) and the Outreach and Voluntary Compliance Program (8 percent). TTB Trade Facilitation Program includes identifying and addressing barriers to trade in the international marketplace. The Outreach and Voluntary Compliance Program promotes compliance by providing regulatory standards and guidance, encouraging use of TTB e-Gov filing systems, and supporting industry members through outreach and education efforts.

Management’s Responsibility for Enterprise Risk Management and Internal Control

Introduction

During FY 2016, TTB contracted with the Bureau of the Fiscal Service’s Administrative Rescource Center (ARC) to handle its administrative, human resources, procurement, travel, and financial functions.

Accounting Systems and Controls

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

The FY 2016 audit of Treasury’s consolidated financial statements, which covered the financial management systems of our service provider, ARC, did not identify any instances in which ARC’s financial management systems did not substantially comply with FFMIA. Specifically, no instances were identified in which ARC’s financial management systems did not substantially comply with: 1) Federal financial management systems requirements, 2) applicable Federal accounting standards, and 3) the United States Government Standard General Ledger at the transaction level.

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

Federal Managers’ Financial Integrity Act of 1982 (FMFIA)

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

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

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

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

These policies address:

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

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

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

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

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

This increased emphasis on management controls has had a positive impact on programs and enabled the Bureau to achieve the intended results. The process also ensures that the utilization of resources is consistent with mission priorities and that program and resources are being used without waste, fraud, or mismanagement. Also, in addition to the A-123 review, TTB conducted a series of office reviews during FY 2016 that included an extensive review of administrative and internal controls.

Financial Statement Highlights

The following overview of the TTB financial statements highlights certain aspects of the financial statements for the fiscal year ended September 30, 2016.

- The Balance Sheet shows the assets, liabilities, and net position as of a point in time, in this case, as of September 30, 2016.
  - The total assets were reported as $100.5 million at the close of the fiscal year. Of this amount, $44.6 million is classified as the fund balance with Treasury. That fund balance account is the undisbursed account balance with the Treasury, primarily resulting from undisbursed appropriations.
  - The total liabilities amount reported is $76.3 million, of which total intragovernmental liabilities amounts to $26.6 million. The other liabilities are classified by type, such as accrued tax refunds, payables, and other liabilities.
- The Statement of Net Cost shows the total net cost of operations at $111.3 million for the Bureau to administer its two budget activities.
  - The total net cost reported as program costs under the Collect the Revenue program was $54.0 million.
  - The total net cost reported as program costs under the Protect the Public program was $57.3 million.
- The Statement of Change in Net Position shows a total net position balance of $24.2 million, and that amount represents the unexpended appropriations from both prior periods and from the current operating cycle in addition to Cumulative Results of Operations.
- The Statement of Budgetary Resources shows the budgetary resources received and the status of those resources. For TTB, the resources are primarily annual appropriations received from in the amount of $106.4 million, in addition to spending authority from collections. The offsetting collections amount was $5.7 million. Of that amount, $3.0 million is from the recovery of costs for maintaining enforcement operations in Puerto Rico.
- The Statement of Custodial Activity shows the amount of revenue received during FY 2016 compared with FY 2015, along with tax refunds, drawback on Manufacturer of Nonbeverage Products (MNBP) claims, and cover-over payments. The amount displayed shows that the total Federal excise tax revenues collected from alcohol, tobacco, firearms, and ammunition amounted to $22.1 billion. Within this total, the Bureau processed tax refunds, drawback claims, and cover-over payments in the amount of $815.4 million.
  - **Drawback claims** of $355.7 million were processed based on claims filed from MNBPs. Under current law, a drawback claim is allowed when distilled spirits on which the tax has been paid were unfit for beverage purposes and used in the production of medicines, medicinal preparations, food products, flavors, flavoring extracts, or perfumes.

- **Tax refunds** and other adjustments (e.g., interest) were processed in the amount of $34.8 million.
- **Cover-over payments** were returned to Puerto Rico and the Virgin Islands in the amount of $424.8 million. Such taxes collected on rum imported in the United States are "covered over," or paid into, the treasuries of Puerto Rico and the Virgin Islands.
- **The disposition of the custodial revenue**, after refunds, claims, and cover-over payments, nets to $21.3 billion, and that amount was deposited to the U.S. Treasury to fund the Federal Government, with the exception of the Federal firearms and ammunition Federal excise taxes. Those revenues, in the amount of $749.4 million, were remitted to the Fish and Wildlife Restoration Fund under provisions of the Pittman Robertson Act of 1937.

Notes to the Basic Financial Statements

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

Required Supplementary Information

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

Financial Statements, Accompanying Notes, and Supplemental Information

Limitations of Financial Statements

The principal statements have been prepared to report the financial position and results of operations of the entity, pursuant to the requirements of 31 U.S.C. 3515(b). While the statements have been prepared from the books and records of the entity in accordance with generally accepted accounting principles (GAAP) for federal entities and the formats prescribed by the Office of Management and Budget (OMB), the statements are in addition to the financial reports used to monitor and control budgetary resources, which are prepared from the same books and records. For fiscal years 2016 and 2015, all financial statements and notes have been audited.

Management Responsibilities

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

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

TTB in Relation to Treasury's Annual Financial Statements

The Department of the Treasury received an unmodified audit opinion on its FY 2016 financial statements. The financial activities of the Bureau are an integral part of the information reported by the Department of the Treasury.

This unmodified audit opinion means that the financial information presented by the Treasury, which includes TTB's financial activities, was presented fairly and in conformity with GAAP of the United States.

KPMG LLP
Suite 12000
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Washington, DC 20006

Independent Auditors' Report

Inspector General
U.S. Department of the Treasury

Administrator
Alcohol and Tobacco Tax and Trade Bureau

Report on the Financial Statements

We have audited the accompanying financial statements of the Alcohol and Tobacco Tax and Trade Bureau, which comprise the balance sheets as of September 30, 2016 and 2015, and the related statements of net cost, changes in net position, custodial activity, and budgetary resources for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America, in accordance with the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and in accordance with Office of Management and Budget (OMB) Bulletin No. 15-02, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 15-02 require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion on the Financial Statements

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Alcohol and Tobacco Tax and Trade Bureau as of September 30, 2016 and 2015, and its net costs, changes in net position, custodial activity, and budgetary resources for the years then ended in accordance with U.S. generally accepted accounting principles.

Other Matters

Interactive Data

Management has elected to reference to information on websites or other forms of interactive data outside the *FY 2016 Annual Report* to provide additional information for the users of its financial statements. Such information is not a required part of the basic financial statements or supplementary information required by the Federal Accounting Standards Advisory Board. The information on these websites or the other interactive data has not been subjected to any of our auditing procedures, and accordingly we do not express an opinion or provide any assurance on it.

Required Supplementary Information

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

Other Information

Our audits were conducted for the purpose of forming an opinion on the basic financial statements as a whole. The Other Accompanying Information included in (1) pages i through vi, (2) *Part II: Program Performance Results,* (3) *Message from the Chief Financial Officer,* (4) pages 41 through 50 and pages 82 through 88 of *Part III, Financial Results, Position, Condition and Auditors' Reports,* and (5) *Part IV: Appendices* is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audits of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

KPMG

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 19, 2016 on our consideration of the Alcohol and Tobacco Tax and Trade Bureau's internal control over financial reporting and our report dated December 19, 2016 on our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the result 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* in considering the Alcohol and Tobacco Tax and Trade Bureau's internal control over financial reporting and compliance.

KPMG LLP

December 19, 2016

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

Independent Auditors' Report on Internal Control Over Financial Reporting

Inspector General
U.S. Department of the Treasury

Administrator
Alcohol and Tobacco Tax and Trade Bureau

We have audited, in accordance with auditing standards generally accepted in the United States of America, in accordance with the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and in accordance with Office of Management and Budget (OMB) Bulletin No. 15-02, *Audit Requirements for Federal Financial Statements*, the financial statements of the Alcohol and Tobacco Tax and Trade Bureau , which comprise the balance sheets as of September 30, 2016 and 2015, and the related statements of net cost, changes in net position, custodial activity, and budgetary resources for the years then ended, and the related notes to the financial statements, and have issued our report thereon dated December 19, 2016.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements as of and for the year ended September 30, 2016, we considered the Alcohol and Tobacco Tax and Trade Bureau's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Alcohol and Tobacco Tax and Trade Bureau's internal control. Accordingly, we do not express an opinion on the effectiveness of the Alcohol and Tobacco Tax and Trade Bureau's internal control. 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. 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.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

KPMG

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and the result of that testing, and not to provide an opinion on the effectiveness of the Alcohol and Tobacco Tax and Trade Bureau's internal control. This report is an integral part of an audit performed in accordance with Government Auditing Standards in considering the Alcohol and Tobacco Tax and Trade Bureau's internal control. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

December 19, 2016

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

Independent Auditors' Report on Compliance and Other Matters

Inspector General
U.S. Department of the Treasury

Administrator
Alcohol and Tobacco Tax and Trade Bureau

We have audited, in accordance with auditing standards generally accepted in the United States of America, in accordance with the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and in accordance with Office of Management and Budget (OMB) Bulletin No. 15-02, *Audit Requirements for Federal Financial Statements*, the financial statements of the Alcohol and Tobacco Tax and Trade Bureau, which comprise the balance sheets as of September 30, 2016 and 2015, and the related statements of net cost, changes in net position, custodial activity, and budgetary resources for the years then ended, and the related notes to the financial statements, and have issued our report thereon dated December 19, 2016.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Alcohol and Tobacco Tax and Trade Bureau's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests of compliance disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 15-02.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of compliance and the result of that testing, and not to provide an opinion on the Alcohol and Tobacco Tax and Trade Bureau's compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Alcohol and Tobacco Tax and Trade Bureau's compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

December 19, 2016

ALCOHOL AND TOBACCO TAX AND TRADE BUREAU
BALANCE SHEETS
As of September 30, 2016 and 2015
(In Thousands)

	2016	2015
ASSETS		
Intragovernmental Assets:		
Fund Balance with Treasury (Note 2)	$44,583	$43,215
Accounts Receivable (Note 3)	303	275
Due from the General Fund (Notes 5 and 8)	19,210	14,209
Total Intragovernmental Assets	64,096	57,699
Accounts Receivable (Note 3)	461	483
Tax and Trade Receivables, Net (Notes 4 and 8)	25,291	26,070
Property, Plant and Equipment, Net (Note 6)	10,647	13,429
Advances (Note 7)	34	80
TOTAL ASSETS (Note 8)	$100,529	$97,761
LIABILITIES		
Intragovernmental Liabilities:		
Accounts Payable	$789	$903
Payroll Benefits	525	386
FECA Liabilities (Note 10)	13	26
Due to the General Fund (Notes 4 and 5)	18,541	21,125
Other Liabilities (Note 9)	6,750	4,946
Total Intragovernmental Liabilities	26,618	27,386
Accounts Payable	4,066	3,741
Payroll Benefits	1,937	1,494
FECA Actuarial Liability (Note 10)	131	158
Refunds Payable (Note 5)	19,210	14,209
Unfunded Leave (Note 10)	4,469	4,453
Cash Bond Liabilities	16,261	15,085
Other Liabilities (Note 9)	3,638	3,862
TOTAL LIABILITIES (Note 10)	$76,330	$70,388
Commitments and Contingencies (Note 19)		
NET POSITION		
Unexpended Appropriations - Other Funds	$18,150	$18,468
Cumulative Results of Operations - Other Funds	6,049	8,905
TOTAL NET POSITION - OTHER FUNDS	$24,199	$27,373
TOTAL LIABILITIES AND NET POSITION	$100,529	$97,761

The accompanying notes are an integral part of these statements.

ALCOHOL AND TOBACCO TAX AND TRADE BUREAU
STATEMENTS OF NET COST
For the Years Ended September 30, 2016 and 2015
(In Thousands)

	2016	2015
COLLECT THE REVENUE		
Program Costs		
Intragovernmental Gross Costs	$14,648	$14,231
Less: Intragovernmental Earned Revenue	(2,503)	(2,370)
Intragovernmental Net Costs	12,145	11,861
Gross Costs with the Public	44,124	41,592
Less: Earned Revenues from the Public	(2,282)	(2,320)
Net Costs with the Public	41,842	39,272
Total Net Program Cost	$53,987	$51,133
PROTECT THE PUBLIC		
Program Costs		
Intragovernmental Gross Costs	$14,672	$14,207
Less: Intragovernmental Earned Revenue	(792)	(708)
Intragovernmental Net Costs	13,880	13,499
Gross Costs with the Public	44,195	41,518
Less: Earned Revenues from the Public	(722)	(693)
Net Costs with the Public	43,473	40,825
Total Net Program Cost	$57,353	$54,324
NET COST OF OPERATIONS (Note 13)	$111,340	$105,457

The accompanying notes are an integral part of these statements.

ALCOHOL AND TOBACCO TAX AND TRADE BUREAU
STATEMENTS OF CHANGES IN NET POSITION
For the Years Ended September 30, 2016 and 2015
(In Thousands)

	2016	2015
Cumulative Results of Operations		
Beginning Balances	$8,905	$12,129
Budgetary Financing Sources		
Appropriations Used	104,899	98,715
Other Financing Sources (Non-exchange)		
Imputed Financing from Costs Absorbed by Others (Note 12)	3,585	3,520
Transfers of the General Fund and Other	-	(2)
Total Financing Sources	108,484	102,233
Net Cost of Operations (Note 13)	(111,340)	(105,457)
Net Change	(2,856)	(3,224)
Cumulative Results of Operations	$6,049	$8,905
UNEXPENDED APPROPRIATIONS		
Beginning Balances	$18,468	$17,723
Budgetary Financing Sources		
Appropriations Received	106,439	100,000
Other Adjustments	(1,858)	(540)
Appropriations Used	(104,899)	(98,715)
Total Budgetary Financing Sources	(318)	745
Total Unexpended Appropriations	$18,150	$18,468
TOTAL NET POSITION	$24,199	$27,373

The accompanying notes are an integral part of these statements.

ALCOHOL AND TOBACCO TAX AND TRADE BUREAU
STATEMENTS OF BUDGETARY RESOURCES
For the Years Ended September 30, 2016 and 2015
(In Thousands)

	2016	2015
BUDGETARY RESOURCES (Note 14)		
Unobligated Balance Brought Forward, Oct 1	$5,164	$4,273
Recoveries of Prior Year Unpaid Obligations	1,126	1,104
Other Changes in Unobligated Balance	(1,840)	(408)
Unobligated Balance from Prior Year Budget Authority, Net	4,450	4,969
Appropriations (discretionary and mandatory)	106,439	100,000
Spending Authority from Offsetting Collections (discretionary and mandatory)	5,702	6,101
TOTAL BUDGETARY RESOURCES	$116,591	$111,070
STATUS OF BUDGETARY RESOURCES		
New Obligations and Upward Adjustments (Note 15)	$113,875	$105,906
Unobligated Balance, End of Year:		
Apportioned, Unexpired Accounts	345	1,573
Unexpired Unobligated Balance, End of Year	345	1,573
Expired Unobligated Balance, End of Year	2,371	3,591
Unobligated Balance, End of Year	2,716	5,164
TOTAL STATUS OF BUDGETARY RESOURCES	$116,591	$111,070

The accompanying notes are an integral part of these statements.

ALCOHOL AND TOBACCO TAX AND TRADE BUREAU
STATEMENTS OF BUDGETARY RESOURCES
For the Years Ended September 30, 2016 and 2015
(In Thousands)

	2016	2015
CHANGE IN OBLIGATED BALANCE		
Unpaid Obligations:		
Unpaid Obligations Brought Forward, Oct 1	$21,258	$20,903
New Obligations and Upward Adjustments (Note 15)	113,875	105,906
Outlays, Gross	(110,516)	(104,447)
Recoveries of Prior Year Unpaid Obligations	(1,126)	(1,104)
Unpaid Obligations, End of Year, Gross	23,491	21,258
Uncollected Payments:		
Uncollected Payments Brought Forward, Federal Sources, Oct 1	(2,151)	(3,230)
Change in Uncollected Payments, Federal Sources	585	1,079
Uncollected Payments, Federal Sources, End of Year	(1,566)	(2,151)
OBLIGATED BALANCE, END OF YEAR	$21,925	$19,107
OBLIGATED BALANCE, START OF YEAR	$19,107	$17,673
BUDGET AUTHORITY AND OUTLAYS, NET		
Budget Authority:		
Budget Authority, Gross (discretionary and mandatory)	$112,141	$106,101
Actual Offsetting Collections (discretionary and mandatory)	(6,305)	(7,312)
Change in Uncollected Customer Payments, Federal Sources (discretionary and mandatory)	585	1,079
Recoveries of Prior Year Paid Obligations (discretionary and mandatory)	18	132
BUDGET AUTHORITY, NET (discretionary and mandatory)	$106,439	$100,000
Outlays, Gross (discretionary and mandatory)	110,516	104,447
Actual Offsetting Collections (discretionary and mandatory)	(6,305)	(7,312)
Outlays, Net (discretionary and mandatory)	104,211	97,135
Distributed Offsetting Receipts	(1)	(9)
AGENCY OUTLAYS, NET (discretionary and mandatory)	$104,210	$97,126

The accompanying notes are an integral part of these statements.

ALCOHOL AND TOBACCO TAX AND TRADE BUREAU
STATEMENTS OF CUSTODIAL ACTIVITY
For the Years Ended September 30, 2016 and 2015
(In Thousands)

	2016	2015
SOURCES OF CUSTODIAL REVENUE		
Revenue Received		
Excise Taxes (Note 16)	$22,098,164	$22,257,284
Interest, Fines and Penalties	2,479	1,930
Other Custodial Revenue	1	7
Total Revenue Received (Note 17)	22,100,644	22,259,221
Less Refunds and Drawbacks (Note 16)	(390,629)	(334,567)
Net Revenue Received	21,710,015	21,924,654
Accrual Adjustment	(5,779)	(17,929)
Total Sources of Custodial Revenue	$21,704,236	$21,906,725
DISPOSITION OF CUSTODIAL REVENUE		
Amounts Provided to:		
General Fund	$20,535,806	$20,935,636
Wildlife Restoration Fund	749,419	638,496
Amounts Provided to Fund the Federal Government (Note 17)	21,285,225	21,574,132
Amounts Provided to Non-Federal Entities (Note 16)	424,790	350,522
Increases/(Decreases) in Amounts Yet to be Provided:		
General Fund	(2,583)	(4,047)
Wildlife Restoration Fund	1,804	(799)
(Increase)/Decrease in Accrued Refunds	(5,000)	(13,083)
Total Disposition of Custodial Revenue	$21,704,236	$21,906,725
NET CUSTODIAL REVENUE ACTIVITY	$ -	$ -

The accompanying notes are an integral part of these statements.

Notes to the Financial Statements

Note 1. Summary of Significant Accounting Policies

A. Reporting Entity

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

B. Basis of Presentation

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

C. Basis of Accounting

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

The Statement of Custodial Activity is presented on the modified cash basis. The related activity is detailed in Note 1.E.

D. Revenue and Financing Sources

(1) Exchange Revenue

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

(2) Financing Sources

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

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

(3) Imputed Financing Sources

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

E. Custodial Revenue

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

F. Fund Balance with Treasury

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

G. Accounts Receivable

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

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

H. Property, Plant, and Equipment

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

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

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

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

I. Advances

Advances are payments made to cover certain periodic expenses before those expenses are incurred. Advances generally consist of prepaid services agreements for support or maintenance.

J. Non-entity Assets

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

K. Liabilities

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

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

L. Litigation Contingencies and Settlements

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

M. Annual, Sick, and Other Leave

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

N. Interest on Late Payments

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

O. Retirement Plan

Employees hired after December 31, 1983, are automatically covered by Federal Employees Retirement System (FERS) and Social Security. For most employees hired after December 31, 1983, TTB also contributes the employers' matching share of Social Security. For the FERS basic benefit, employees contributed .8 to 4.4 percent of basic pay in FY 2016, the same as FY 2015. TTB contributed between 13.7 and 11.9 percent, for a total contribution rate of 14.5 to 16.3 percent in FY 2016, depending on employees' retirement categories. The total contribution rate in FY 2015 was between 14.0 and 15.5 percent. The cost of providing a FERS basic benefit, as provided by the Office of Personnel Management (OPM), is equal to the amounts contributed by TTB and the employees.

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

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

P. Federal Employees' Compensation Act

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

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

Q. Use of Estimates

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

R. Tax Exempt Status

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

S. Changes in Presentation

In FY 2016, changes to the presentation of the Statements of Budgetary Resources were made, in accordance with guidance provided in OMB Circular A-136. As such, activity and balances reported on the FY 2015 Statement of Budgetary Resources have been changed to conform to the current year presentation.

T. Subsequent Events

Subsequent events and transaction occurring after September 30, 2016 through the date of the auditors' opinion have been evaluated for potential recognition or disclosure in the financial statements.

Note 2. Fund Balance with Treasury

Fund Balance with Treasury as of September 30, 2016 and 2015 consisted of the following (in thousands):

	2016	2015
Fund Balances:		
General Funds	$24,641	$24,271
Other Funds	19,942	18,944
Total	$44,583	$43,215
Status of Fund Balances:		
Unobligated Balance - Available	$345	$1,573
Unobligated Balance - Unavailable	2,371	3,591
Obligated Balance Not Yet Disbursed	21,925	19,107
Subtotal	24,641	24,271
Adjustment for Non-Budgetary Funds	19,942	18,944
Total Status of Fund Balances	$44,583	$43,215

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

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

Note 3. Accounts Receivable

Accounts Receivable as of September 30, 2016 and 2015 consisted of the following (in thousands):

	2016	2015
Intragovernmental Accounts Receivable:		
Due from Treasury Executive Office of Asset Forfeiture	$110	$171
Due from Community Financial Development Institutions Fund	142	58
Due from Treasury Departmental Offices	1	-
Due from Department of Agriculture	50	19
Due from Department of Health and Human Services	-	27
Total Intragovernmental Accounts Receivable	$303	$275
Due from the Government of Puerto Rico	$460	$477
Due from Employees	1	6
Total Accounts Receivable Due from the Public	$461	$483

No allowance for doubtful accounts has been recognized, nor have any accounts been written off in either FY2016 or FY2015. All intragovernmental accounts receivable are considered fully collectible. Additionally, other non-Federal receivables consist of a receivable from the government of Puerto Rico, which is collected via an offset to cover-over payments the Bureau remits to Puerto Rico, and employee accounts receivable, which can be collected via salary offsets.

Note 4. Tax and Trade Receivables, Net

Tax and Trade Receivables as of September 30, 2016 and 2015 consisted of the following (in thousands):

	2016	2015
Tax and Trade Receivables	$179,923	$158,463
Interest Receivable	27,168	25,321
Penalties, Fines and Administrative Fees Receivable	78,538	72,996
Total Tax and Trade Receivables	285,629	256,780
Allowance for Doubtful Accounts	(260,338)	(230,710)
Total Tax and Trade Receivables, Net	$25,291	$26,070

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

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

Due from the General Fund and Due to the General Fund as of September 30, 2016 and 2015 consisted of the following (in thousands):

	2016	2015
Due from the General Fund	$19,210	$14,209

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

	2016	2015
Due to the General Fund	$18,541	$21,125

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

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

Property, Plant and Equipment as of September 30, 2016 and 2015 consisted of the following (in thousands):

2016	Estimated Useful Life (Years)	Acquisition Value	Accumulated Depreciation	Net Book Value
Internal Use Software	3 - 5	$13,644	$13,226	$418
Equipment	4 - 6	13,437	10,413	3,024
Leasehold Improvements	2 - 5	1,956	1,407	549
Building	40	9,772	3,116	6,656
Total PP&E		$38,809	$28,162	$10,647

2015	Estimated Useful Life (Years)	Acquisition Value	Accumulated Depreciation	Net Book Value
Internal Use Software	3 - 5	$13,644	$11,353	$2,291
Equipment	4 - 6	14,058	10,572	3,486
Leasehold Improvements	2 - 5	1,956	1,213	743
Building	40	9,772	2,863	6,909
Total PP&E		$39,430	$26,001	$13,429

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

The balance in the buildings account represents TTB's 13.2 percent equity interest in the National Laboratory Center facility in Beltsville, Maryland, which TTB co-owns with the Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF).

Note 7. Advances

Advances as of September 30, 2016 and 2015 consisted of the following (in thousands):

	2016	2015
Beginning Balance	$80	$34
Prepayments	-	103
Liquidations	(46)	(57)
Advance Balance	$34	$80

Advances with the public generally consist of prepaid services agreements for support or maintenance.

Note 8. Non-entity Assets

Non-entity Assets as of September 30, 2016 and 2015 consisted of the following (in thousands):

	2016	2015
Intragovernmental Non-entity Assets:		
Fund Balance with Treasury	$19,942	$18,944
Due from the General Fund	19,210	14,209
Total Intragovernmental Non-entity Assets	39,152	33,153
Accounts Receivable	-	1
Tax and Trade Receivables, Net	25,291	26,070
Total Non-Entity Assets	64,443	59,224
Total Entity Assets	36,086	38,537
Total Assets	$100,529	$97,761

Note 9. Other Liabilities

Other Liabilities as of September 30, 2016 and 2015 consisted of the following (in thousands):

	2016	2015
Due to the Fish and Wildlife Fund	$6,750	$4,946
Other Intragovernmental Liabilities	6,750	4,946
Offers-in-Compromise not yet Accepted	3,638	3,862
Total Other Liabilities with the Public	3,638	3,862
Total Other Liabilities	$10,388	$8,808

All Other Liabilities are considered current liabilities.

Note 10. Liabilities Not Covered by Budgetary Resources

Liabilities not Covered by Budgetary Resources as of September 30, 2016 and 2015 consisted of the following (in thousands):

	2016	2015
Accrued FECA Liability	$13	$26
Total Intragovernmental Liabilities not Covered by Budgetary Resources	13	26
FECA Actuarial Liability	131	158
Unfunded Leave	4,469	4,453
Total Liabilities with the Public not Covered by Budgetary Resources	4,600	4,611
Total Liabilities not Covered By Budgetary Resources	4,613	4,637
Total Liabilities Covered by Budgetary Resources	71,717	65,751
Total Liabilities	$76,330	$70,388

Note 11. Future Funding Requirements

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

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

Note 12. Imputed Financing

Imputed Financing as of September 30, 2016 and 2015 consisted of the following (in thousands):

	2016	2015
Health Insurance	$2,516	$2,216
Life Insurance	8	8
Pension	1,061	1,296
Total Imputed Financing	$3,585	$3,520

Imputed financing recognizes actual cost of future benefits to be paid by other Federal entities. These benefits include Federal Employees Health and Benefits Program (FEHB), Federal Employees Group Life Insurance Program (FEGLI), and pensions. Imputed financing also recognizes costs paid by the Judgment Fund. The Fund was established and funded by Congress under 31 U.S.C. 1304 to pay in whole or in part court judgments and settlement agreements negotiated by Treasury on behalf of agencies, as well as certain types of administrative awards. The Judgment Fund did not pay out any awards on TTB's behalf during fiscal years 2016 or 2015.

TTB does not report CSRS assets, FERS assets, accumulated plan benefits, or unfunded liabilities, if any, applicable to retirement plans because the accounting for and reporting of such amounts is the responsibility of OPM. Based on cost factors provided by OPM, which vary by retirement plan, estimated future pension benefits for TTB employees, to be paid by OPM, totaled $1.1 million and $1.3 million for fiscal years 2016 and 2015 respectively. Similarly, OPM rather than TTB, reports liabilities for future payments to retired employees who participate in the FEHB and FEGLI programs. The FEHB cost factor applied to a weighted average number of employees enrolled in the FEHB program increased in FY 2016 to $6,266 from $5,469 in FY 2015, resulting in $2.5 million of imputed cost for employees' health benefits in FY2016 versus $2.2 million in FY 2015. The cost factor, as provided by OPM, for employees enrolled in the FEGLI program, remained unchanged from FY 2015 to FY 2016, at .02 percent of employees' basic pay. The FEGLI amounts totaling $8,000 for each fiscal year are also included as an expense and imputed financing source in TTB financial statements.

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

Consolidated Gross Cost and Earned Revenue by Budget Function Classification as of September 30, 2016 and 2015 consisted of the following (in thousands):

Fiscal Year Ended September 30, 2016

Activity	Budget Function Classification (BFC)	BFC Code	Gross Costs	Earned Revenue	Net Costs
Intragovernmental	Central Fiscal Operations	803	$29,320	$(3,295)	$26,025
With the Public	Central Fiscal Operations	803	88,319	(3,004)	85,315
Consolidated	Central Fiscal Operations	803	$117,639	$(6,299)	$111,340

Fiscal Year Ended September 30, 2015

Activity	Budget Function Classification (BFC)	BFC Code	Gross Costs	Earned Revenue	Net Costs
Intragovernmental	Central Fiscal Operations	803	$28,438	$(3,078)	$25,360
With the Public	Central Fiscal Operations	803	83,110	(3,013)	80,097
Consolidated	Central Fiscal Operations	803	$111,548	$(6,091)	$105,457

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

The following chart displays balances from the FY 2015 Statement of Budgetary Resources and actual fiscal year balances included in the FY 2017 President's Budget. There were no differences. The FY 2018 budget, which would include FY 2016 actuals, had not been published at the time of this report.

Fiscal Year Ended September 30, 2015 (in millions)	Statement of Budgetary Resources	President's Budget
Budgetary Resources:		
Appropriations	$100	$100
Spending Authority from Offsetting Collections	6	6
Budgetary Resources Available for Obligation	$106	$106
Change in Obligated Balances:		
Unpaid Obligations brought forward, Beginning of Period	$21	$21
New Obligations and Upward Adjustments	106	106
Outlays, Gross	(105)	(105)
Recoveries of Prior Year Unpaid Obligations	(1)	(1)
Unpaid Obligations, End of Period	$21	$21
Uncollected Payments, Federal Sources, End of Period	(2)	(2)
Obligated Balance, End of Period	$19	$19
Outlays:		
Outlays, Gross	$105	$105
Actual Offsetting Collections	(7)	(7)
Outlays, Net	$98	$98

Additionally, the FY 2017 President's Budget disclosed budget authority of $343 million for FY 2015, funding cover-over payments to Puerto Rico, which is not reported in the Statement of Budgetary Resources.

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

Note 15. Apportionment Categories of New Obligations and Upward Adjustments

New Obligations and Upward Adjustments as of September 30, 2016 and 2015 consisted of the following (in thousands):

Fiscal Year	Apportionment Category	Direct Obligations	Reimbursable Obligations	Total New Obligations and Upward Adjs
2016	Category B	$108,142	$5,733	$113,875
2015	Category B	$99,751	$6,155	$105,906

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

New Obligations and Upward Adjustments represents amounts that have been obligated or expended during each of the respective years. Whereas, Undelivered Orders represents the balance of obligations at the end of the respective years.

	2016	2015
Undelivered Orders, End of Year	$16,252	$14,811

Note 16. Net Custodial Revenue Activity

- **Excise Taxes**

  As an agent of the Federal Government and as authorized by 26 U.S.C., TTB collects excise taxes from alcohol, tobacco, firearms, and ammunition industries. In addition, special occupational taxes are collected from certain alcohol and tobacco businesses. During FY 2016 and FY 2015, TTB collected $22.1 billion and $22.3 billion respectively in taxes, interest, and other custodial revenues.

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

- **Refunds and Other Payments**

  During FY 2016 and FY 2015, TTB issued $815 million and $685 million in refunds, cover-over payments, and drawback payments in the respective years.

Tax Refunds

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

Cover-over Payments

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

TTB maintains operations in Puerto Rico to enforce the provisions of chapter 51 in respect to items of Puerto Rican manufacture brought in to the United States. These operations include conducting annual revenue, application, and product integrity investigations of large alcohol and tobacco industry members. Except for application investigations, TTB investigates medium and small alcohol and tobacco producers in response to specific problems and risk indicators. Revenue inspections are used to verify that TTB is collecting all of the revenue that is rightfully due from the taxpayer. TTB staff in Puerto Rico also conducts qualification inspections of all distilled spirits producers/processors, wineries, wholesalers, importers, Manufacturer of Nonbeverage Products (MNBP) claimants, and Specially Denatured Alcohol permit applicants. All costs associated with the functioning and supporting of the Puerto Rico office, $3.0 and $3.1 million in FY 2016 and FY 2015 respectively, are offset against the cover-over payments made by the United States to Puerto Rico.

Drawbacks

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

Refunds, Drawbacks and Cover-over Payments as of September 30, 2016 and 2015 consisted of the following (in thousands):

	2016	2015
Alcohol, Tobacco, and Firearms Excise Tax Refunds	$34,799	$27,776
Drawbacks on MNBP Claims	355,668	306,640
Interest and Other Payments	162	151
Refunds and Drawbacks	390,629	334,567
Cover-over Payments - Puerto Rico	416,815	343,429
Cover-over Payments - Virgin Islands	7,975	7,093
Amounts Provided to Non-federal Entities	424,790	350,522
Total Refunds, Drawbacks and Coverover Payments	$815,419	$685,089

Note 17. Custodial Revenue

Collection and Disposition of Custodial Revenue as of September 30, 2016 and 2015 consisted of the following (in thousands):

FY 2016 Collections and Refunds by Tax Year and Type

Revenue Type	2016	2015	2014	Pre-2014	FY 2016 Total
Excise Taxes	$16,097,312	$5,991,266	$3,394	$6,192	$22,098,164
Fines, Penalties, Interest and Other	486	351	564	1,079	2,480
Total Revenue Received	16,097,798	5,991,617	3,958	7,271	22,100,644
Less: Amounts Collected for Non-federal Entities	(424,790)	-	-	-	(424,790)
Total	$15,673,008	$5,991,617	$3,958	$7,271	$21,675,854
Refund Type					
Excise Taxes	$156,827	$227,819	$2,699	$3,122	$390,467
Fines, Penalties, Interest and Other	1	43	13	105	162
Total Refunds & Drawbacks	156,828	227,862	2,712	3,227	390,629
Amounts Provided to Fund the Federal Government	$15,516,180	$5,763,755	$1,246	$4,044	$21,285,225

FY 2015 Collections and Refunds by Tax Year and Type

Revenue Type	2015	2014	2013	Pre-2013	FY 2015 Total
Excise Taxes	$16,310,546	$5,926,009	$3,927	$16,802	$22,257,284
Fines, Penalties, Interest and Other	572	470	267	628	1,937
Total Revenue Received	16,311,118	5,926,479	4,194	17,430	22,259,221
Less: Amounts Collected for Non-federal Entities	(350,522)	-	-	-	(350,522)
Total	$15,960,596	$5,926,479	$4,194	$17,430	$21,908,699
Refund Type					
Excise Taxes	$158,696	$172,085	$2,158	$1,495	$334,434
Fines, Penalties, Interest and Other	2	91	28	12	133
Total Refunds & Drawbacks	158,698	172,176	2,186	1,507	334,567
Amounts Provided to Fund the Federal Government	$15,801,898	$5,754,303	$2,008	$15,923	$21,574,132

Note 18. Reconciliation of Net Cost of Operations to Budget

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

Reconciliation of Net Cost of Operations to Budget, as of September 30, 2016 and 2015 consisted of the following (in thousands):

	2016	2015
Resources Used to Finance Activities		
Budgetary Resources Obligated		
Obligations Incurred	$113,875	$105,906
Less: Spending Authority from Offsetting Collections and Recoveries	(6,846)	(7,337)
Obligations Net of Offsetting Collections and Recoveries	107,029	98,569
Less: Offsetting Receipts	(1)	(6)
Net Obligations	107,028	98,563
Other Resources		
Imputed Financing from Costs Absorbed by Others	3,585	3,520
Other Resources	-	(2)
Net Other Resources Used to Finance Activities	3,585	3,518
Total Resources Used to Finance Activities	$110,613	$102,081

	2016	2015
Resources Used to Finance Items not Part of the Net Cost Of Operations		
Change in Budgetary Resources Obligated for Goods, Services and Benefits Ordered but not Yet Provided (+/-)	$2,037	$(939)
Resources that Fund Expenses Recognized in Prior Periods	35	25
Other Budgetary Offsetting Collections and Receipts that do not Affect Net Cost of Operations	(1)	(6)
Resources that Finance the Acquisition of Assets	1,152	1,733
Total Resources Used to Finance Items not Part of the Net Cost of Operations	3,223	813
Total Resources Used to Finance the Net Cost of Operations	$107,390	$101,268
Components of the Net Cost of Operations Requiring or Generating Resources in Future Periods		
Components Requiring or Generating Resources in Future Periods:		
Other (+/-)	$16	$33
Total Components of Net Cost of Operations that will Require or Generate Resources in Future Periods	$16	$33
Components of the Net Cost of Operations not Requiring or Generating Resources		
Depreciation and Amortization	$3,874	$4,151
Revaluation of Assets or Liabilities	60	4
Other (+/-)	-	1
Total Components of Net Cost of Operations that will not Require or Generate Resources	$3,934	$4,156
Total Components of Net Cost of Operations that will not Require or Generate Resources in the Current Period	$3,950	$4,189
NET COST OF OPERATIONS	$111,340	$105,457

Note 19: Contingent Liabilities

As of September 30, 2016, TTB is not party to any legal matters where the likelihood of a material loss is reasonably possible.

Required Supplementary Information (Unaudited)

Budgetary Information

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

Excise Tax and Other Collections

Required Supplementary Information
Excise Tax and Other Collections by Fiscal Year
Unaudited (In Thousands)

Fiscal Year	Alcohol	Tobacco	FAET	SOT	FST	Other	Total
2007	$7,232,138	$7,194,081	$287,835	$2,808	$ -	$32	$14,716,894
2008	7,420,576	6,851,705	312,622	448	-	634	14,585,985
2009	7,424,292	11,548,504	452,693	272	1,192,375	970	20,619,106
2010	7,476,789	15,913,479	360,813	300	8,558	180	23,760,119
2011	7,594,330	15,515,073	344,262	268	5,220	2,257	23,461,410
2012	7,856,391	15,002,616	514,622	249	5,942	61	23,379,881
2013	7,851,953	14,321,017	762,836	280	1,521	38	22,937,645
2014	7,924,951	13,552,711	768,927	332	465	2	22,247,388
2015	7,997,467	13,620,497	638,518	288	2,444	7	22,259,221
2016	8,075,476	13,274,371	749,789	258	245	505	22,100,644
Average	$7,685,436	$12,679,405	$519,292	$550	$121,677	$469	$21,006,829

FAET – Firearms and Ammunition Excise Tax

SOT – Special Occupational Tax

FST – Floor Stocks Tax

TTB collects FAET taxes on behalf of the Department of Interior, U.S. Fish and Wildlife Service, and deposits the collections directly into the Fish and Wildlife Restoration Fund. During fiscal years 2016 and 2015, TTB incurred $1.8 million and $1.6 million respectively of direct and indirect costs associated with collecting the FAET taxes. The law currently does not provide for TTB to recover these costs. The cost of the program was communicated to the U.S. Fish and Wildlife Service so the agency could properly record an imputed cost in its financial records.

Refunds, Cover-over Payments, and Drawback Payments

Required Supplementary Information
Refunds, Cover-over Payments and Drawback Payments by Fiscal Year
Unaudited (In Thousands)

Fiscal Year	Cover-over Puerto Rico	Cover-over Virgin Islands	AT&F Excise Tax	Drawbacks MNBP Claims	Interest and Other	Total
2007	$459,278	$8,054	$13,208	$335,706	$972	$817,218
2008	373,418	7,615	14,125	283,462	2,938	681,558
2009	472,695	8,624	17,791	268,612	252	767,974
2010	378,186	8,871	28,232	297,596	315	713,200
2011	452,040	9,592	33,414	306,584	418	802,048
2012	376,373	9,337	30,293	289,330	3,824	709,157
2013	349,017	8,706	35,278	345,231	452	738,684
2014	303,457	8,279	40,600	316,040	358	668,734
2015	343,429	7,093	27,776	306,640	151	685,089
2016	416,815	7,975	34,799	355,668	162	815,419
Average	$392,471	$8,415	$27,552	$310,487	$984	$739,908

AT&F – Alcohol, Tobacco, and Firearms

MNBP – Manufacturer of Nonbeverage Products

Other Accompanying Information (Unaudited)

Other Accompanying Information
Combined Schedule of Spending
For the Years Ended September 30, 2016 and 2015
Unaudited (In Thousands)

	2016	2015
What Money is Available to Spend		
Total Resources	$116,591	$111,070
Less: Amount Available but not Agreed to be Spent	(345)	(1,573)
Less: Amount Not Available to Be Spent	(2,371)	(3,591)
Total Amounts Agreed to be Spent	$113,875	$105,906
How was the Money Spent		
Collect the Revenue		
Object Class 11: Personnel Compensation	$24,419	$23,637
Object Class 12: Personnel Benefits	7,804	7,342
Object Class 21: Travel	1,325	1,347
Object Class 23: Rent, Utilities, and Telecommunications Services	2,930	2,961
Object Class 25: Contractual Services	17,732	16,657
Object Class 31: Equipment and Software	2,422	2,531
Other	410	585
Total Collect the Revenue	57,042	55,060
Protect the Public		
Object Class 11: Personnel Compensation	24,322	23,902
Object Class 12: Personnel Benefits	7,587	7,173
Object Class 21: Travel	521	581
Object Class 23: Rent, Utilities, and Telecommunications Services	2,840	2,678
Object Class 25: Contractual Services	15,740	13,376
Object Class 31: Equipment and Software	1,976	1,305
Other	488	372
Total Protect the Public	53,474	49,387
Total Spending	110,516	104,447
Change in Amounts Remaining to be Spent	3,359	1,459
Total Amounts Agreed to be Spent	$113,875	$105,906
Who did the Money go to		
Federal Recipients	$25,723	$25,071
Non-Federal Recipients	84,793	79,376
Total Spending	110,516	104,447
Change in Amounts Remaining to be Spent	3,359	1,459
Total Amounts Agreed to be Spent	$113,875	$105,906

Intragovernmental Assets

Other Accompanying Information
Intragovernmental Assets
As of September 30, 2016
Unaudited (In Thousands)

Trading Partner	Agency Code	Fund Balance W/ Treasury	Accounts Receivable
Department of Agriculture	012	$-	$50
Department of the Treasury	020	-	253
General Fund	--	44,583	19,210
Total		$44,583	$19,513

Other Accompanying Information
Intragovernmental Assets
As of September 30, 2015
Unaudited (In Thousands)

Trading Partner	Agency Code	Fund Balance W/ Treasury	Accounts Receivable
Department of Agriculture	012	$-	$19
Department of the Treasury	020	-	229
Department of Health and Human Services	075	-	27
General Fund	--	43,215	14,209
Total		$43,215	$14,484

Intragovernmental Liabilities

Other Accompanying Information
Intragovernmental Liabilities
As of September 30, 2016
Unaudited (In Thousands)

Trading Partner	Agency Code	Accounts Payable	Accrued FECA	Custodial and Other Liabilities
Government Printing Office	004	$6	$-	$-
Department of the Interior	014	-	-	6,750
Department of Justice	015	546	-	-
Department of Labor	016	-	13	-
US Postal Service	018	6	-	-
Department of the Treasury	020	73	-	-
Office of Personnel Management	024	28	-	393
General Services Administration	047	130	-	-
General Fund	--	-	-	18,673
Total		$789	$13	$25,816

Other Accompanying Information
Intragovernmental Liabilities
As of September 30, 2015
Unaudited (In Thousands)

Trading Partner	Agency Code	Accounts Payable	Accrued FECA	Custodial and Other Liabilities
Government Printing Office	004	$95	$-	$-
Department of the Interior	014	-	-	4,946
Department of Justice	015	385	-	-
Department of Labor	016	-	26	-
US Postal Service	018	11	-	-
Department of the Treasury	020	56	-	-
Office of Personnel Management	024	-	-	289
General Services Administration	047	289	-	-
Department of Defense	097	67	-	-
General Fund	--	-	-	21,222
Total		$903	$26	$26,457

Intragovernmental Earned Revenue

Other Accompanying Information
Intragovernmental Earned Revenue
For the Fiscal Years Ended September 30, 2016 and 2015
Unaudited (In Thousands)

Trading Partner	Agency Code	2016	2015
Department of Agriculture	012	$50	$18
Department of Treasury	020	3,151	2,951
Department of Health and Human Services	075	94	109
Total		$3,295	$3,078

Budget Function Classification (BFC)	BFC Code	2016	2015
Central Fiscal Operations	803	$3,295	$3,078
Total		$3,295	$3,078

Intragovernmental Gross Cost

Other Accompanying Information
Intragovernmental Gross Cost
For the Fiscal Years Ended September 30, 2016 and 2015
Unaudited (In Thousands)

Trading Partner	Agency Code	2016	2015
Library of Congress	003	$59	$63
Government Printing Office	004	214	211
Department of Commerce	013	1	2
Department of Interior	014	42	44
Department of Justice	015	794	794
Department of Labor	016	6	27
United States Postal Services	018	29	35
Department of the Treasury	020	5,866	5,437
Office of Personnel Management	024	13,976	13,149
General Services Administration	047	4,656	5,127
Department of the Air Force	057	7	-
Department of Homeland Security	070	298	284
Department of Health and Human Services	075	18	34
National Archives Records Administration	088	36	56
Department of Defense	097	43	38
General Fund	--	3,275	3,137
Total		$29,320	$28,438

During fiscal years 2016 and 2015, TTB incurred costs with other Federal agencies totaling approximately $29.3 million and $28.4 million, in each year respectively. The majority of those costs were associated with the five entities detailed below.

- **Department of Justice**: TTB paid ATF $794,000 in each of fiscal years 2016 and 2015 respectively, for shared lab space and shared building services.
- **Department of the Treasury:** The Bureau received law enforcement services from the IRS, as well as administrative services from the Bureau of the Fiscal Service's Administrative Resource Center, in fiscal years 2016 and 2015 in the amounts of $5.9 million and $5.4 million respectively.
- **Office of Personnel Management:** TTB incurred $14.0 million and $13.1 million in costs for employee benefits during fiscal years 2016 and 2015 respectively.
- **General Services Administration:** TTB paid $4.7 million and $5.1 million to GSA for rent and information technology services in fiscal years 2016 and 2015 respectively.
- **General Fund:** The Bureau paid $3.3 and $3.1 million, in fiscal years 2016 and 2015 respectively, for employee benefits and lockbox fees.

Part IV: Appendices

Principal Officers of TTB

Administrator. . . . . John Manfreda

Deputy Administrator . . . . Mary Ryan

Chief of Staff. . . . . Elisabeth Kann

Assistant Administrator, Field Operations . . . . Tom Crone

Assistant Administrator, Headquarters Operations . . . . .Theresa McCarthy

Assistant Administrator, Management/CFO . . . . Cheri Mitchell

Assistant Administrator, Information Resources/CIO . . . . Robert Hughes

Executive Liaison for Industry and State Matters . . . . .Susan Evans

Equality, Diversity, and Inclusion . . . . .Tram-Tiara Ngo

Strategic Planning and Program Evaluation . . . . Jill Murphy

Congressional and Public Affairs . . . . .Tom Hogue

Chief Counsel . . . . .Anthony Gledhill

For additional information, contact:

Alcohol and Tobacco Tax and Trade Bureau

1310 G Street, NW, Box 12

Washington, DC 20005

(202) 453-2000

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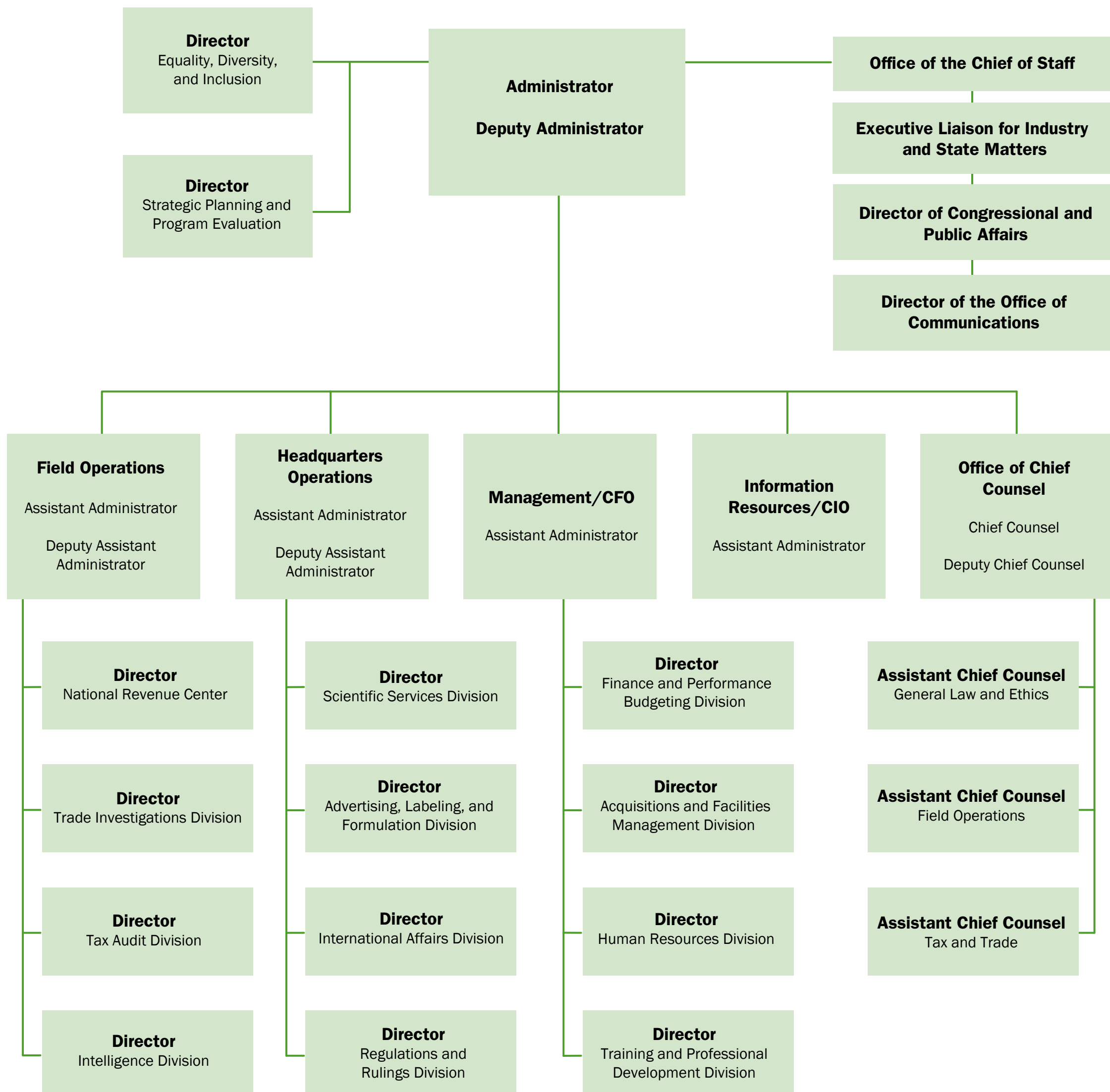
TTB Organization Chart



Connecting the Treasury and TTB Strategic Plans

TREASURY GOALS	TTB STRATEGIC GOALS	TTB OBJECTIVES
TREASURY STRATEGIC GOAL: Promote domestic economic growth and stability while continuing reforms of the financial system	**PROTECT THE PUBLIC (PTP):** Alcohol and tobacco industry operators meet permit qualifications, and alcohol beverage products comply with federal production, labeling, and marketing requirements	**PTP 1. BUSINESS INTEGRITY:** Ensure that only qualified persons and business entities operate within the industries TTB regulates **PTP 2. PRODUCT INTEGRITY:** Ensure that alcohol beverage products comply with federal production, labeling, and advertising requirements **PTP 3. MARKET INTEGRITY:** Ensure fair trade practices throughout the alcohol beverage marketplace
TREASURY STRATEGIC GOAL: Fairly and effectively reform and modernize federal financial management, accounting, and tax systems	**COLLECT THE REVENUE (CTR):** Enforce the tax code to ensure proper federal tax payment on alcohol, tobacco, firearms, and ammunition products	**CTR 1. TAX VERIFICATION AND VALIDATION:** Assure voluntary compliance in the timely and accurate remittance of tax payments **CTR 2. CIVIL AND CRIMINAL ENFORCEMENT:** Detect and address noncompliance, excise tax evasion, and other criminal violations of the Internal Revenue Code in the industries TTB regulates
TREASURY STRATEGIC GOAL: Create a 21st–century approach to government by improving efficiency, effectiveness, and customer interaction	**MANAGEMENT AND ORGANIZATIONAL EXCELLENCE (MGT):** Maximize performance, efficiency, and program results through effective resource and human capital management	**MGT 1. HUMAN CAPITAL MANAGEMENT:** Maintain a qualified, engaged, and satisfied workforce **MGT 2. TECHNOLOGY SOLUTIONS:** Deliver effective, streamlined, and flexible IT solutions that add value and support program performance **MGT 3. FINANCE AND PERFORMANCE RESULTS:** Facilitate strategic management and financial accountability through the delivery of timely and reliable financial and performance information

Note: *TTB revised its goals and objectives in FY 2012, and is operating under these goals until the publication of its revised strategic plan.*

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