Alcohol and Tobacco Tax and Trade Bureau

Annual Report

Fiscal Year 2017

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Table of Contents

Introduction i

Message from the Administrator iii

Vision, Mission, and Values iv

TTB Strategic Goals and Objectives v

TTB Office Locations vi

Part I: Management's Discussion and Analysis 1

1.1 Profile of a Bureau 1

1.2 Performance Highlights 3

1.3 Financial Highlights 29

1.4 FY 2017 Bureau Budget 31

1.5 Bureau Challenges 33

Part II: Program Performance Results 35

2.1 Performance Overview 35

2.2 Summary of Collect the Revenue Performance 36

2.3 Summary of Protect the Public Performance 38

2.4 Summary of Management and Organizational Excellence Performance 42

Message from the Chief Financial Officer 49

Part III: Financial Results, Position, Condition, and Auditors' Reports 51

3.1 Budget Highlights by Fund Account 51

3.2 Linking Budget and Program Spending 53

3.3 Management's Responsibility for Enterprise Risk Management and Internal Control 57

3.4 Auditor's Reports, Financial Statements, and Accompanying Notes 62

Independent Auditors' Reports 62

Financial Statements 67

Notes to the Financial Statements 73

3.5 Supplemental Information 93
Required Supplementary Information (Unaudited) 93
Other Accompanying Information (Unaudited) 95

Part IV: Appendices 101
4.1 Principal Officers of TTB 101
4.2 TTB Organization Chart 102
4.3 Connecting the Treasury and TTB Strategic Plans 103

Introduction

Within its FY 2017 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, 2017, and September 30, 2016, 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

On countless occasions over the course of my career, I have been profoundly proud of the dedication and accomplishments of my colleagues in the federal service, but never more so than this past year.

We began the year with significant performance challenges and with clear mandates from industry and congressional stakeholders to improve our service, reduce compliance burden, and increase enforcement. Using a data driven approach and strategically investing our resources, we demonstrated our ability to produce results in key programs that facilitate trade and support economic growth.

For those already in the business of producing or distributing alcohol products, label and formula approval times were presenting a barrier to effectively running and growing their business. Through a combination of strategic initiatives, as well as an infusion of resources to bring on additional staff, we reduced our turnaround times from approximately 30 days for each of these required approvals in FY 2016 to less than 10 days this year.

For those looking to open a business, obtaining a federal permit to begin operating was a cumbersome and costly process, with lengthy approval times placing their investment at risk and delaying small business growth. Through comprehensive changes to our permit business processes, and continuing to focus on customer service, we were able to cut permit approval times in half for alcohol producers, from a high of over 200 days in FY 2016 to under 100 days at year-end. We expect to maintain these improvements going forward, with additional efficiencies and improved service levels anticipated from the redesigned Permits Online system that will be released in FY 2018.

We also remain committed to effective tax administration that minimizes burden while ensuring revenue protection. A major step forward this year came from the successful implementation of the Protecting Americans from Tax Hikes Act, which decreased burdens for eligible small alcohol beverage manufacturers by reducing the tax return filing and payment frequency and eliminating the requirement to obtain a bond for these taxpayers.

At the same time, our enforcement efforts have never been more focused, with the use of multi-disciplined teams, effective law enforcement partnerships, and advanced analytic tools to detect and address those that flout their tax obligations. Relying on these proven techniques, and with additional resources, we also expanded our enforcement of prohibited anti-competitive practices in the trade of alcohol beverages. This work to ensure a fair and competitive marketplace has never been more relevant given the continued expansion of the alcohol industry.

Looking ahead, we will continue to focus on conducting our operations in the most efficient way and creating a level playing field where all can thrive. These are more than words – it is our regulatory and enforcement philosophy. While FY 2017 marked a turning point in our performance, given the creativity and commitment of the TTB team that I have witnessed this past year, I expect to demonstrate continued progress and improved performance next year.

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

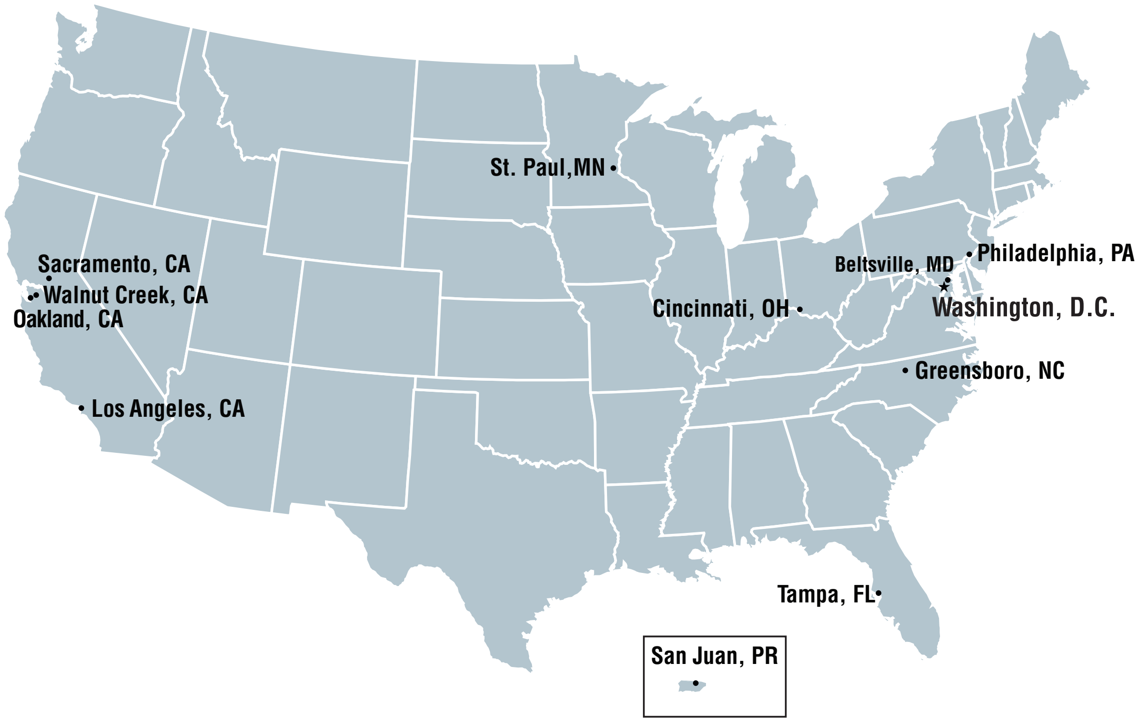
Effectively manage resources and human capital for maximum performance, efficiency, and program results

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



TTB at a Glance	FY 2016	FY 2017
Employees	494	507
Office Locations	12	12
Budget Authority	$106.4 Million	$111.4 Million
Revenue Collected	$22.1 Billion	$21.8 Billion

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

Part I:
Management's Discussion and Analysis

1.1 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 500 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 contain 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.

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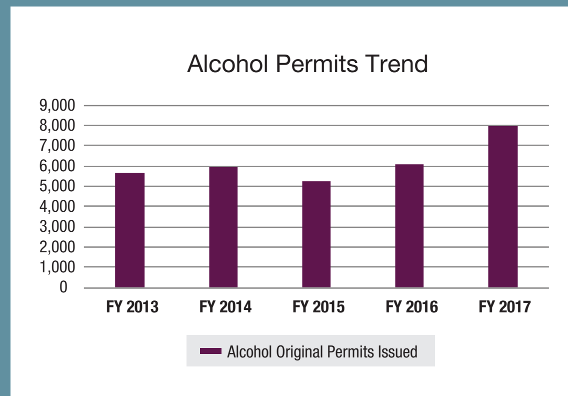
1 Chapters 51 and 52 of the IRC provide for excise taxation and authorize operations of alcohol and tobacco producers and related industries, and IRC sections 4181 and 4182 provide for excise taxes for firearms and ammunition.

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.

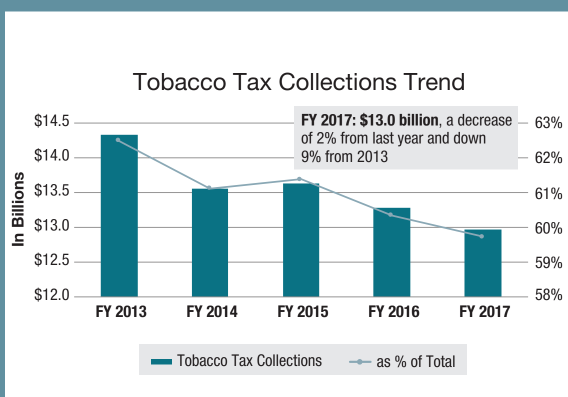
3 The ABLA mandates that a government warning statement appear on all alcohol beverages offered for sale or distribution in the United States.

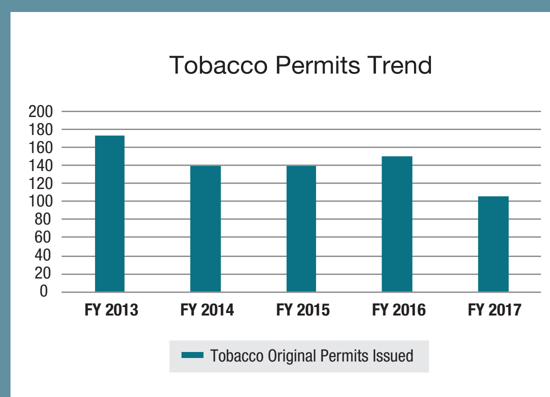
4 The Webb-Kenyon Act prohibits the shipment of alcohol beverages into a state in violation of that state's laws.

Alcohol Industry Snapshot

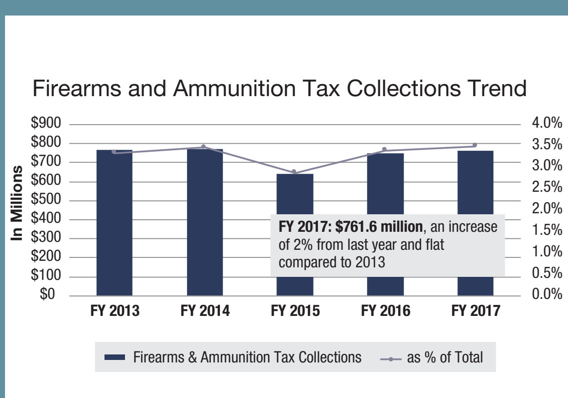


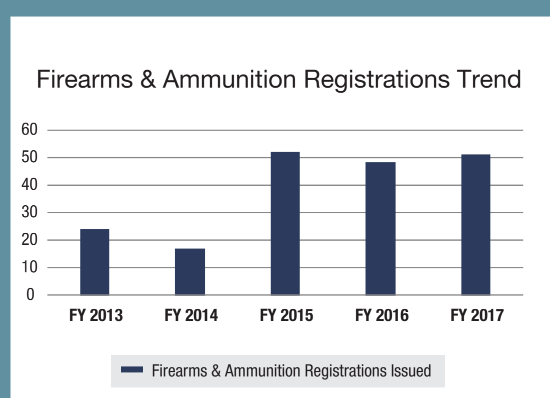
Tobacco Industry Snapshot





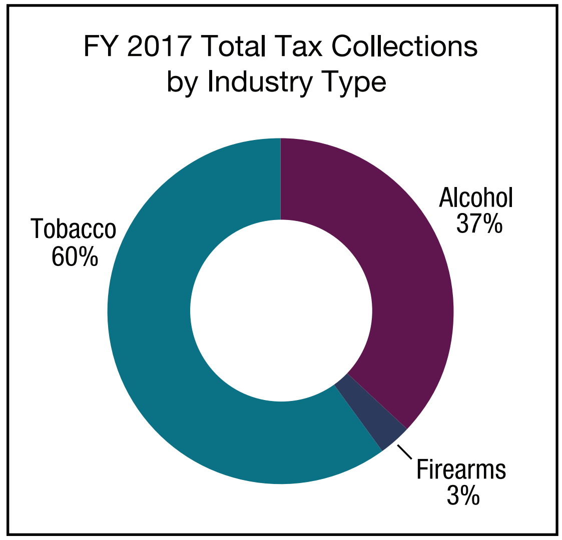
Firearms & Ammunition Industry Snapshot





1.2 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 approximately 60 percent of TTB's total excise tax collections.

In FY 2017, TTB collected nearly $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 to ensure the collection of revenue that is due.

The alcohol beverage industry in the United States accounts for approximately 37 percent of the excise tax revenue collected by TTB. In FY 2017, TTB collected more than $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. Further, while the number of wineries, breweries, and distilleries has increased significantly, the majority are small producers that may be eligible for reduced tax rates or tax credits depending on the commodity and production volume. This trend is expected to continue through FY 2018, although it may shift if pending legislation that would generally lower federal excise tax rates for alcohol beverage products, particularly for small producers, is enacted.

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 $313 million in FY 2008 to $762 million in FY 2017, an increase of $449 million over the past decade, or a 144 percent growth in tax revenue. Historically, increases in FAET revenue can be attributed to growth in sales due to external factors as well as TTB's enforcement presence, which 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 and investigations 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 seven 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.

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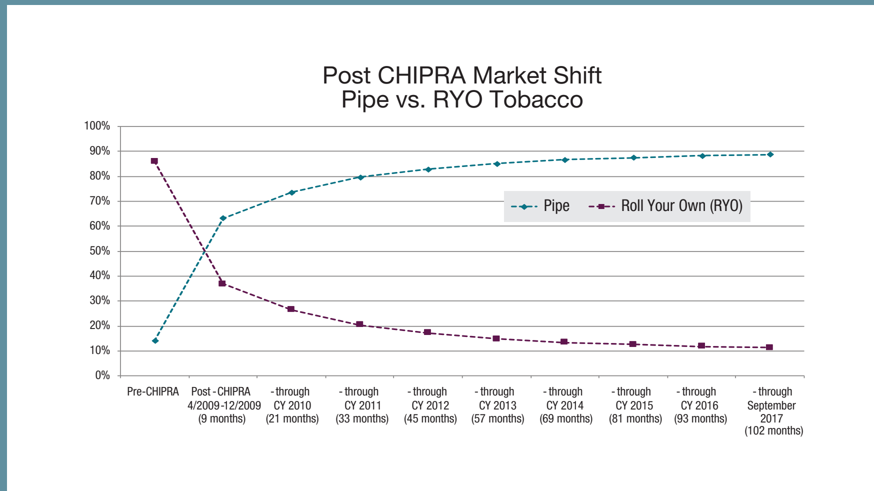
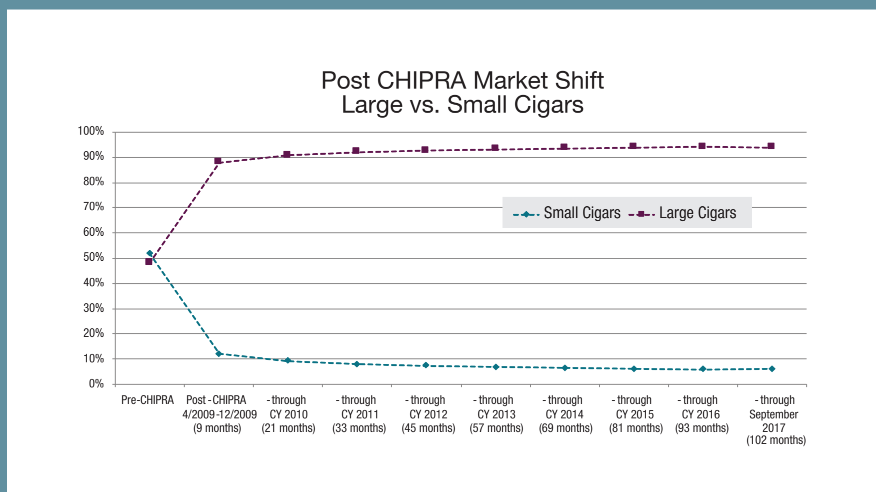
5 Prior to 2009, the tax rates on pipe tobacco and roll-your-own tobacco were the same at just under $1.10 per pound. Beginning in 2009, the tax on pipe tobacco was increased to just over $2.83 per pound, while the tax on roll-your-own tobacco was increased to $24.78 per pound.

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.

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 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 2017, TTB hosted delegations from India and Spain to provide information on the U.S. framework for alcohol regulation, including tax administration, enforcement methods, and export-related requirements.

Further, in FY 2017, TTB hosted multiple meetings as Chair of the Interagency Working Group to Combat Illicit Tobacco, a group created by the U.S. Department of State to facilitate information sharing and collaboration between agencies on reducing the domestic and international illicit tobacco trade. Participants include CBP, the Immigration and Customs Enforcement Homeland Security Investigations (HSI), the Bureau of Alcohol, Tobacco, Firearms and Explosives, the Federal Bureau of Investigation, and the Food and Drug Administration.

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 2017, 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. The research findings have been presented at the Cooperation Centre for Scientific Research Relative to Tobacco (CORESTA) Conference in Berlin, Germany, in support of international cooperation in tobacco science, and submitted for publication in a peer-reviewed scientific journal. TTB also continued its efforts to validate a method for the analysis of emerging products that claim to be tobacco-

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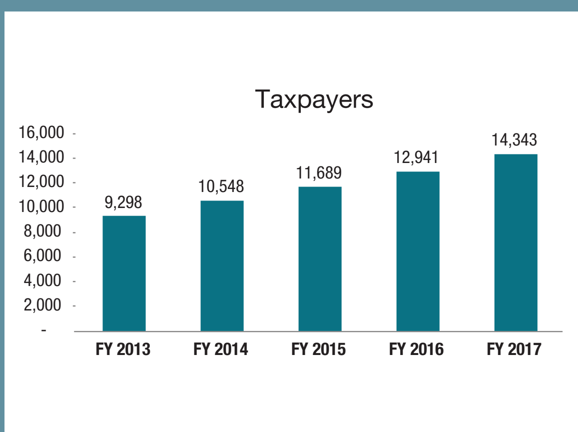
6 Large cigars are the only tobacco product for which the excise tax is based on the manufacturer or importer's sale price, up to a maximum amount; all other tobacco products are taxed at a flat rate based either on the number of units or the weight of the product. As a result, since the tax increase 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.

free, such as e-cigarettes and e-liquid, which could assist TTB in determining if these products are subject to its jurisdiction.

In FY 2017, TTB also participated in an international wine technical summit, 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 wine-producing and importing economies, such as Argentina, Australia, Canada, Chile, China, Georgia, Indonesia, Malaysia, Mexico, Peru, Thailand, and Vietnam, as well as new attendees from Kenya, South Africa, and Ukraine. The technical principles discussed during the international forum support a multi-year project to promote coherence in wine regulation throughout the Asia-Pacific region.

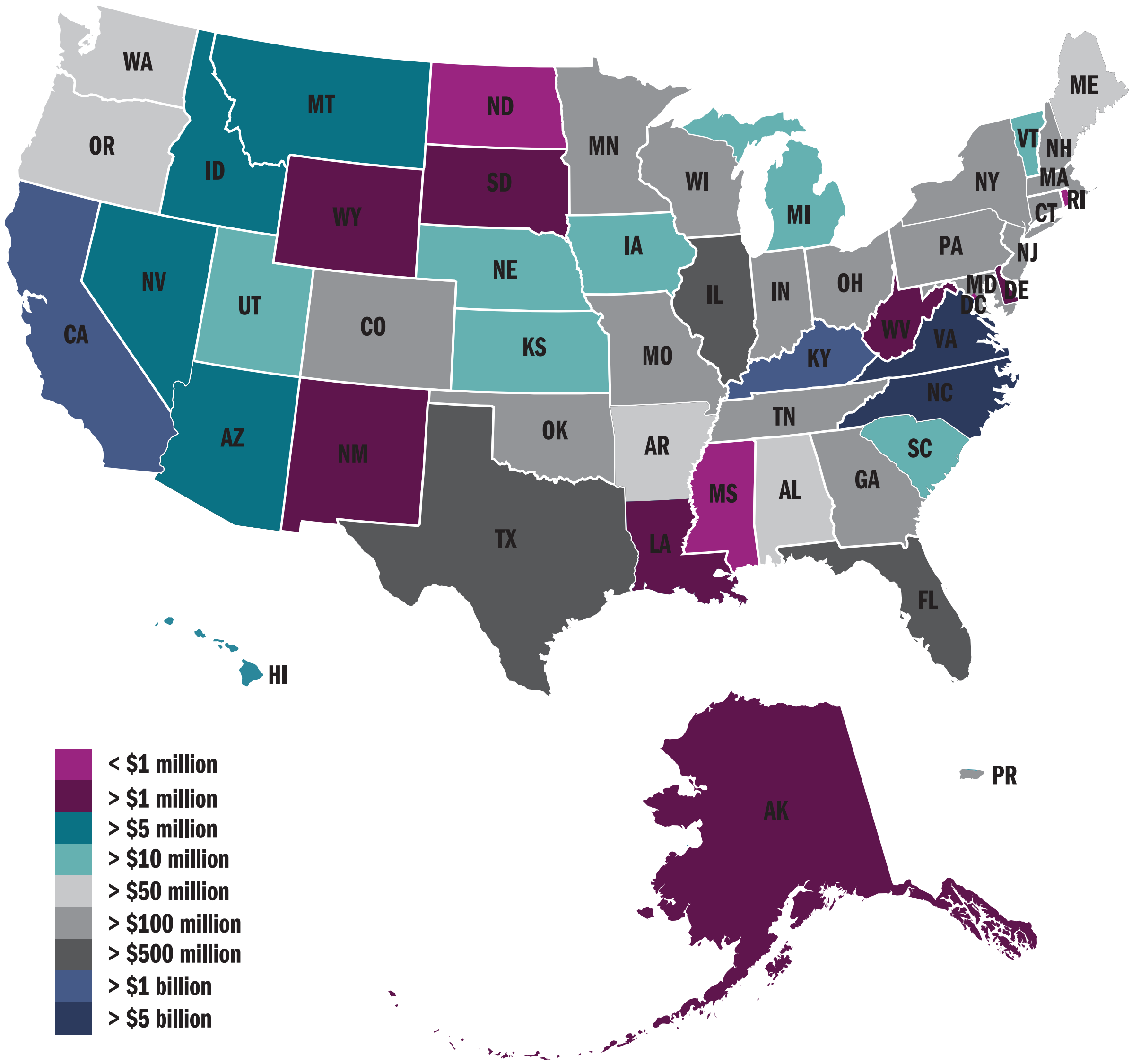
Tax Verification

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 its data-driven analyses, TTB continues to focus on identifying the highest risk activity for audits and investigations. Continuous refinements to these data analytic tools and sound intelligence enable TTB to efficiently deploy its enforcement resources to address the most serious revenue threats.



TTB regulates approximately 92,700 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. In the last five years, the number of taxpayers has increased more than 60 percent, with the TTB tax base growing by approximately 10 percent or more in FY 2017 for the seventh consecutive fiscal year.

FY 2017 Tax Collections by State



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 $550 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 2017, 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 2017, 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 more than $50 million in identified tax liabilities as well as criminal referrals.

In addition, given the 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). 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 2017, with the completion of a successful system pilot for importers and the publication of a final rule that fully implemented ITDS for all TTB-permitted importers in December 2016.

TTB intends to make progress in the export area in FY 2018. 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.

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 source of funding for criminal enterprises.

7 Represents the estimated tax liability for all exported bottled distilled spirits and cigarettes in calendar year 2016.

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.[8] 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 market, 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.

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 Investigations division, TTB's criminal enforcement program has exhibited notable results. Since 2011, TTB has opened a total of 150 cases, with identified liabilities of approximately $613 million in estimated alcohol, tobacco, firearms, and ammunition excise taxes and approximately $125 million in criminal seizures. To date, approximately 98 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 United States, 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

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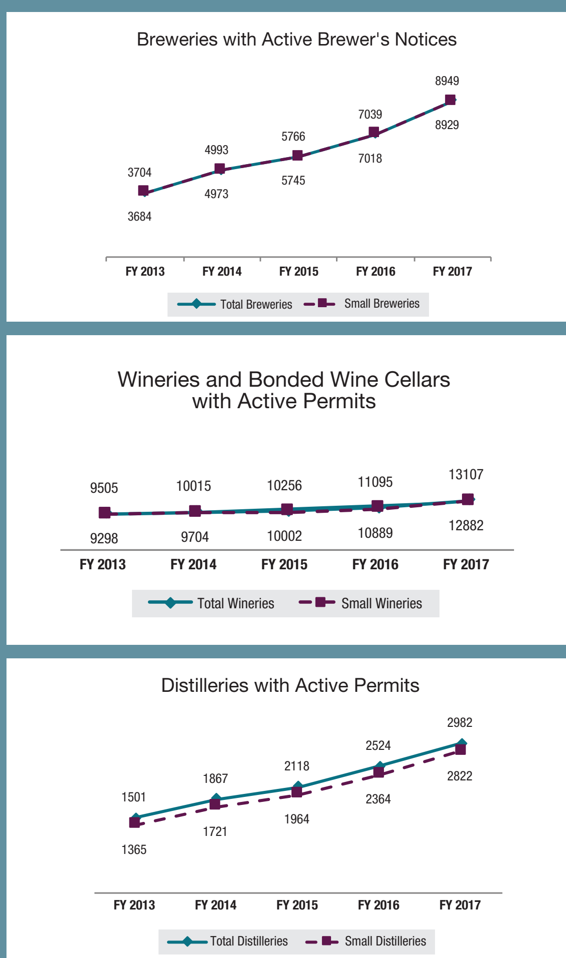
8 Illicit Tobacco: Various Schemes are Used to Evade Taxes and Fees," U.S. Government Accountability Office, GAO-11-313, March 2011.

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 approximately 8,000 applications for an original permit or registration. Today, the Bureau regulates more than 92,700 industry members.

Under its statutory authority, TTB evaluates applications prior to approval 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 engaging in illicit activity.

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

Growth in Alcohol Producers



The number of U.S. wineries, breweries, and distilleries continues to increase. Since 2013, the number of permitted wineries has grown nearly 40 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 over 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 permitted distillers, which has nearly doubled in the last five years. 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 107 percent since 2013. This data reflects all permits with potential activity.

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 2017, TTB received approximately 8,800 applications for a federal permit or registration, and qualified approximately 6,850 new business operations. These are predominantly small businesses, which contribute to local job opportunities and often lead the industry in product innovation.

In recent years, industry growth in the number of alcohol beverage producers, driven by a boom in small breweries, distilleries, and wineries, has contributed to delays in permit approval 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 2017, approximately 60 percent of new permit applications were returned to applicants for correction or additional information.

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 have climbed, reaching a high of 85 percent in FY 2017, the average processing time for a new permit application has increased, nearly doubling from 65 days in FY 2010 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 40 percent, and TTB resources have not kept up with this level of demand for its services.

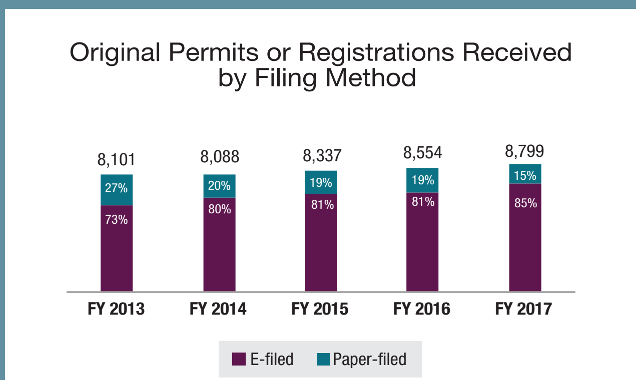
Given these challenges, TTB established a priority project to improve its business qualification process, which includes comprehensive changes to its systems, policies, and practices to streamline this critical line of business. A series of business process changes that began in FY 2016 culminated this fiscal year in major improvements in approval times for permit applications, with TTB reducing processing times from a high of over 200 days in FY 2016 to an average of 96 days for new breweries, wineries, and distilleries at the end of FY 2017.

Additionally, in FY 2017, TTB continued its development of a redesigned version of Permits Online. The new design, scheduled for release in FY 2018, will enhance usability for industry members and improve the compliance rate of submissions, reducing resubmitted applications and the overall workload volume that is contributing to delays. The redesigned system will also improve the ease of amendment filing for existing Permits Online users and enable the more than 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 approval times for the businesses it serves.

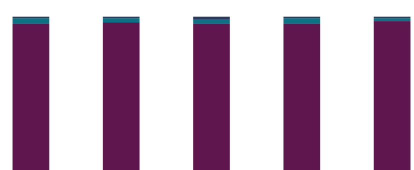
TTB also will continue to update its procedures used to screen permit applicants, refining its risk criteria and modeling used to vet applicants for suitability to hold a federal permit in the alcohol and tobacco industries. Increased focus on risk modeling and statistical sampling will help to ensure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

TTB also recognized the need for broader changes in this core line of business to meet the growing demand and, in FY 2017, the Bureau initiated an evaluation of its permit application requirements. TTB intends to proceed with revisions to its permit applications in FY 2018, which include removing certain filing requirements entirely, reducing supporting documentation requested for certain elements of the application, and streamlining the application questions. While this modernization effort will be a multi-year initiative, requiring both rulemaking and system enhancements to fully implement, initial burden-reducing efforts are planned for FY 2018, and the ultimate result will be substantial and sustained reductions to the filing burden for industry as well as improved permit approval times.

Permitting Stats



Original Permits Issued by TTB



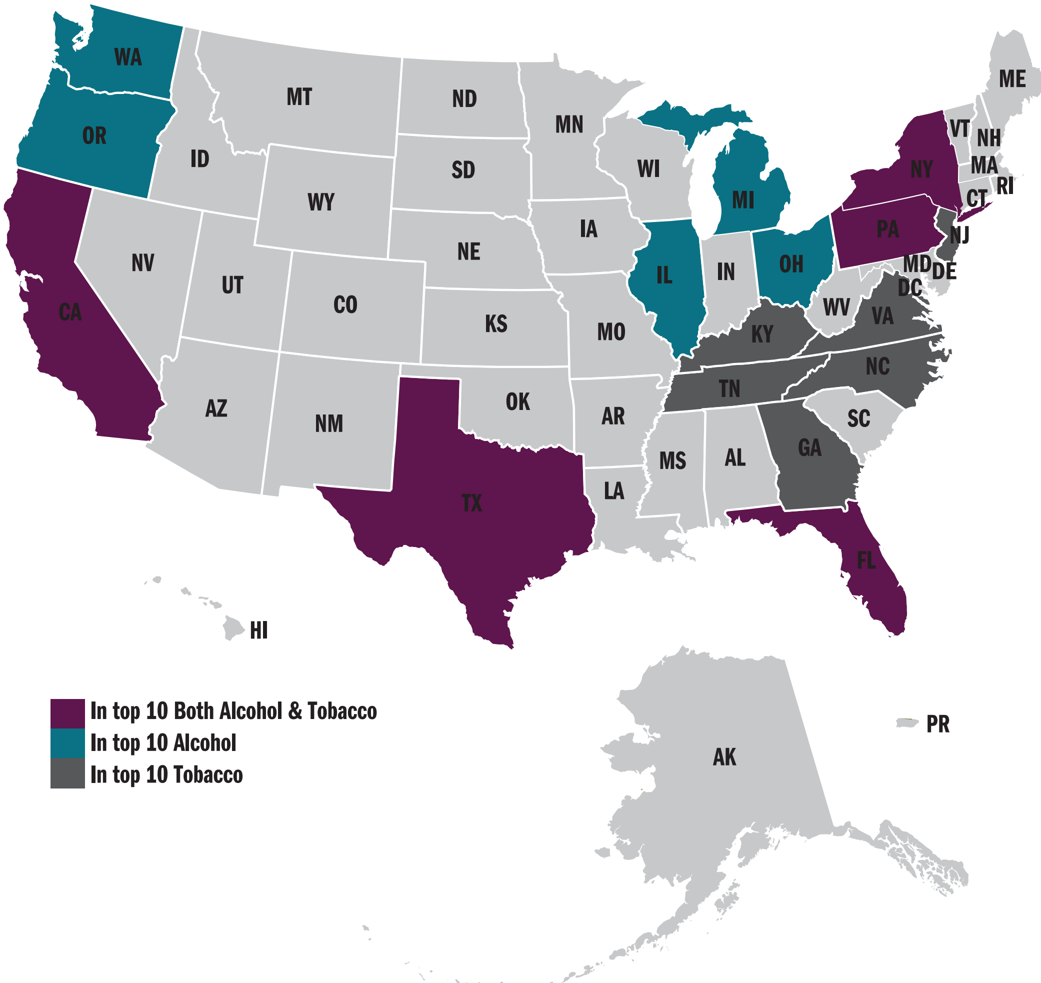
	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
Firearms	24	17	52	48	51
Tobacco	174	140	140	151	106
Alcohol	5,660	5,959	5,261	6,050	7,946

Since FY 2010, the industries that TTB permits and regulates have rapidly expanded. Each year since FY 2012, TTB has received more than 8,000 permit applications or registrations annually, driven in large part by growth in the number of small wineries, breweries, and distilleries.

In FY 2017, TTB issued more than 8,100 permits and registrations, primarily to new alcohol beverage producers importers, and wholesalers.

Electronic filing rates remain high, increasing to 85 percent in FY 2017. TTB expects the electronic filing rate to increase following the next release of the Permits Online in FY 2018.

FY 2017 Permittees by State



Top 10 States by Number of Alcohol Permits	
State	**# Permit Holders**
California	8,567
New York	2,239
Washington	2,219
Texas	1,837
Pennsylvania	1,651
Oregon	1,465
Florida	1,234

Top 10 States by Number of Tobacco Permits	
State	**# Permit Holders**
Florida	248
California	100
North Carolina	86
New York	73
Virginia	50
Texas	49
New Jersey	37
Pennsylvania	35
Kentucky	27
Georgia & Tennessee	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 the 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.

These functions fall 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.

Modernizing the Alcohol Beverage Labeling Program

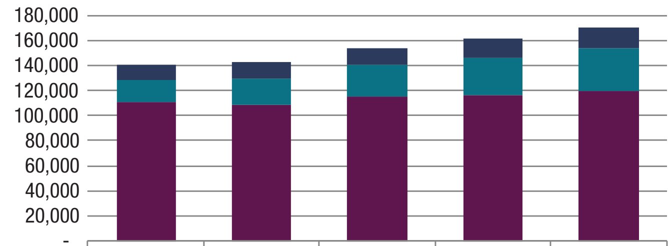
In FY 2017, TTB received approximately 170,000 label applications and 14,500 formula applications. The rapid expansion of the alcohol beverage industry, combined with market trends toward formulated products, have contributed to the high volume of applications.

Recognizing this trend, TTB has implemented policy changes since FY 2012 to reduce label and formula applications without compromising its market protection role, issuing guidance to exempt certain alcohol 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; however, industry trends have resulted in increased submissions that have offset these reductions. Since last year, label applications increased another 6 percent, reaching a new historic high. Formula applications held relatively constant with the prior year, despite several policy changes issued since FY 2014 to eliminate the formula approval requirement

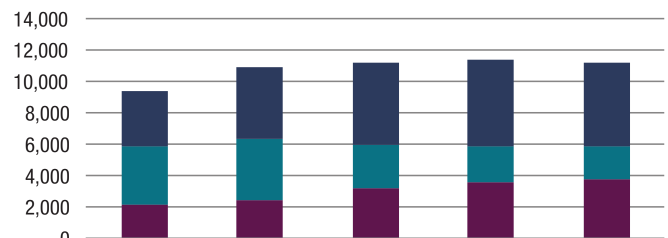
Volume of Label and Formula Submissions by Commodity

Alcohol Beverage Label Applications by Commodity



	2013	2014	2015	2016	2017
Distilled Spirits	12,389	12,984	12,986	15,107	16,096
Malt Beverage	17,602	20,629	25,398	29,798	34,166
Wine	110,330	108,827	115,483	116,126	119,782

Alcohol Beverage Formula Applications by Commodity*



	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
Distilled Spirits	3,459	4,539	5,271	5,521	5,280
Malt Beverages	3,733	3,861	2,759	2,302	2,057
Wine	2,183	2,512	3,203	3,629	3,845

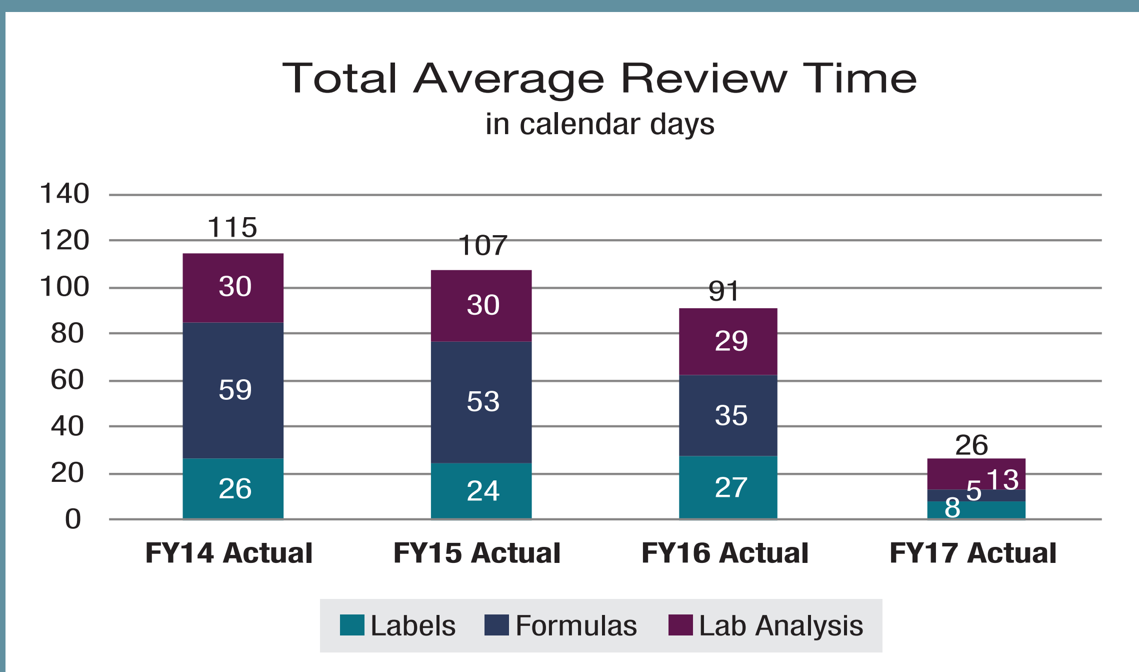
Since FY 2013, the total number of alcohol beverage label applications has increased approximately 20 percent, despite TTB's intervention strategies to reduce filing requirements in certain low-risk areas. Without these policy changes, TTB was on track to receive nearly 195,000 label applications in FY 2017. These increases continue to be driven by increases in both malt beverage and spirits label applications. In the last five years, malt beverage applications have nearly doubled, and distilled spirits applications have increased by 30 percent, tracking with the recent expansion in these industries.

Over the same period, the total number of alcohol beverage formula applications increased nearly 20 percent. The policy changes implemented by TTB in FYs 2015 and 2016 were successful in temporarily curbing the growth in formulas, particularly in malt beverage submissions, which ended FY 2017 nearly 50 percent below FY 2014, the high water mark for malt beverage filings. However, market trends in spirits and wine, including significant growth in flavored wine and hard cider, have resulted in increased formulas for these products, generally offsetting these reductions.

for certain ingredients and products. This year, product trends in wine and spirits products resulted in increased formula applications that have nearly completely offset the substantial reduction in malt beverage formulas resulting from these policy changes, and TTB expects this trend to continue.

Additionally, industry members often require extensive assistance during the label and formula approval process and frequently submit applications that require correction, both of which add to processing times. In FY 2017, more than 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 270,000 label and more than 22,500 formula applications in FY 2017, creating challenges to timely service.

Even with these workload challenges, TTB significantly improved its service to U.S. malt beverage, wine, and spirits producers and importers in FY 2017, effectively using an infusion of resources in its FY 2016 and 2017 budgets to accelerate processing times for labels and formulas. Prior to this funding, the total approval time for industry members could exceed three months for alcohol beverage products requiring lab analysis, formula, and label approval. By investing in a combination of staff and system upgrades, TTB ended FY 2017 at target, with 85 percent of lab analyses, formula, and label applications meeting its new 10-day service standard.

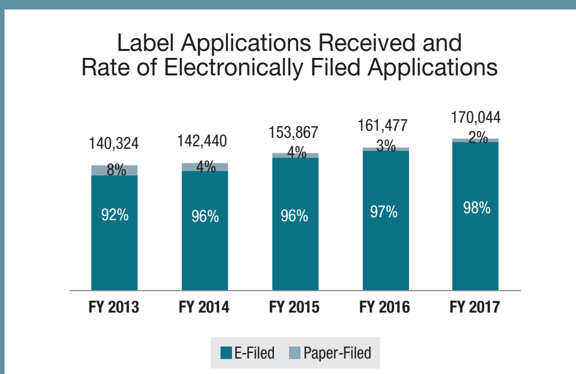


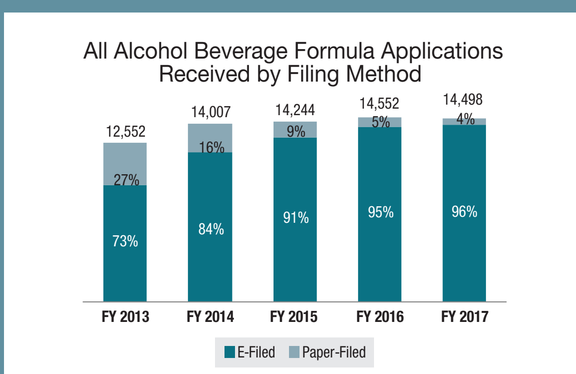
TTB has significantly accelerated review times for required approvals for alcohol beverage products. For products requiring lab analysis and formula review prior to label approval, TTB has reduced total review time by 75 percent since FY 2015.

Throughout FY 2017, 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 increasing the number of applications approved on the first submission. These changes were successful in reducing certain errors, such as missing or incomplete application fields; however, errors related to regulatory compliance issues increased, leaving overall error rates unchanged from the prior year. As a principal driver of total processing time, TTB will continue its efforts to reduce application error rates in FY 2018 through guidance and system-based validations.

Sustaining service levels will also be supported through TTB's planned updates to the federal labeling regulations to clarify and simplify requirements and ongoing improvements to online guidance.

Label and Formula Electronic Filing Rates





Electronic filing rates for label and formula applications continued to increase in FY 2017. Electronic filing has many benefits, particularly for industry members, who generally experience faster response times compared to paper filers.

Electronic filing, however, does not decreasethe 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 its service standards for label and formula applications in FY 2018.

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 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 it is fully and accurately labeled (i.e., whether the label accurately reflects the content of the bottle) by reviewing its label 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 identify and 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 by the industry member. 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.

Moving forward in FY 2018, the program will include both a random and risk-based sample. The risk-based sample will allow TTB to evaluate products that may have a higher probability of being non-compliant based on certain risk factors. These results will be used to help inform decisions on enforcement actions and priorities, and will allow the Bureau to employ its investigative resources in a more efficient and effective manner.

Ensuring Accurate Product Information for Consumers

TTB worked with its domestic and international counterpart regulators in FY 2017 to resolve several incidents related to mislabeled alcohol beverages. In response to an inquiry from the Mexican Tequila Regulatory Commission, TTB investigated a domestically bottled tequila that allegedly did not meet the standard of identity for tequila. Through a joint investigation with state officials and other federal agencies, TTB was able to confirm the product was mislabeled and took appropriate action.

In FY 2017, TTB also effectively leveraged its global network of regulators in its efforts to protect the U.S. market and promptly address compliance issues in the international trade of alcohol beverages by responding to a complaint alleging the importation of a fraudulently labeled Italian wine. TTB worked with the Italian government authorities to confirm whether the wine was labeled in accordance with Italian law. TTB found that the wine was not entitled to the appellation shown on the label and, therefore, was mislabeled under U.S. law. In this case, TTB worked with its international counterparts and the U.S. importers to ensure that the mislabeled product did not enter the U.S. market. TTB also worked with the Spanish government regarding a wine that was improperly labeled with a Rioja appellation.

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 2017, TTB worked with industry members on the voluntary recall of several alcohol beverage products, including malt beverages with glass particles that had fractured from the bottle, and two products found to contain additional yeast that caused off-flavors and the possibility of bottle breakage as a result of additional fermentation.

In addition, TTB's laboratories continued to develop new analytical methods to support the effective detection of adulterants and contaminants in alcohol beverage products. Among its advancements in FY 2017, TTB completed work on a validated method for arsenic speciation, which will allow for TTB to differentiate between the four species of organic and inorganic arsenic in wine. Further, TTB laboratories completed the validation of a method for testing for cyanide in alcohol beverages produced from stone fruits. Through these efforts, TTB will be better able to prevent and address potential health hazards in alcohol beverage products in the U.S. market.

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 actively enforces the provisions of the FAA Act that prohibit unfair trade practices in alcohol beverage distribution, including exclusive outlets, tied house arrangements, commercial bribery, and consignment sales. These unlawful trade practices threaten fair competition because they undermine equal access to the marketplace and limit consumer choices by allowing influential suppliers of wine, distilled spirits, and malt beverages to unlawfully interfere with the supply chain.

In May 2017, in the enacted FY 2017 budget, TTB received $5 million in directed funding for the purpose of increasing trade practice enforcement, available through the end of FY 2018. Prior to receiving this funding, TTB averaged two trade practice investigations per year based on its limited enforcement resources and the resource-intensive nature of these investigations. With the additional resources, TTB has created an Office of Special Operations within its Trade Investigations Division, which includes dedicated investigators to increase trade practice enforcement. With these additional resources, TTB intends to substantially increase the number of trade practice investigations and increase outreach to the regulated industry to prevent and address violations. At the end of FY 2017, TTB had 11 active trade practice investigations, two of which are large-scale investigations involving National Response Teams (NRT) that are being conducted jointly with the states of Florida and Illinois.

In FY 2017, TTB also reached a $750,000 settlement to conclude a case with Craft Beer Guild, LLC relating to alleged violations of the trade practice provisions of the FAA Act, which is the largest offer-in-compromise that TTB has received to date from a single industry member for trade practice violations. Craft Beer Guild, LLC allegedly paid “slotting fees” to retailers in exchange for favorable product placement and shelf space. This sort of pay-to-play activity undermines fair competition and will remain an enforcement priority for TTB going forward.

TTB is also committed to preventing anti-competitive conduct by providing industry members with sufficient guidance to voluntarily comply with TTB’s trade practice regulations. In this vein, in FY 2017, TTB issued formal guidance in TTB Ruling 2017-2, Freshness Dating and Allowable Returns of Malt Beverage Products, to clarify permissible activity related to the return and receipt of malt beverage products that have been deemed unsuitable for sale because of freshness concerns without violating the consignment sales provision of the FAA Act and TTB regulations. TTB also improved its online presence for trade practice issues, enhancing related guidance on TTB.gov and creating a dedicated e-mail inbox for the submission of trade practice related questions or complaints about unlawful conduct in the marketplace. Further, in response to current industry marketing trends, TTB issued two newsletter articles in FY 2017 to remind industry members about trade practice implications of promoting retailers on social media and TTB’s role in regulating certain prohibited marketing practices that are deemed to cause unfair competition. TTB also engaged directly with industry members, with representatives attending several trade association meetings as panel members or presenters, which helped to educate a wide audience on trade practice regulations and enforcement and allowed for open questions to address specific concerns.

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 and continuing opportunities for U.S. businesses in overseas markets. U.S. exports of alcohol beverages totaled approximately $3.5 billion in 2016, the most recent full year of data available. In line with increases in overall export volume, alcohol beverage exports have increased approximately 11 percent since 2012. 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 products are permitted entry.

TTB's workload in processing export certificates increased by more than 70 percent between FYs 2009 and 2013, reflecting increased overseas demand for U.S. spirits and wine. Continuous efforts by TTB to eliminate and reduce burdensome certification requirements, however, has resulted in a reduction in the number of certifications issued, from a peak of more than 15,000 in FY 2013 to approximately 11,300 in FY 2016 (the most recent full year of data available).

Toward this end, TTB 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, which was endorsed by APEC in early 2016. Given that approximately 60 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 FY 2017, TTB continued its efforts to encourage the voluntary implementation of this certificate among these economies, with its use under active consideration by Chile and Canada for exports to other APEC economies.

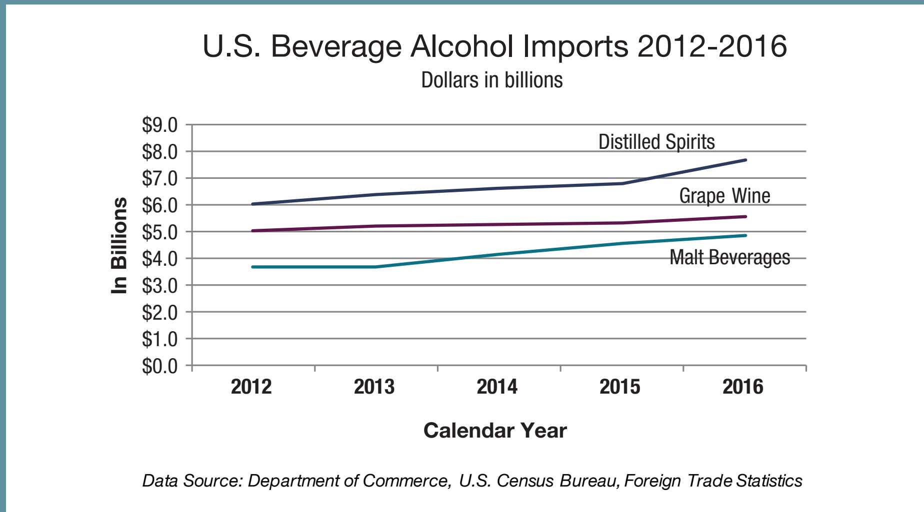
Preventing and Addressing Barriers to Trade

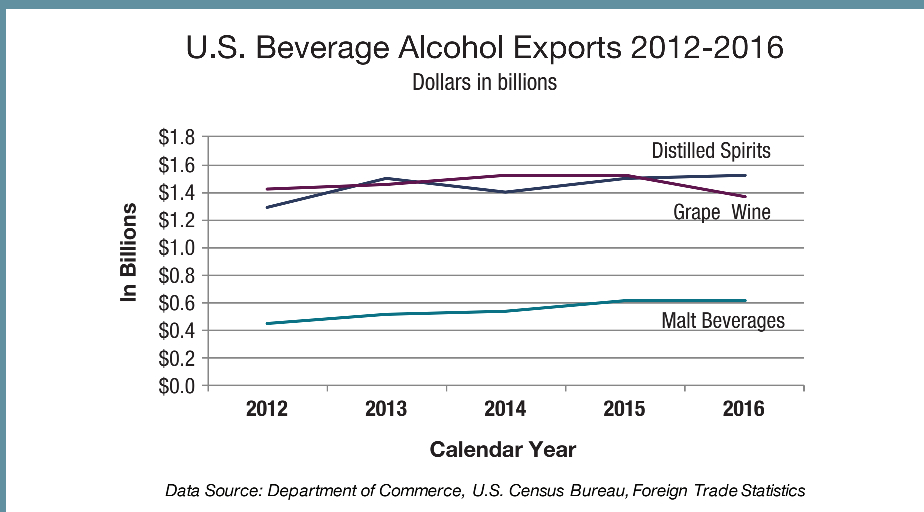
The TTB Trade Facilitation Program also includes identifying and addressing barriers to trade in the international marketplace. TTB is the principal technical expert for the Office of the United States Trade Representative (USTR) and other federal agencies in the administration of U.S. alcohol laws, 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 2017, 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 2017, TTB addressed more than 40 issues related to alcohol beverage regulations or standards proposed by various governments, including major markets for U.S. products, such as Brazil, China, India, and South Korea. Notably, TTB is leading the U.S. government response to China's 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 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

Alcohol Beverage Imports and Exports





The value of U.S. import trade in 2016, the most recent full year of data available, increased 5 percent over 2015 to a total of $18.1 billion. Wine, distilled spirits, and malt beverages all experienced moderate increases. The five-year trend indicates continued U.S. demand for imported products.

Overseas demand for the products TTB regulates remains high, although exports decreased slightly in 2016, and the total value of U.S. exports for all alcohol beverages declined 4 percent to approximately $3.5 billion in 2016 compared to the prior year. U.S. exports of beer totaled more than $611 million, consistent with 2015 totals. Over the same period, U.S. exports of distilled spirits decreased by 10 percent, to $1.4 billion. Meanwhile, U.S. exports of wine increased by 1 percent, to $1.5 billion.

TTB has undertaken a variety of efforts to directly support exports 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.

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, such as date marking for alcohol beverage products.

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

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 2017 include:

- Promoted U.S. export trade in wine through the APEC Wine Regulatory Forum (WRF). 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 encouraging the adoption of a model wine export certificate for trade among WRF-participating economies, TTB contributed to progress in the working groups' efforts to: 1) establish a searchable, online compendia of wine regulatory requirements for APEC economies and add a new compendium on methods of analysis, 2) conduct the third iteration of a laboratory ring test to promote consistency and accuracy in analytical testing of key wine characteristics, 3) assess the viability of implementing 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 2018 APEC WRF meeting.
- Participated in the World Wine Trade Group (WWTG) meeting in October 2016, which reviewed various topics, including the WWTG's status in international standards organizations, expanding cooperation in external fora, 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.

TTB Participates in International Wine Trade Meetings

In October 2016, 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 Ottawa, Canada.

Other U.S. government agencies in attendance included the Office of the United States Trade Representative and the 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 roundtable discussion on new wine trade developments, observer status at international organizations, an 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 included government officials and industry representatives from 14 economies, including Australia, Canada, Chile, China, Japan, Malaysia, Mexico, New Zealand, Peru, Philippines, Russia, Thailand, United States, and Vietnam.

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.

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 and guidance on broader issues affecting the regulated commodities.

Supporting Compliance through Online Support

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 industry education and outreach in recent years to operate a voluntary compliance program with limited resources. 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 and guidance to reach industry members.

In FY 2017, TTB continued to improve TTB.gov and Formulas Online to implement recent rulings that eliminated the formula requirement for certain malt beverage, wine, and spirits products and further reduce the number of overall submissions through industry education. These improvements include creating a new “Formula Approval’ webpage that consolidates and expands TTB’s online guidance related to formulas to assist industry members in understanding if formula approval is needed as well as the required information and supporting documentation for a formula application. These site features include a revamped web-based “Do I need a formula?” tool and a range of examples of acceptable supporting documentation, an area of frequent confusion for industry members. In addition, to reduce the error rate on applications, new and enhanced guidance was also embedded in Formulas Online, based in part on industry input received during system usability studies, to support industry members in completing their online application.

In addition, in FY 2017, TTB used data relating to high frequency errors in label and formula applications to identify areas where additional online guidance is needed to support industry in submitting applications that could be approved upon first submission. TTB made progress in updating its web guidance to address these areas in FY 2017, and plans to continue this effort in FY 2018, with a focus on improving labeling web guidance. Through these efforts, TTB expects that the volume of applications submitted to TTB that are approvable upon initial submission should increase in FY 2018.

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 2017, TTB used its web analytics data and user survey feedback to launch a redesign of the TTB.gov homepage intended to improve the accessibility of the most frequently sought after content as well as enhance the overall site navigability and user experience. These changes, which include prominent homepage links to the key TTB “business tools” relied on by industry, have resulted in a significant seven point increase in TTB’s site satisfaction survey score since the redesign was launched in March 2017.

In addition, TTB issued its fourth annual web-based customer survey in FY 2017 to garner feedback from industry members on several areas, including the quality and availability of guidance. Approximately 3,000 industry members responded to the survey, with some notable findings relating to the ability to obtain timely support and guidance from TTB. In FY 2018, TTB intends to use this data in developing initiatives to improve overall compliance and customer interactions with TTB. One priority area of focus will be call center support for industry members seeking TTB assistance. TTB plans to implement new call and e-mail management software in FY 2018, which will further enhance the accessibility, consistency, and quality of customer support, as well as enable TTB to derive additional insights on areas for future guidance.

Streamlining Regulations to Reduce the Compliance Burden

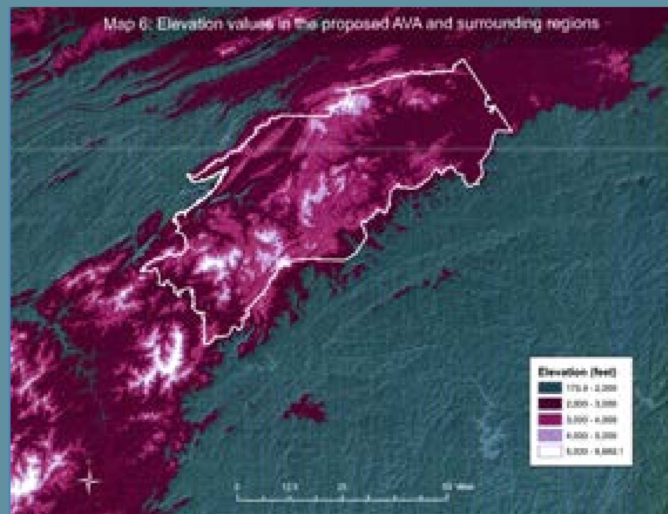
TTB also seeks to promote voluntary compliance through clear and unambiguous regulations and guidance. TTB is engaged in an ongoing regulations modernization effort to ensure that its regulations and enforcement strategies keep up with changes in the industries that it regulates. In FY 2017, TTB made progress in updating its regulations to implement statutory mandates and achieve efficiencies for industry and TTB.

On December 18, 2015, the Protecting Americans from Tax Hikes Act of 2015 (the "PATH Act") was signed into law. 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. To implement these statutory changes, which took effect in January 2017, TTB published two separate rulemaking projects concurrent with accompanying system and guidance updates.

In FY 2017, TTB also issued a final rule to streamline the importation of TTB-regulated products and facilitate use of the International Trade Data System, which reduces burden on industry by allowing for the electronic filing of import information. As a result of this rulemaking, importers of TTB-regulated products now have the option to file import-related data electronically with CBP as an alternative to the prior TTB requirement that importers submit paper documents to CBP upon importation.

TTB intends to propose additional burden-reducing regulatory changes in FY 2018, focusing on requirements related to permitting and alcohol beverage labeling to improve the regulatory framework by which TTB protects fair markets and federal revenues. These actions will be informed by proposals that were submitted by industry in response to the Department of the Treasury's June 2017 Request for Information, which asked the public to submit views and recommendations for Treasury regulations that can be eliminated, modified, or streamlined to reduce burdens. In addition to reducing compliance burdens, by simplifying and clarifying TTB's regulatory requirements, these actions should also result in a reduced volume of initial label and permit applications submitted with errors, which would contribute to improved approval times.

American Viticultural Areas



Elevation values of the new Appalachian High Country AVA and surrounding regions.

An American Viticultural Area (AVA) is a delimited grape-growing region having a name, a delineated boundary, and distinguishing features as described in Part 9 of the TTB regulations. Distinguishing features may include climate, geology, soils, physical features, and elevation.

An AVA designation allows vintners and consumers to attribute a quality reputation, or other characteristic of a wine made from grapes grown in an area to its geographic region. The establishment of an AVA allows vintners to more accurately describe the origin of their wines to consumers and helps consumers to identify wines that they may purchase.

During FY 2017, TTB published three AVA-related rulemaking documents. Of these three documents, two were proposed rules: one document proposed a new AVA covering portions of Sonoma and Marin Counties in California (Petaluma Gap), and the other proposed a new AVA covering portions of Lumpkin and White Counties in Georgia (Dahlonega Plateau). The third document was a final rule to establish a new multi-State AVA that covers portions of Virginia, Tennessee, and North Carolina (Appalachian High Country).

As a result of this final rule, at the end of FY 2017, TTB and its predecessor agency, the Bureau of Alcohol, Tobacco and Firearms, have established a total of 239 AVAs.

1.3 Financial Highlights

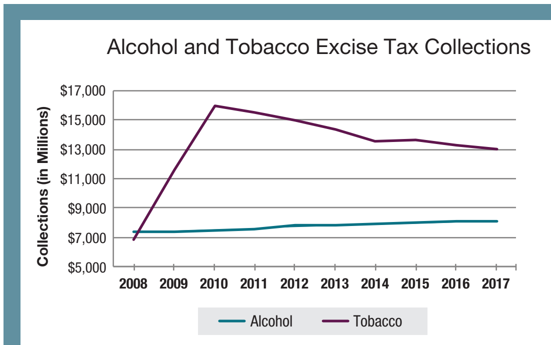
Federal Excise Tax Collections

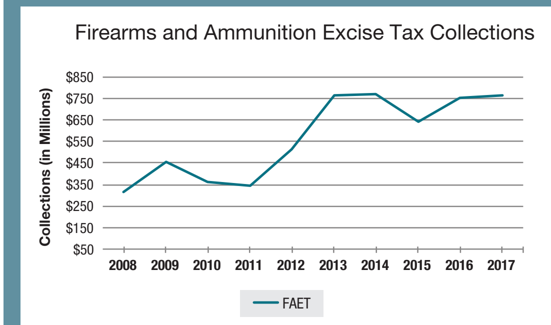
TTB collects excise taxes from the alcohol, tobacco, firearms, and ammunition industries. In addition, the Bureau collects Special Occupational Tax (SOT) from certain tobacco businesses. During FY 2017, TTB collected $21.8 billion in taxes, interest, and other revenues.

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 2017 Excise Tax Collections:

Alcohol	$	8,103,714,000
Tobacco	$	12,966,317,000
FAET	$	761,630,000
SOT	$	227,000
FST	$	69,000
Other	$	521,000
Total	**$**	**21,832,478,000**





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 2017 decreased in line with consumption patterns and consumer trends toward lower taxed alternative products.

Revenue for firearms and ammunition excise taxes increased by 2 percent from the prior year. Since TTB assumed the responsibility for administering FAET in 2003, collections have increased from $193,414,000 to $761,630,000, a 294 percent increase.

Refund, Cover-Over, and Drawback Payments

During FY 2017, TTB issued $776 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 United States 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.[9]

During FY 2017, cover-over payments totaled $370 million, with $365 million paid to Puerto Rico and $5 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 to USVI for imported USVI rum.

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 2017, drawback payments totaled $350 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 TTB for analysis prior to approval of the nonbeverage claim.

FY 2017 Refund, Cover-Over, and Drawback Payments:

Alcohol and Tobacco Excise Tax Refunds	$	55,839,000
Cover-over Payments, Puerto Rico	$	364,804,000
Cover-over Payments, Virgin Islands	$	5,122,000
Drawbacks on MNBP Claims	$	350,055,000
Interest and Other Payments	$	136,000
Total	**$**	**775,956,000**

9 The cover-over payments made to Puerto Rico and USVI based on taxes collected on “other rum” are distributed between the territories based on a formula set forth in 27 CFR 26.31.

1.4 FY 2017 Bureau Budget

Direct Appropriations (Salaries & Expense Account)

The 2017 Consolidated Appropriations Act (Public Law 115-31) authorized $111.4 million, which provides for 507 full-time equivalent (FTE) positions for TTB's programs. This amount included $5 million in direct 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. The appropriation also included $5 million in two-year directed funding (available until September 30, 2018) for increased enforcement of the trade practice provisions of the FAA Act.

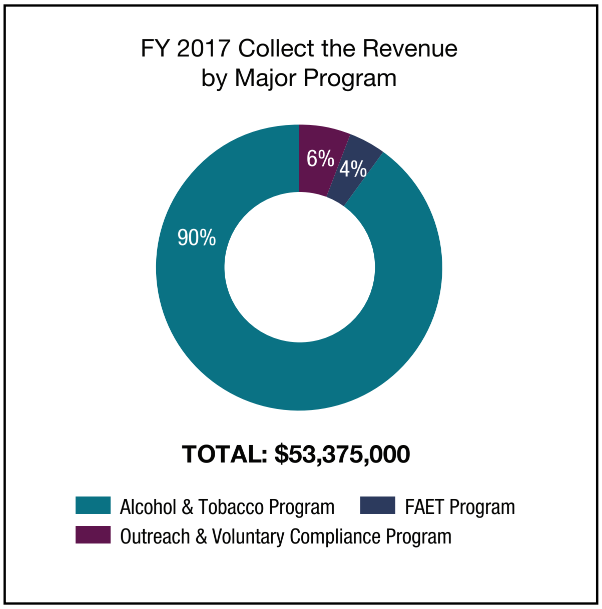
Anticipated Collections, Reimbursements, and Other

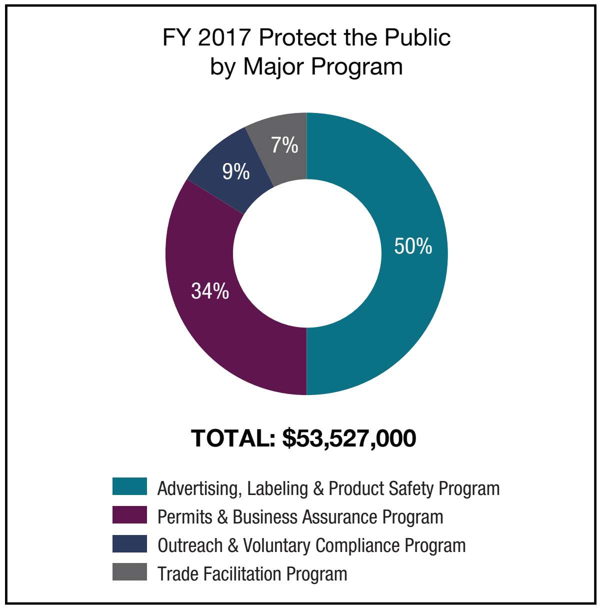
During FY 2017, TTB had $7.4 million in current year spending authority from offsetting collections and reimbursable activity. Of that amount, TTB incurred obligations and expenditures of $6.3 million. The funds originated from multiple sources, including:

- 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 and the Super Surplus Account to cover lab equipment;
- Reimbursement from the FDA for laboratory services;
- Reimbursement from Treasury Departmental Offices (DO) and Financial Crimes Enforcement Network (FinCEN) for TTB detailed employee; and
- Balance Transfer of 50 percent of the prior year unobligated balances to replace IT servers and security equipment.

BFY 2017 Anticipated Collections, Reimbursements, and Other		
	Apportioned Authority	Obligations and Expenditures
Offsetting Collections		
Puerto Rico Cover Over Administrative Expense Offset	$3,251,000	$3,198,129
Community Development Financial Institutions Fund (CDFI)	$3,000,000	$ 2,049,412
Treasury Executive Office for Asset Forfeiture - Mandatory Account	$600,000	$550,107
U.S. Food and Drug Administration (FDA)	$60,000	$8,521
Financial Crimes Enforcement Network (FinCEN)	$44,500	$43,882
Department of Justice, Bureau of Alcohol, Tobacco, Firearms and Explosives (ATFE)	$12,000	$-
Treasury Departmental Offices (DO)	$4,500	$4,405
Treasury Executive Office for Asset Forfeiture - Super Surplus Account	$200,000	$ 196,998
Balance Transfer (50 Percent of Prior Year Unobligated Balance)	$249,567	$249,567
BFY 2017 Anticipated Collections, Reimbursements, and Other Totals	**$7,421,567**	**$6,301,021**

Obligations and Expenditures by TTB Program





Audit of TTB's FY 2017 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 2017 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 2017. TTB provides reasonable assurance that the objectives of the Federal Managers' Financial Integrity Act were achieved in FY 2017, 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 2017, 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."

1.5 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.

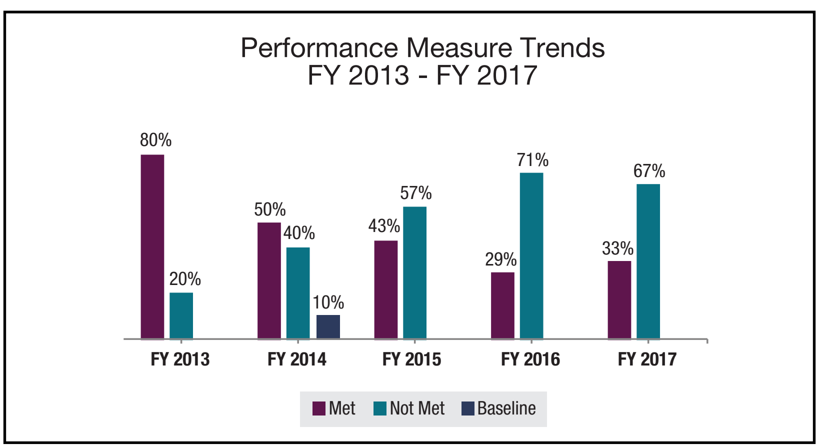
Part II:
Program Performance Results

2.1 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 for required federal approvals. In FY 2017, TTB met or exceeded the performance targets for three of its nine measures, including two new measures introduced to support data-driven decision making in our Protect the Public mission. Despite falling short in many of its annual performance goals in FY 2017, performance improvements in the second half of the year indicate that the Bureau may near or meet its targets in the year ahead.

Based on external factors and the results achieved this fiscal year, TTB reviewed its performance goals and set FY 2018 targets that reflect workload projections, resource levels, planned business process improvements, and anticipated impacts from technology enhancements. To meet its performance goals in FY 2018, 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 2017 Performance Measure Status	
Performance Targets Met	3
Performance Targets Not Met	6
Total Performance Measures	**9**



2.2 Summary of Collect the Revenue Performance

Measure	FY 2013 Actual	FY 2014 Actual	FY 2015 Actual	FY 2016 Actual	FY 2017 Actual	FY 2017 Target	FY 2018 Target	FY 2017 Target Met?	% of Target Reached
Amount of Revenue Collected Per Program Dollar	457	457	437	414	406	400	400	Y	102%
Percent of Voluntary Compliance from Large Taxpayers in Filing Tax Payments Timely (In Terms of Revenue)	92	90	88	87	85	90	90	N	94%

Performance Discussion

In FY 2017, 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 2017, TTB achieved a return on investment of $406 for every program dollar spent on collection activities, which exceeded the 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. In FY 2018, 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, with investigations into schemes that involve the diversion of non-taxpaid products intended for export resulting in the identification of significant tax liabilities. Going forward, TTB will continue to develop and build analytic tools 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 2017, TTB achieved a compliance rate of 85 percent from its large taxpayers, which fell below the performance target of 90 percent. The declining compliance rate in recent years is due, in part, to an increase in the universe of industry members paying more than $50,000 in annual taxes due to continued industry growth and expansion, which increasingly includes more recent permittees who may be less familiar with TTB's statutory and regulatory requirements.

Although TTB analysis indicates that this trend does not represent a significant revenue risk, non-compliance undermines the level playing field, which is critical for small producers who comprise the majority of TTB taxpayers. In FY 2018, addressing low compliance rates, particularly newer taxpayers and small- and medium-sized taxpayers, is a priority for TTB, with plans including the testing of new compliance check procedures and additional education and outreach strategies.

2.3 Summary of Protect the Public Performance

Measure	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017		FY 2018	FY 2017	% of Target
	Actual	Actual	Actual	Actual	Actual	Target	Target	Target Met?	Reached
Percent of Electronically Filed Permit Applications	73	80	81	81	85	82	87	Y	104%
Percentage of Permit Applications Processed within Service Standards	50	58	47	32	48	85	85	N	56%
Initial Error Rate for Permit Applications	BASE	72	67	57	60	25	25	N	40%
Average Number of Days to Process an Original Permit Application for a New Alcohol or Tobacco Business	81	84	DISC	DISC	DISC	N/A	N/A	N/A	N/A
Customer Satisfaction Rate with TTB Permitting Process	N/A	BASE	76	71	80	80	80	Y	100%
Percent of Electronically Filed Label and Formula Applications	90	93	94	97	98	95	95	Y	103%
Percentage of Alcohol Beverage Label and Formula Applications Processed within Service Standards 1/	50	71	80	80	62	85	85	N	73%
Initial Error Rate for Label and Formula Applications	BASE	39	42	44	43	25	25	N	28%
Percent of Electronically Filed Certificate of Label Approval Applications	92	94	DISC	DISC	DISC	N/A	N/A	N/A	N/A
Percentage of Importers Identified by TTB as Operating without a Federal Permit	11	15	DISC	DISC	DISC	N/A	N/A	N/A	N/A

Key: DISC - Discontinued and BASE - Baseline

1/ TTB established new service standards of 10 days for both labels and formulas in FY 2017 following an infusion of dedicated resources in the FY16/17 enacted budgets. The standards were 30-days for labels and 45-days for formulas in fiscal years 2013 - 2016. Though annual results are below target, TTB met its target in September 2017, as projected. All data has been revised to reflect a methodology update to exclude label applications deemed abandoned by the applicant (i.e., no action after 30 days).

Performance Discussion

In FY 2017, TTB met three of its seven annual targets for the performance measures under its Protect the Public mission. TTB reports on its success in meeting its goal to facilitate lawful commerce for the protection of U.S. businesses and consumers 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. This year, TTB is introducing two new measures that track the error rate on permit applications and label and formula applications, as applications submitted with errors significantly add to TTB's overall workload and present a critical risk to TTB achieving its timely processing goals. 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 application requirements, and providing clearer guidance to industry members.

Improve Efficiency and Effectiveness of Permitting Process

TTB protects federal revenues and U.S. consumers by screening permit applicants to ensure only qualified persons engage in the alcohol, tobacco, firearms, and ammunition industries. For this purpose, in FY 2017, TTB processed approximately 8,000 original permit applications, performing investigations into high-risk applicants to meet the objectives of TTB's business integrity program. 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 2017, TTB met its 75-day service standard for 48 percent of original permit applications, a significant year-to-year improvement but still well below the 85 percent performance target. In recent years, the increased volume of submissions, particularly in the more complex application types related to producing alcohol beverage products, has caused approval times to increase. Approval times spiked to over 200 days in FY 2016 for alcohol producer applications, creating potential financial hardships for these applicants. In FY 2017, TTB realized the benefits of several crosscutting initiatives to update its permitting business process instituted over the last two years. The initiatives included policy, workflow, and system changes that, by year-end, combined to result in a dramatic reduction in the backlog of applications and average approval times below 100 days. In FY 2018, TTB intends to meet its 75-day standard for 85 percent of permit applications through a combination of industry education efforts and ongoing enhancements to Permits Online. Additionally, TTB is undertaking a comprehensive review of its qualification requirements, informed by public comment, to further streamline the application requirements and further reduce burdens related to the filing process.

According to its measure of the Percent of Electronically Filed Permit Applications, which tracks the electronic filing rate for new business applications, TTB received approximately 85 percent of permit applications via Permits Online in FY 2017. This year-to-year increase is attributed to TTB.gov improvements to better direct applicants to the online filing system. TTB expects this trend to continue following the release of the redesigned Permits Online system, targeted for the early part of FY 2018, which will include improved guidance for first-time filers to reduce errors on applications that delay processing times as well as a simplified method for amending an existing permit that replaces the current paper-based process. These system changes, combined with effective outreach and training for industry, will support TTB in achieving its targeted electronic filing rate of 87 percent in FY 2018.

The Permits Online enhancements should also contribute to improved outcomes for TTB's new measure of the Initial Error Rate on Permit Applications, which tracks how many applications are submitted either incomplete or with errors. This measure is critical to timely processing, as the error rate significantly influences total approval time, given the necessary back-and-forth with applicants to obtain additional documentation or accurate information. In FY 2017, the error rate trended negatively, with 60 percent of original permit applications submitted with errors. This rate is well above the target of 25 percent, and reflects the need for improved guidance and system validations to ensure applicants are able to submit correctly the first time. Following the FY 2018 system release, and planned TTB.gov enhancements, TTB expects to draw closer to its target by year-end. Broader changes to the application requirements, many of which will require rulemaking to fully implement, are underway and may be required before TTB can achieve its targeted performance level.

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 2017 met the annual target of 80 percent, driven in large part by improvements in the level of service received and timeliness of TTB's response. Satisfaction rates are expected to remain at or above target in FY 2018, with new features planned for release in the new version of Permits Online that will improve the overall customer experience with the system. TTB will also implement process changes 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 2017, TTB received approximately 170,000 label applications and 14,500 formula applications, which reflect levels at or above the prior year and indicate 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, under its service standards of 30 days for a label approval and 45 days for a formula approval, many businesses were waiting nearly three months on average from the time they filed for a formula approval to being able to bottle and distribute a new product. In FY 2017, with additional staffing resources hired using directed funding to accelerate these approvals, TTB established new service standards of 10 days for both label and formula applications. Following a period of onboarding and training, which affected performance in the first half of FY 2017, TTB significantly reduced approval times and, by September, achieved the 10-day standard for 85 percent of labels and formulas. While TTB expects to maintain this performance target for FY 2018, sustaining these service delivery improvements may present a challenge given anticipated increases in overall workload driven by industry trends.

In recent years, to help address processing delays, TTB has used its authority to implement risk-based policy changes to reduce the volume of label and formula applications without compromising TTB's market protection role. These changes successfully reduced the volume of label and formula submissions in the short-term; however, in FY 2017, industry growth combined with market trends toward products that require an approved formula prior to production have resulted in increased submissions that have offset these reductions. At the same time, TTB has employed a complementary strategy to reduce total workload volume through initiatives to reduce label and formula application errors. Application errors are a key driver of processing times, as additional review is required for each resubmitted application. TTB has established a new measure of the Initial Error Rate of Label and Formula Applications to monitor error trends and evaluate the effect of system and guidance enhancements on first-time approvals. In FY 2017, the initial error rate was 43 percent, falling short of the targeted performance level of 25 percent, indicating that TTB will need to expand and improve on the system-based help and online guidance features that it implemented this year.

Going forward, TTB will continue to make iterative enhancements to COLAs Online and Formulas Online, informed by user testing and feedback, which will support advanced help features and system-based validations to reduce application errors. According to its measure of the Percent of Electronically Filed Label and Formula Applications, TTB now receives 98 percent of applications via COLAs Online and Formulas, indicating that continued focus on system validations is warranted and will support performance goals in increasing accurate applications and accelerating approval times. TTB expects that these ongoing improvements will help TTB continue to attract users to its online systems and maintain performance above its 95 percent target in FY 2018.

Further, in FY 2018, TTB will also continue its initiatives to improve industry guidance, including its labeling modernization project, which will update and streamline the labeling regulations to reflect current TTB policy and modern industry practices, and through additional compliance information on TTB.gov related to obtaining label and formula approval for alcohol beverage products.

2.4 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 2017, 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. This year, TTB began developing effective human resource goals to support TTB's priorities over the next five years, focusing first on its labeling and permitting mission activities. In addition, 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 positions related to cybersecurity and data analytics.

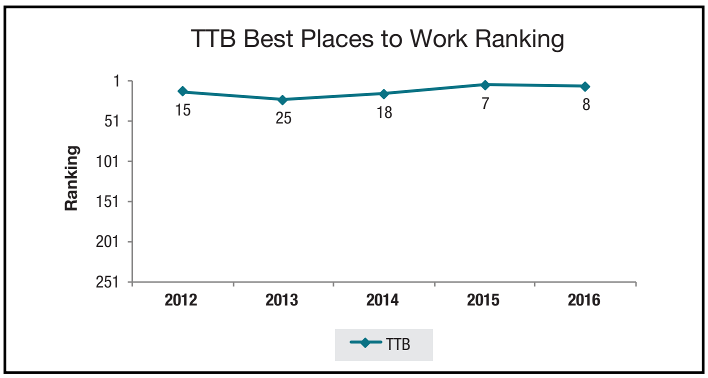
Significantly, like many government agencies, TTB is facing a potential retirement wave, with 30 percent of the TTB workforce eligible to retire within the next three years. TTB intends to continue its proactive approach to addressing this mission risk by using a variety of human capital policies and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

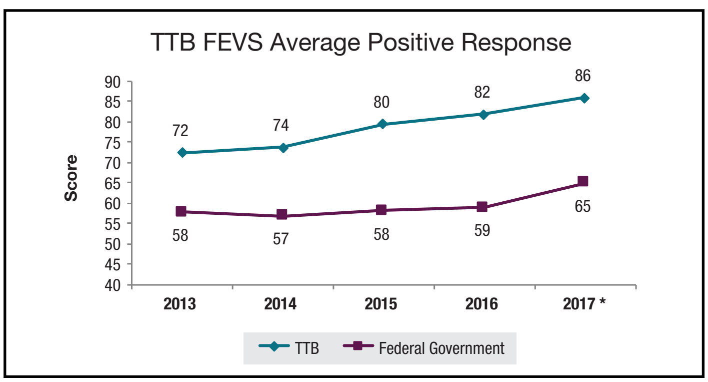
- Flexible work schedules and telework to promote a positive work/life balance to retain experienced staff;
- Hiring reemployed annuitants and developing specialized training to retain critical job knowledge;
- Partnering with a diverse range of universities, community organizations, and professional associations;
- Expanding the use of special hiring authorities, including those for veterans and persons with disabilities;
- Conducting a succession risk assessment by evaluating key leadership positions and required competencies, bench strength, and recruitment challenges; and
- Attracting and developing up and coming talent through the Presidential Management Fellows program to develop and retain talented employees for leadership positions.

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

2018, TTB is using participant feedback to expand the program to include an experiential learning opportunity in the form of a collaborative, cross-organizational “capstone” project requirement 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 86 percent in FY 2017. For FY 2016, TTB ranked 8th out of 305 sub-component agencies in the Best Places to Work in Federal Government, with FY 2017 results pending release.





The reported scores indicate the average of three survey items related to job and organization satisfaction that identify overall employee satisfaction.

** Estimate based on initial FEVS results; final results are available at www.bestplacestowork.org.*

TTB's Employee Engagement Action Plan for FY 2017 focused on improving training and internal communications, the two areas with the greatest opportunity for improvement across TTB divisions. Specifically, TTB continued its priority initiatives to revitalize its training programs, with significant progress this year in improving the experience of new hires through the implementation of a new onboarding program. In the area of communication, TTB launched the "TTB Twenty5s," a monthly videoconference series offered to all employees on Bureau priorities, programs, and emerging issues. The Bureau also continued to conduct virtual town hall meetings to review accomplishments and discuss priorities. These meetings also enable employees to ask questions and directly engage with senior leadership.

Though TTB made some strides in increasing workforce satisfaction through its FY 2017 action plan, TTB intends to remain focused on these two areas in FY 2018 to maintain its status as an employer of choice in the federal government. To encourage continuous development, TTB will improve its promotion of training opportunities, leveraging available online tools to increase and improve information sharing on internal training sessions on specialized program areas as well as opportunities available through the Department of the Treasury. Other anticipated areas of focus based on FY 2017 FEVS results include revamping the Bureau's annual training assessment process, enhancing its use of individual development plans, and evaluating the implementation of a phased retirement program.

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 2017, 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; and
- Reporting and account maintenance tasks completed by established due dates.

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 onboard 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 2017, 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 2016 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 2017, TTB received authorization for nearly $250,000 from unobligated FY 2016 funds to invest in IT servers and security equipment.

Further, 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 2017, 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 timely processing of filings by industry. In FY 2017, more than half of all system releases automated manual business processes, freeing TTB staff resources to perform mission-essential activities. These releases included enhancements to COLAs Online that reduced certain error types on label applications, updates to Formulas Online to streamline the user interface based on feedback collected through a usability study, and improvements to both Formulas Online and the Laboratory Information Management System that streamlined the process for logging in alcohol beverage product samples. Thus far, these enhancements have supported improved processing times for label and formula approvals and have increased industry member satisfaction rates with these online systems to 76 percent, a 10 percent improvement in just one year.

Additionally, TTB made changes to its Permits Online system and business processes to alter the approval process for certain permit types, helping to reduce processing delays. TTB also updated Permits Online to support the implementation of the Protecting Americans from Tax Hikes Act of 2015, which took effect in January 2017, and reduced the filing burden for eligible small alcohol beverage manufacturers by reducing the tax return filing and payment frequency to quarterly or annually (depending on their tax liability) and eliminated the bond requirement for these industry members.

A new Permits Online system release scheduled for deployment early in FY 2018 will improve the user interface for filing and processing original and amended permit applications and better enable TTB permittees who originally filed a paper permit application to file for amendments electronically through Permits Online. Given that 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 TTB processing times.

In FY 2017, 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. These new capabilities are allowing TTB to retire legacy data reporting tools and enable self-service analytics and consistent reporting. Additionally, based on identified shortcomings in TTB's call centers that were impeding TTB responsiveness to its customers, the Bureau held a cross-directorate workshop to identify common problems and desired capabilities to improve service levels to callers seeking live assistance from TTB. A critical issue relates to the use of disparate tools and processes by TTB's call centers, which has resulted in certain inefficiencies and low visibility into previous support provided to an industry member. The workshop led to the implementation of a new "contact us" page on TTB.gov to assist with call routing issues to the correct service desk and an initiative to implement call center software that will improve the customer experience beginning in FY 2018.

In FY 2017, 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. The modernization has enabled the automated deployment for certain systems, an updated approach to system releases that will allow TTB to deploy more frequent and seamless updates to its online systems as well as significantly reduce the amount of time its systems must be taken offline for maintenance. Additionally, TTB further consolidated and optimized 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 2017, TTB continued to improve its ability to combat cybersecurity threats through advanced technology and employee education. TTB improved its ability to both detect and prevent malware attacks and improve reporting and response time to identify and block malicious e-mails. Through these efficiencies, TTB is able to spend more time on other advanced techniques to further secure its systems. 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.

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Message from the Chief Financial Officer

Prudent financial management is an ongoing bureau priority. As a steward of public resources, and the third largest tax collection agency in the federal government, TTB is committed to strong internal controls and sound management practices to ensure the collection and verification of $22 billion in annual excise tax collections from the alcohol, tobacco, firearms, and ammunition industries.

In fiscal year 2017, for the eighth consecutive year, TTB obtained an unmodified (clean) audit opinion on its financial statements from an independent Certified Public Accounting firm, demonstrating our dedication to financial reporting excellence. This audit provides reasonable assurance that TTB's financial statements are free from material misstatement and prepared in accordance with generally accepted accounting principles.

TTB faced a multitude of fiscal and programmatic challenges at the beginning of this year, including lengthy processing times for key services that are relied upon by our regulated industries. In facing these challenges, TTB continued our proven approach of data driven decision-making and strategic workforce management to ensure that we fulfill our diverse mission of market protection and revenue collection.

This year, as part of our continuous review of our organizational structure and alignment, TTB completed two restructuring efforts to ensure the best use of limited resources. First, in an effort to explore how best to leverage finite analytical resources within the bureau, TTB established a pilot centralized analytics office. The new office stood up an improved analytics environment to consolidate data, designed to enhance the accuracy and speed of TTB reporting and analysis, and delivered improved tools to interpret data and streamline operations. TTB also restructured its Field Operations directorate, placing appropriate executive oversight over both our tax enforcement and tax administration mission areas.

TTB also continued to employ its Balanced Scorecard strategic management framework, focusing this year on integrating Enterprise Risk Management (ERM) principles into strategic planning. Already, TTB is using ERM to better assess its risk environment, inform its strategic planning, and manage its annual business plan. The assessment completed this year of TTB's key strengths, weaknesses, opportunities, and threats will serve as the basis for the next strategic plan.

We will continue to face the uncertainties and challenges ahead by relying on our exceptional workforce and integrating our strategic plan with our management and investment decisions. This, 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
Assistant Administrator, Management/CFO

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

3.1 Budget Highlights by Fund Account

This section highlights the TTB program activity in FY 2017 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 2017 Salaries and Expenses	
Fund Source	
Salaries & Expenses FY 2017 **One-Year Appropriation (P.L. 115-31 Consolidated Appropriations Act, 2017) 1/**	**$106,439,000**
Obligations Incurred in FY 2017 from Current Year Appropriations	$106,059,184
Salaries & Expenses FY 2017/18 **Two-Year Appropriation (P.L. 115-31 Consolidated Appropriations Act, 2017) 2/**	**$5,000,000**
Obligations Incurred in FY 2017 from Current Year Appropriations	$842,949
Salaries & Expenses FY 2016/17 **50% Prior Year Reapportionment) 3/**	**$249,567**
Obligations Incurred in FY 2017 from Current Year Appropriations	$249,567
Transfer in From Other Appropriations **(TEOAF Super Surplus Fund)**	**$200,000**
Obligations Incurred in FY 2017 from Current Year Appropriations	$196,998
Reimbursable Authority **(Various Customers)**	**$6,972,000**
Obligations Incurred in FY 2017 from Current Year Appropriations	$5,854,455

1/ The 2017 Consolidated Appropriations Act included $5 million in one-year direct funding for TTB to use for the costs of accelerating the processing of formula and label applications..

2/ The 2017 Consolidated Appropriations Act included $5 million in two-year direct funding for TTB to enforce trade practice provisions of the FAA Act.

In FY 2017, TTB received $111.4 million in discretionary appropriations under the FY 2017 Consolidated Appropriations Act and an authorized staffing level of 507 full-time equivalent (FTE) positions. Of this amount, $106.4 million was one-year funding, of which $5 million was set aside for the costs of accelerating the processing of label and formula applications. The remaining $5 million was two-year funding (available until September 30, 2018) to enforce the trade practice provisions of the FAA Act.

In FY 2017, the Bureau obligated or expended more than 99.5 percent of the $106.4 million of discretionary funding from its one-year Salaries and Expenses appropriation and 17 percent of the $5 million from its two-year Salaries and Expenses appropriation. The year-end balance from the two-year funding for trade practice enforcement of $4.157 million is available for FY 2018 program spending.

Anticipated Collections, Reimbursements, and Other

During FY 2017, the Bureau realized $5.9 million in obligations in 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; and reimbursement for laboratory services from the Food and Drug Administration and the Bureau of Alcohol, Tobacco, Firearms, and Explosives.

Additionally, the Bureau received $200 thousand from a direct appropriations transfer from the Treasury Executive Office of Asset Forfeiture (TEOAF) Super Surplus fund to support enforcement activity by TTB's laboratories.

TTB also received Congressional authorization in FY 2017 to use an additional $250 thousand from the prior year account of unobligated available balances (also referred to as the 50 percent account) to replace IT servers and security equipment.

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 ($365 million) and the U.S. Virgin Islands ($5 million).

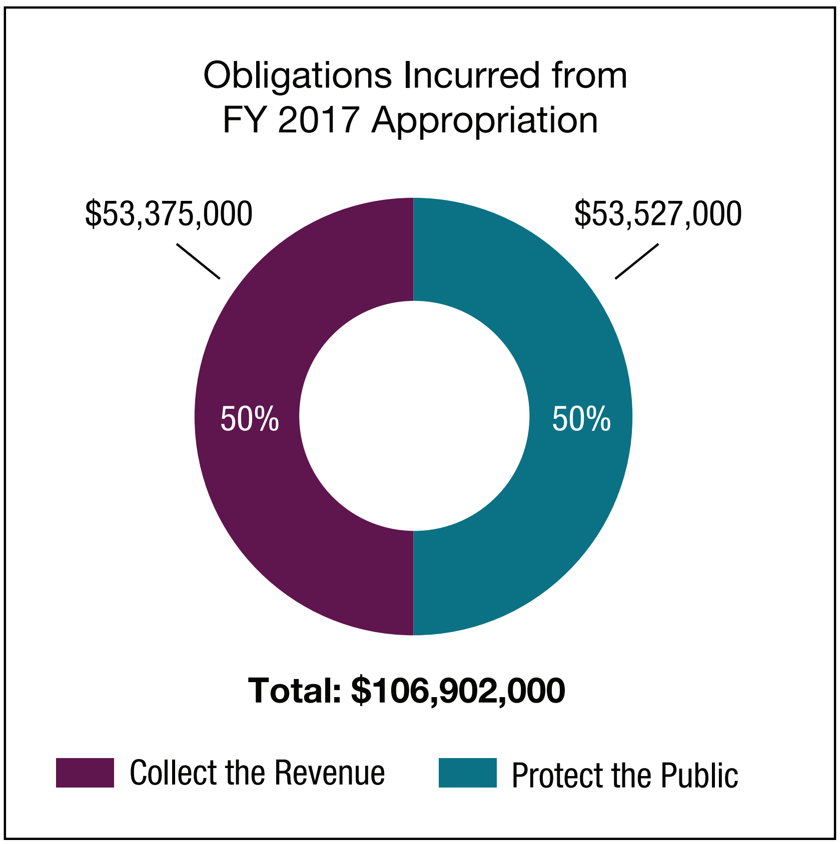
In Puerto Rico, TTB conducts annual audits and investigations of industry members regarding the collection of revenue, application processing, and product integrity. These examinations are integral to TTB's fulfillment of its obligations to verify tax compliance and ensure the payment of all cover-over 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 through the Department of the Interior for rum it produces and transports to the U.S.

3.2 Linking Budget and Program Spending

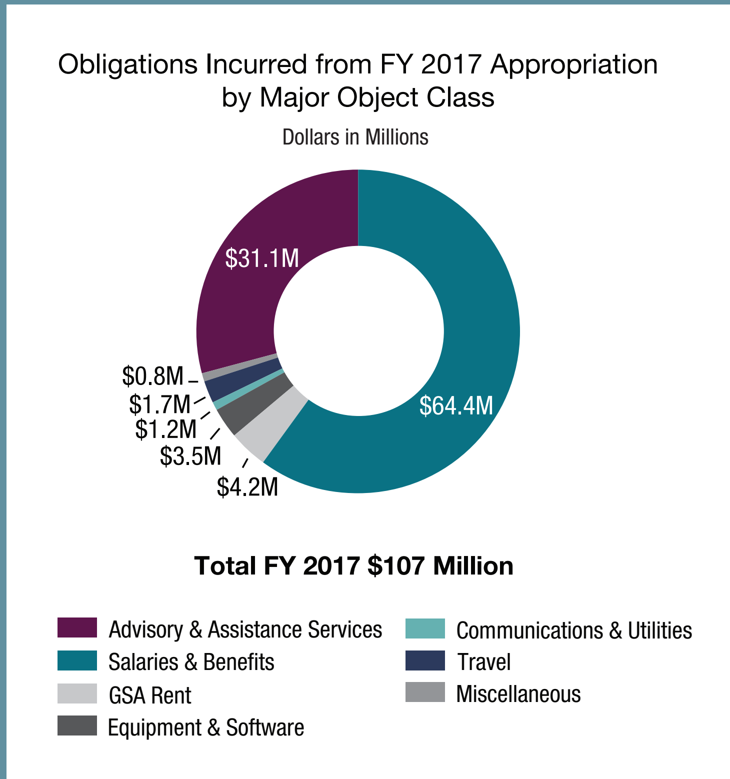
TTB has two primary budget activities that directly align to its mission and strategic goals: Collect the Revenue and Protect the Public. TTB uses an account code structure that provides a direct link from the Bureau budget to specific programs and project activities. To ascertain the full costs of each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

An analysis of the FY 2017 data stemming from the account code structure shows that TTB incurred obligations of $106,902,000 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 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 (89 percent) fall into two principal major object classes: Salaries & Benefits and Advisory & Assistance Services (Contracts).



Salaries & Benefits comprise 60 percent of total obligations incurred by object class, and cover the cost of TTB's roughly 478 onboard positions in FY 2017. The Advisory & Assistance Services object class constitutes 29 percent of FY 2017 incurred obligations, and covers the cost of both commercial and intragovernmental 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 scanning and imaging of paper submissions, lab maintenance, and web site development.

Intra-governmental services include administrative support services provided by TTB's 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, and Federal Protective Services and Departmental franchise services.

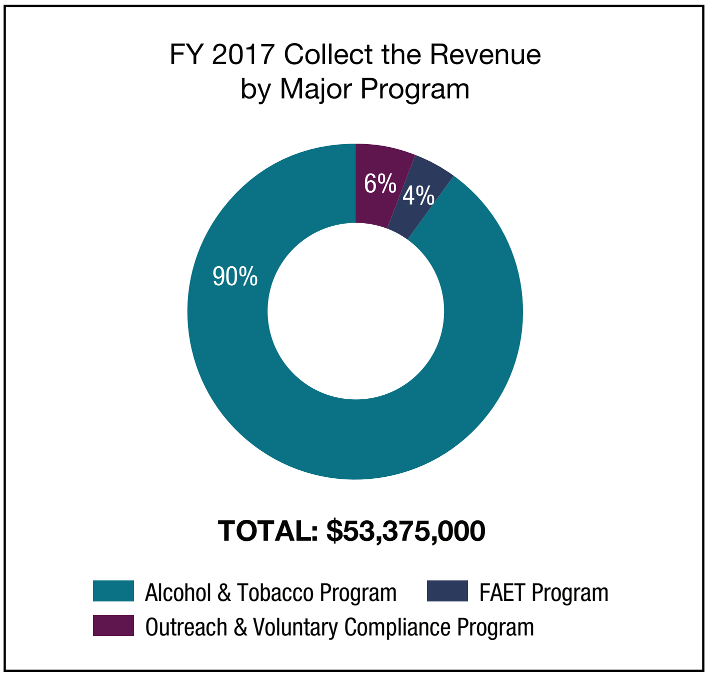
In FY 2017, the Bureau's travel costs were primarily related to core mission activities for audits and investigations. The remaining object classes that cover the FY 2017 obligations incurred include cost categories for rent, communications, equipment, and other miscellaneous categories.

Obligations Incurred from FY 2017 Appropriations by Budget Activity

Collect the Revenue……$53,357,000

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.

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



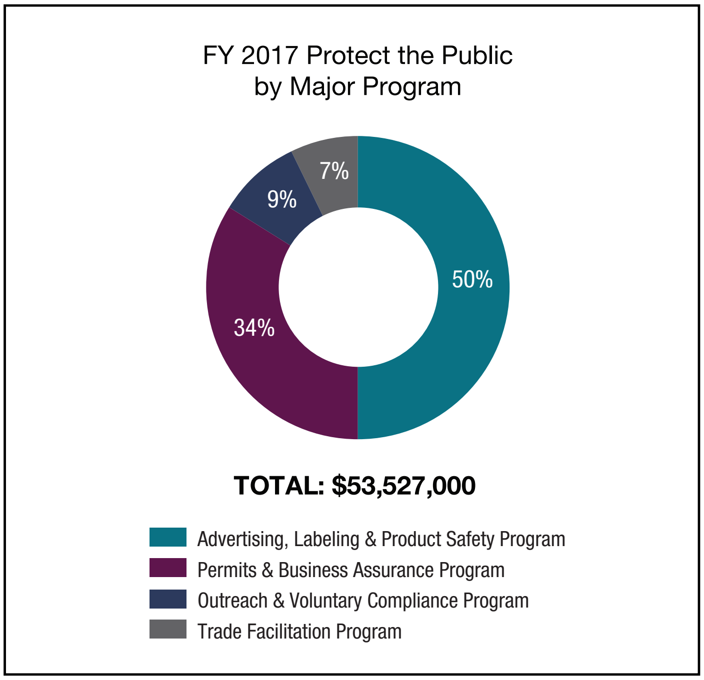
In FY 2017, TTB expended 90 percent of its Collect the Revenue resources in collecting federal excise taxes from the alcohol and tobacco industries and 4 percent in collecting FAET. These costs include activities relating to the processing of tax returns and operational reports at the National Revenue Center and the audits and investigations conducted on alcohol, tobacco, and firearms and ammunition industry members.

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

Protect the Public..... $53,527,000

The Protect the Public budget activity encompasses TTB's strategy to ensure industry compliance with laws and regulations designed to protect the alcohol beverage market, 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.



In FY 2017, TTB expended 84 percent of its Protect the Public resources on two programs: Permits and Business Assurance (34 percent), and Labeling, Advertising, and Product Safety (50 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 (7 percent) and the Outreach and Voluntary Compliance Program (9 percent). TTB's 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.

3.3 Management's Responsibility for Enterprise Risk Management and Internal Control

Introduction

During FY 2017, TTB contracted with the Bureau of the Fiscal Service's Administrative Resource 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 2017 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.

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 2017 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, 2017.

- The Balance Sheet shows the assets, liabilities, and net position as of a point in time, in this case, as of September 30, 2017.
    - The total assets were reported as $90.2 million at the close of the fiscal year. Of this amount, $43.0 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 $64.8 million, of which total intragovernmental liabilities amount to $25.5 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 $112.2 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 $51.2 million.
    - The total net cost reported as program costs under the Protect the Public program was $61.0 million.
- The Statement of Change in Net Position shows a total net position balance of $25.4 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 in the amount of $111.4 million, in addition to spending authority from collections. The offsetting collections amount was $6.0 million. Of that amount, $3.2 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 2017 compared with FY 2016, 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 $21.8 billion. Within this total, the Bureau processed tax refunds, drawback claims, and cover-over payments in the amount of $776.0 million.

- **Drawback claims** of $350.1 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 $55.8 million.
- **Cover-over payments** were returned to Puerto Rico and the Virgin Islands in the amount of $369.9 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 $21.1 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 $760.2 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. A table has also been included to show the refunds, cover-over payments, and drawback payments for the past 10 years.

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 2017 and 2016, 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 2017 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.

3.4 Auditors' Reports, Financial Statements, and Accompanying Notes

KPMG LLP
Suite 12000
1801 K Street, NW
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, 2017 and 2016, and the related statements of net cost, changes in net position, custodial activity, and statements of 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. 17-03, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 17-03 require that we plan and perform the audit to obtain reasonable assurance about whether the 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, 2017 and 2016, 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 2017 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) sections 3.1 through 3.3 and section 3.5 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.

Other Reporting Required by *Government Auditing Standards*

In accordance with Government Auditing Standards, we have also issued our report dated December 18, 2017 on our consideration of the Alcohol and Tobacco Tax and Trade Bureau's internal control over financial reporting and our report dated December 18, 2017 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 18, 2017

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

Independent Auditors' Report on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

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. 17-03, *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, 2017 and 2016, and the related statements of net cost, changes in net position, custodial activity, and statements of budgetary resources for the years then ended, and the related notes to the financial statements, and have issued our report thereon dated December 18, 2017.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements as of and for the year ended September 30, 2017, 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 18, 2017

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

Independent Auditors' Report on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

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. 17-03, *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, 2017 and 2016, and the related statements of net cost, changes in net position, custodial activity, and statements of budgetary resources for the years then ended, and the related notes to the financial statements, and have issued our report thereon dated December 18, 2017.

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 disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 17-03.

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 18, 2017

ALCOHOL AND TOBACCO TAX AND TRADE BUREAU
BALANCE SHEETS
As of September 30, 2017 and 2016
(In Thousands)

	2017	2016
ASSETS		
Intragovernmental Assets:		
Fund Balance with Treasury (Note 2)	$ 43,020	$ 44,583
Accounts Receivable (Note 3)	456	303
Due from the General Fund (Notes 5 and 8)	12,384	19,210
Total Intragovernmental Assets	55,860	64,096
Accounts Receivable (Note 3)	515	461
Tax and Trade Receivables, Net (Notes 4 and 8)	23,959	25,291
Property, Plant and Equipment, Net (Note 6)	9,639	10,647
Advances (Note 7)	182	34
TOTAL ASSETS (Note 8)	$ 90,155	$100,529
LIABILITIES		
Intragovernmental Liabilities:		
Accounts Payable	$ 992	$ 789
Payroll Benefits	550	525
FECA Liabilities	5	13
Due to the General Fund (Notes 4 and 5)	15,854	18,541
Due to the Wildlife Restoration Fund (Note 5)	8,105	6,750
Total Intragovernmental Liabilities	25,506	26,618
Accounts Payable	3,894	4,066
Payroll Benefits	2,020	1,937
FECA Actuarial Liability	92	131
Refunds Payable	12,384	19,210
Unfunded Leave	4,747	4,469
Cash Bond Liabilities	14,384	16,261
Other Liabilities (Note 9)	1,758	3,638
TOTAL LIABILITIES	$ 64,785	$ 76,330
Commitments and Contingencies (Note 19)		
NET POSITION		
Unexpended Appropriations - Other Funds	$ 20,374	$ 18,150
Cumulative Results of Operations - Other Funds	4,996	6,049
TOTAL NET POSITION - OTHER FUNDS	$ 25,370	$ 24,199
TOTAL LIABILITIES AND NET POSITION	$ 90,155	$100,529

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, 2017 and 2016
(In Thousands)

	2017	2016
COLLECT THE REVENUE		
Program Costs		
Intragovernmental Gross Costs	$ 14,347	$ 14,648
Less: Intragovernmental Earned Revenue	(1,893)	(2,503)
Intragovernmental Net Costs	12,454	12,145
Gross Costs with the Public	41,368	44,124
Less: Earned Revenues from the Public	(2,595)	(2,282)
Net Costs with the Public	38,773	41,842
Total Net Program Cost	$ 51,227	$ 53,987
PROTECT THE PUBLIC		
Program Costs		
Intragovernmental Gross Costs	$ 15,983	$ 14,672
Less: Intragovernmental Earned Revenue	(437)	(792)
Intragovernmental Net Costs	15,546	13,880
Gross Costs with the Public	46,085	44,195
Less: Earned Revenues from the Public	(599)	(722)
Net Costs with the Public	45,486	43,473
Total Net Program Cost	$ 61,032	$ 57,353
NET COST OF OPERATIONS (Note 13)	$ 112,259	$ 111,340

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, 2017 and 2016
(In Thousands)

	2017	2016
Cumulative Results of Operations		
Beginning Balances	$ 6,049	$ 8,905
Budgetary Financing Sources		
Appropriations Used	108,061	104,899
Transfers-in without reimbursement	200	-
Other Financing Sources (Non-exchange)		
Imputed Financing from Costs Absorbed by Others (Note 12)	2,946	3,585
Transfers of the General Fund and Other	(1)	-
Total Financing Sources	111,206	108,484
Net Cost of Operations (Note 13)	(112,259)	(111,340)
Net Change	(1,053)	(2,856)
Cumulative Results of Operations	$ 4,996	$ 6,049
UNEXPENDED APPROPRIATIONS		
Beginning Balances	$ 18,150	$ 18,468
Budgetary Financing Sources		
Appropriations Received	111,439	106,439
Other Adjustments	(1,154)	(1,858)
Appropriations Used	(108,061)	(104,899)
Total Budgetary Financing Sources	2,224	(318)
Total Unexpended Appropriations	$ 20,374	$ 18,150
TOTAL NET POSITION	$ 25,370	$ 24,199

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, 2017 and 2016
(In Thousands)

	2017	2016
BUDGETARY RESOURCES (Note 14)		
Unobligated Balance Brought Forward, Oct 1	$ 2,716	$ 5,164
Recoveries of Prior Year Unpaid Obligations	1,208	1,126
Other Changes in Unobligated Balance	(1,077)	(1,840)
Unobligated Balance from Prior Year Budget Authority, Net	2,847	4,450
Appropriations (discretionary and mandatory)	111,439	106,439
Spending Authority from Offsetting Collections (discretionary and mandatory)	6,015	5,702
TOTAL BUDGETARY RESOURCES	$ 120,301	$ 116,591
STATUS OF BUDGETARY RESOURCES		
New Obligations and Upward Adjustments (Note 15)	$ 114,184	$ 113,875
Unobligated Balance, End of Year:		
Apportioned, Unexpired Accounts	4,540	345
Unexpired Unobligated Balance, End of Year	4,540	345
Expired Unobligated Balance, End of Year	1,577	2,371
Unobligated Balance, End of Year	6,117	2,716
TOTAL STATUS OF BUDGETARY RESOURCES	$ 120,301	$ 116,591

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, 2017 and 2016
(In Thousands)

	2017	2016
CHANGE IN OBLIGATED BALANCE		
Unpaid Obligations:		
Unpaid Obligations Brought Forward, Oct 1	$ 23,491	$ 21,258
New Obligations and Upward Adjustments (Note 15)	114,184	113,875
Outlays, Gross	(113,691)	(110,516)
Recoveries of Prior Year Unpaid Obligations	(1,208)	(1,126)
Unpaid Obligations, End of Year, Gross	22,776	23,491
Uncollected Payments:		
Uncollected Payments Brought Forward, Federal Sources, Oct 1	(1,566)	(2,151)
Change in Uncollected Payments, Federal Sources	(475)	585
Uncollected Payments, Federal Sources, End of Year	(2,041)	(1,566)
OBLIGATED BALANCE, END OF YEAR	$ 20,735	$ 21,925
OBLIGATED BALANCE, START OF YEAR	$ 21,925	$ 19,107
BUDGET AUTHORITY AND OUTLAYS, NET		
Budget Authority:		
Budget Authority, Gross (discretionary and mandatory)	$ 117,454	$ 112,141
Actual Offsetting Collections (discretionary and mandatory)	(5,616)	(6,305)
Change in Uncollected Customer Payments, Federal Sources (discretionary and mandatory)	(475)	585
Recoveries of Prior Year Paid Obligations (discretionary and mandatory)	76	18
BUDGET AUTHORITY, NET (discretionary and mandatory)	$ 111,439	$ 106,439
Outlays, Gross (discretionary and mandatory)	113,691	110,516
Actual Offsetting Collections (discretionary and mandatory)	(5,616)	(6,305)
Outlays, Net (discretionary and mandatory)	108,075	104,211
Distributed Offsetting Receipts	(2)	(1)
AGENCY OUTLAYS, NET (discretionary and mandatory)	$ 108,073	$ 104,210

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, 2017 and 2016
(In Thousands)

	2017	2016
SOURCES OF CUSTODIAL REVENUE		
Revenue Received		
Excise Taxes (Note 16)	$ 21,829,658	$ 22,098,164
Interest, Fines and Penalties	2,819	2,479
Other Custodial Revenue	1	1
Total Revenue Received (Note 17)	21,832,478	22,100,644
Less Refunds and Drawbacks (Note 16)	(406,030)	(390,629)
Net Revenue Received	21,426,448	21,710,015
Accrual Adjustment	5,493	(5,779)
Total Sources of Custodial Revenue	$ 21,431,941	$ 21,704,236
DISPOSITION OF CUSTODIAL REVENUE		
Amounts Provided to:		
General Fund	$ 20,296,332	$ 20,535,806
Wildlife Restoration Fund	760,190	749,419
Amounts Provided to Fund the Federal Government (Note 17)	21,056,522	21,285,225
Amounts Provided to Non-Federal Entities (Note 16)	369,926	424,790
Increases/(Decreases) in Amounts Yet to be Provided:		
General Fund	(2,686)	(2,583)
Wildlife Restoration Fund	1,354	1,804
(Increase)/Decrease in Accrued Refunds	6,825	(5,000)
Total Disposition of Custodial Revenue	$ 21,431,941	$ 21,704,236
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 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 federal 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 Plans

Most employees hired prior to January 1, 1984 participate in the Civil Service Retirement System (CSRS), and employees hired between January 1, 1984 and December 31, 1986 are covered under the CSRS Offset system, to which TTB contributes 7.0 percent of pay for employees covered by both. On January 1, 1987, the Federal Employees' Retirement System (FERS) went into effect. FERS is a three-tiered retirement system consisting of a Basic Benefit Plan, Thrift Savings Plan (TSP), and Social Security Benefits. For the FERS Basic Benefit Plan, TTB contributes between 11.9 to 13.7 percent of pay for regular employees. The Bureau has not employed any law enforcement employees. As such, the contribution rates associated with those types of employees are not applicable to TTB.

All employees are eligible to contribute to TSP, a 401(k)-type saving plan. For those employees participating in 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 of base pay, for FERS-eligible employees who contribute to their TSP accounts. Matching contributions are not made to the TSP accounts established by CSRS employees. For most employees hired after December 31, 1983, the Bureau also contributes the employer's matching share for Social Security.

TTB recognized the full cost of providing future pension and other retirement benefits (ORB) for current employees as required. 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 development 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 Special Benefit 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

There were no changes in presentation between FY 2016 and FY 2017.

T. Subsequent Events

Subsequent events and transaction occurring after September 30, 2017 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, 2017 and 2016 consisted of the following (in thousands):

	2017	2016
Fund Balances:		
General Funds	$ 26,852	$ 24,641
Other Funds	16,168	19,942
Total	$ 43,020	$ 44,583
Status of Fund Balances:		
Unobligated Balance - Available	$ 4,540	$ 345
Unobligated Balance - Unavailable	1,577	2,371
Obligated Balance Not Yet Disbursed	20,735	21,925
Subtotal	26,852	24,641
Adjustment for Non-Budgetary Funds	16,168	19,942
Total Status of Fund Balances	$ 43,020	$ 44,583

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, 2017 and 2016 consisted of the following (in thousands):

	2017	2016
Intragovernmental Accounts Receivable:		
Due from Treasury Executive Office of Asset Forfeiture	$ 347	$ 110
Due from Community Financial Development Institutions Fund	107	142
Due from Treasury Departmental Offices	-	1
Due from Department of Agriculture	-	50
Due from Department of Health and Human Services	2	-
Total Intragovernmental Accounts Receivable	$ 456	$ 303
Due from the Government of Puerto Rico	$ 498	$ 460
Due from Employees	17	1
Total Accounts Receivable Due from the Public	$ 515	$ 461

No allowance for doubtful accounts has been recognized, nor have any accounts been written off in either FY2017 or FY2016. 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, 2017 and 2016 consisted of the following (in thousands):

	2017	2016
Tax and Trade Receivables	$188,339	$ 179,923
Interest Receivable	28,767	27,168
Penalties, Fines and Administrative Fees Receivable	81,630	78,538
Total Tax and Trade Receivables	298,736	285,629
Allowance for Doubtful Accounts	(274,777)	(260,338)
Total Tax and Trade Receivables, Net	$ 23,959	$ 25,291

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. Net Tax and Trade Receivables have offsetting liabilities reported as Due to the General Fund and Due to the Wildlife Restoration 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, 2017 and 2016 consisted of the following (in thousands):

	2017	2016
Due from the General Fund	$ 12,384	$ 19,210

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.

	2017	2016
Due to the General Fund	$ 15,854	$ 18,541
Due to the Wildlife Restoration Fund	8,105	6,750
Total Custodial Liabilities	$ 23,959	$ 25,291

Amounts due to the General Fund primarily represent the balance of receivables related to Alcohol and Tobacco excise taxes. Similarly, receivables related to Firearms and Ammunition excise taxes equate to custodial liabilities payable to the Department of Interior's Wildlife Restoration Fund, as opposed to the General Fund.

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

Property, Plant and Equipment as of September 30, 2017 and 2016 consisted of the following (in thousands):

2017	Estimated Useful Life (Years)	Acquisition Value	Accumulated Depreciation	Net Book Value
Internal Use Software	3 - 5	$ 13,644	$ 13,644	$ -
Equipment	4 - 6	13,763	11,100	2,663
Leasehold Improvements	2 - 5	2,263	1,689	574
Building	40	9,772	3,370	6,402
Total PP&E		$ 39,442	$ 29,803	$ 9,639

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

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, 2017 and 2016 consisted of the following (in thousands):

	2017	2016
Beginning Balance	$ 34	$ 80
Prepayments	189	-
Liquidations	(41)	(46)
Ending Balance	$ 182	$ 34

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, 2017 and 2016 consisted of the following (in thousands):

	2017	2016
Intragovernmental Non-entity Assets:		
Fund Balance with Treasury	$ 16,168	$ 19,942
Due from the General Fund	12,384	19,210
Total Intragovernmental Non-entity Assets	28,552	39,152
Tax and Trade Receivables, Net	23,959	25,291
Total Non-Entity Assets	52,511	64,443
Total Entity Assets	37,644	36,086
Total Assets	$ 90,155	$100,529

Note 9. Other Liabilities

Other Liabilities as of September 30, 2017 and 2016 consisted of the following (in thousands):

	2017	2016
Offers-in-Compromise not yet Accepted	$ 1,758	$ 3,638
Total Other Liabilities with the Public	$ 1,758	$ 3,638

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, 2017 and 2016 consisted of the following (in thousands):

	2017	2016
Accrued FECA Liability	$ 5	$ 13
Total Intragovernmental Liabilities not Covered by Budgetary Resources	5	13
FECA Actuarial Liability	92	131
Unfunded Leave	4,747	4,469
Total Liabilities with the Public not Covered by Budgetary Resources	4,839	4,600
Total Liabilities not Covered By Budgetary Resources	4,844	4,613
Total Liabilities Covered by Budgetary Resources	59,941	71,717
Total Liabilities	$ 64,785	$ 76,330

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, 2017 and 2016 consisted of the following (in thousands):

	2017	2016
Health Insurance	$ 2,197	$ 2,516
Life Insurance	10	8
Pension	739	1,061
Total Imputed Financing	$ 2,946	$ 3,585

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 2017 or 2016.

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 $739,000 and $1.1 million for fiscal years 2017 and 2016 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 decreased in FY 2017 to $5,412 from $6,266 in FY 2016, resulting in $2.2 million of imputed cost for employees' health benefits in FY2017 versus $2.5 million in FY 2016. The cost factor, as provided by OPM, for employees enrolled in the FEGLI program, remained unchanged from FY 2016 to FY 2017, at .02 percent of employees' basic pay. The FEGLI amounts totaling $10,000 for FY 2017 and $8,000 for FY 2016 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, 2017 and 2016 consisted of the following (in thousands):

Activity	Budget Function Classification (BFC)	BFC Code	Gross Costs	Earned Revenue	Net Costs
Intragovernmental	Central Fiscal Operations	803	$ 30,330	$ (2,330)	$ 28,000
With the Public	Central Fiscal Operations	803	87,453	(3,194)	84,259
Consolidated	Central Fiscal Operations	803	$ 117,783	$ (5,524)	$ 112,259

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

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

The following chart displays balances from the FY 2016 Statement of Budgetary Resources and actual fiscal year balances included in the FY 2018 President's Budget. There were no differences related to the Salaries and Expense accounts. The FY 2019 budget, which would include FY 2017 actuals, had not been published at the time of this report.

Fiscal Year Ended September 30, 2016 (In Millions / Unaudited)	**Statement of Budgetary Resources**	**President's Budget**
Budgetary Resources:		
Appropriations	$ 106	$ 106
Spending Authority from Offsetting Collections	6	6
Budgetary Resources Available for Obligation	$ 112	$ 112
Change in Obligated Balances:		
Unpaid Obligations brought forward, Beginning of Period	$ 21	$ 21
New Obligations and Upward Adjustments	114	114
Outlays, Gross	(110)	(110)
Recoveries of Prior Year Unpaid Obligations	(1)	(1)
Unpaid Obligations, End of Period	$ 24	$ 24
Uncollected Payments, Federal Sources, End of Period	(2)	(2)
Obligated Balance, End of Period	$ 22	$ 22
Outlays:		
Outlays, Gross	$ 110	$ 110
Actual Offsetting Collections	(6)	(6)
Outlays, Net	$ 104	$ 104

Additionally, for Special and Trust Fund Receipts, the FY 2018 President's Budget disclosed budget authority of $417 million for FY 2016, which funded cover-over payments to Puerto Rico.

These amounts were not reported in the Statement of Budgetary Resources because 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, 2017 and 2016 consisted of the following (in thousands):

Fiscal Year	Apportionment Category	Direct Obligations	Reimbursable Obligations	Total New Obligations and Upward Adjs
2017	Category B	$ 108,276	$ 5,908	$ 114,184
2016	Category B	$ 108,142	$ 5,733	$ 113,875

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 apportionments by project. Based on how the Office of Managagement and Budget views TTB's operations in relation to projects, the Category B apportioments have essentially provived the Bureau full-year apportionments of its appropriations.

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.

	2017	2016
Undelivered Orders, End of Year	$ 15,528	$ 16,252

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 2017 and FY 2016, TTB collected $21.8 billion and $22.1 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 Wildlife Restoration Fund under provisions of the Pittman-Robertson Act of 1937.

- **Refunds and Other Payments**

  During FY 2017 and FY 2016, TTB issued $776 million and $815 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, $3.2 and $3.0 million in FY 2017 and FY 2016 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, 2017 and 2016 consisted of the following (in thousands):

	2017	2016
Alcohol, Tobacco, and Firearms Excise Tax Refunds	$ 55,839	$ 34,799
Drawbacks on MNBP Claims	350,055	355,668
Interest and Other Payments	136	162
Refunds and Drawbacks	406,030	390,629
Cover-over Payments - Puerto Rico	364,804	416,815
Cover-over Payments - Virgin Islands	5,122	7,975
Amounts Provided to Non-federal Entities	369,926	424,790
Total Refunds, Drawbacks and Coverover Payments	$ 775,956	$ 815,419

Note 17. Custodial Revenue

Collection and Disposition of Custodial Revenue as of September 30, 2017 and 2016 consisted of the following (in thousands):

FY 2017 Collections and Refunds by Tax Year and Type

Revenue Type	2017	2016	2015	Pre-2015	FY 2017 Total
Excise Taxes	$ 15,877,971	$ 5,939,466	$ 4,818	$ 7,403	$ 21,829,658
Fines, Penalties, Interest and Other	1,003	720	79	1,018	2,820
Total Revenue Received	15,878,974	5,940,186	4,897	8,421	21,832,478
Less: Amounts Collected for Non-federal Entities	(339,813)	(30,113)	-	-	(369,926)
Total	$ 15,539,161	$ 5,910,073	$ 4,897	$ 8,421	$ 21,462,552
Refund Type					
Excise Taxes	$ 155,837	$ 240,611	$ 6,724	$ 2,722	$ 405,894
Fines, Penalties, Interest and Other	7	41	49	39	136
Total Refunds & Drawbacks	155,844	240,652	6,773	2,761	406,030
Amounts Provided to Fund the Federal Government	$ 15,383,317	$ 5,669,421	$ (1,876)	$ 5,660	$ 21,056,522

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

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, 2017 and 2016 consisted of the following (in thousands):

	2017	2016
Resources Used to Finance Activities		
Budgetary Resources Obligated		
Obligations Incurred	$ 114,184	$ 113,875
Less: Spending Authority from Offsetting Collections and Recoveries	(7,300)	(6,846)
Obligations Net of Offsetting Collections and Recoveries	106,884	107,029
Less: Offsetting Receipts	(202)	(1)
Net Obligations	106,682	107,028
Other Resources		
Imputed Financing from Costs Absorbed by Others	2,946	3,585
Other Resources	(1)	-
Net Other Resources Used to Finance Activities	2,945	3,585
Total Resources Used to Finance Activities	$ 109,627	$ 110,613

	2017	2016
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 (+/-)	$ (1,008)	$ 2,037
Resources that Fund Expenses Recognized in Prior Periods	64	35
Other Budgetary Offsetting Collections and Receipts that do not Affect Net Cost of Operations	(202)	(1)
Resources that Finance the Acquisition of Assets	1,226	1,152
Other Resources or Adjustments to Net Obligated Resources that do not Affect Net Cost of Operations (+/-)	(200)	-
Total Resources Used to Finance Items not Part of the Net Cost of Operations	(120)	3,223
Total Resources Used to Finance the Net Cost of Operations	$ 109,747	$ 107,390
Components of the Net Cost of Operations Requiring or Generating Resources in Future Periods		
Components Requiring or Generating Resources in Future Periods:		
Other (+/-)	$ 278	$ 16
Total Components of Net Cost of Operations that will Require or Generate Resources in Future Periods	$ 278	$ 16
Components of the Net Cost of Operations not Requiring or Generating Resources		
Depreciation and Amortization	$ 2,234	$ 3,874
Revaluation of Assets or Liabilities	-	60
Total Components of Net Cost of Operations that will not Require or Generate Resources	$ 2,234	$ 3,934
Total Components of Net Cost of Operations that will not Require or Generate Resources in the Current Period	$ 2,512	$ 3,950
NET COST OF OPERATIONS	$ 112,259	$ 111,340

Note 19: Contingent Liabilities

As of September 30, 2017, TTB is not party to any legal matters where the likelihood of a material loss is reasonably possible.

3.5 Supplemental Information

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
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
2017	8,103,714	12,966,317	761,630	227	69	521	21,832,478
Average	$ 7,772,594	$ 13,256,629	$566,671	$ 292	$ 121,684	$ 518	$ 21,718,388

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 Wildlife Restoration Fund. During fiscal years 2017 and 2016, TTB incurred $2.2 million and $1.8 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
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
2017	364,804	5,122	55,839	350,055	136	775,956
Average	$ 383,023	$ 8,121	$ 31,815	$ 311,922	$ 901	$ 735,782

AT&F – Alcohol, Tobacco, and Firearms
MNBP – Manufacturer of Nonbeverage Products

Other Accompanying Information
Combined Schedule of Spending
For the Years Ended September 30, 2017 and 2016
Unaudited (In Thousands)

	2017	2016
What Money is Available to Spend		
Total Resources	$ 120,301	$ 116,591
Less: Amount Available but not Agreed to be Spent	(4,540)	(345)
Less: Amount Not Available to Be Spent	(1,577)	(2,371)
Total Amounts Agreed to be Spent	$ 114,184	$ 113,875
How was the Money Spent		
Collect the Revenue		
Object Class 11: Personnel Compensation	$ 24,115	$ 24,419
Object Class 12: Personnel Benefits	7,819	7,804
Object Class 21: Travel	1,201	1,325
Object Class 23: Rent, Utilities, and Telecommunications Services	2,753	2,930
Object Class 25: Contractual Services	17,567	17,732
Object Class 31: Equipment and Software	1,607	2,422
Other	387	410
Total Collect the Revenue	55,449	57,042
Protect the Public		
Object Class 11: Personnel Compensation	26,823	24,322
Object Class 12: Personnel Benefits	8,483	7,587
Object Class 21: Travel	611	521
Object Class 23: Rent, Utilities, and Telecommunications Services	2,907	2,840
Object Class 25: Contractual Services	17,529	15,740
Object Class 31: Equipment and Software	1,542	1,976
Other	347	488
Total Protect the Public	58,242	53,474
Total Spending	113,691	110,516
Change in Amounts Remaining to be Spent	493	3,359
Total Amounts Agreed to be Spent	$ 114,184	$ 113,875
Who did the Money go to		
Federal Recipients	$ 27,244	$ 25,723
Non-Federal Recipients	86,447	84,793
Total Spending	113,691	110,516
Change in Amounts Remaining to be Spent	493	3,359
Total Amounts Agreed to be Spent	$ 114,184	$ 113,875

Intragovernmental Assets

Other Accompanying Information
Intragovernmental Assets
As of September 30, 2017
Unaudited (In Thousands)

Trading Partner	Agency Code	Fund Balance W/ Treasury	Accounts Receivable
Department of the Treasury	020	$ -	$ 454
Department of Health and Human Services	075	-	2
General Fund	--	43,020	12,384
Total		$ 43,020	$ 12,840

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

Intragovernmental Liabilities

Other Accompanying Information
Intragovernmental Liabilities
As of September 30, 2017
Unaudited (In Thousands)

Trading Partner	Agency Code	Accounts Payable	Accrued FECA	Custodial and Other Liabilities
Government Printing Office	004	$ 162	$ -	$ -
Department of the Interior	014	-	-	8,104
Department of Justice	015	621	-	-
Department of Labor	016	-	5	-
Department of the Treasury	020	110	-	-
Office of Personnel Management	024	-	-	414
General Services Administration	047	99	-	-
General Fund	--	-	-	15,991
Total		$ 992	$ 5	$ 24,509

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

Intragovernmental Earned Revenue

Other Accompanying Information
Intragovernmental Earned Revenue
For the Fiscal Years Ended September 30, 2017 and 2016
Unaudited (In Thousands)

Trading Partner	Agency Code	2017	2016
Department of Agriculture	012	$ -	$ 50
Department of Treasury	020	2,321	3,151
Department of Health and Human Services	075	9	94
Total		$ 2,330	$ 3,295

Budget Function Classification (BFC)	BFC Code	2017	2016
Central Fiscal Operations	803	$ 2,330	$ 3,295
Total		$ 2,330	$ 3,295

Intragovernmental Gross Cost

Other Accompanying Information
Intragovernmental Gross Cost
For the Fiscal Years Ended September 30, 2017 and 2016
Unaudited (In Thousands)

Trading Partner	Agency Code	2017	2016
Library of Congress	003	$ 52	$ 59
Government Printing Office	004	248	214
Department of Commerce	013	2	1
Department of Interior	014	48	42
Department of Justice	015	805	794
Department of Labor	016	3	6
United States Postal Services	018	20	29
Department of the Treasury	020	6,534	5,866
Office of Personnel Management	024	13,694	13,976
General Services Administration	047	5,052	4,656
Department of the Air Force	057	5	7
Environmental Protection Agency	068	2	-
Department of Homeland Security	070	330	298
Department of Health and Human Services	075	25	18
National Archives Records Administration	088	37	36
Department of Defense	097	45	43
General Fund	–	3,428	3,275
Total		$ 30,330	$ 29,320

During fiscal years 2017 and 2016, TTB incurred costs with other Federal agencies totaling approximately $30.3 million and $29.3 million, in each year respectively. The majority of those costs were associated with the five entities detailed below.

- **Department of Justice:** TTB paid ATF $805,000 and $794,000 in fiscal years 2017 and 2016 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 2017 and 2016 in the amounts of $6.5 million and $5.9 million respectively.
- **Office of Personnel Management:** TTB incurred $13.7 million and $14.0 million in costs for employee benefits during fiscal years 2017 and 2016 respectively.
- **General Services Administration:** TTB paid $5.1 million and $4.7 million to GSA for rent and information technology services in fiscal years 2017 and 2016 respectively.
- **General Fund:** The Bureau paid $3.4 and $3.3 million, in fiscal years 2017 and 2016 respectively, for employee benefits and lockbox fees.

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Part IV: Appendicies

4.1 Principal Officers of TTB

Administrator	John Manfreda
Deputy Administrator	Mary Ryan
Chief of Staff	Elisabeth Kann
Assistant Administrator, Field Operations	Tom Crone
Assistant Administrator, Permitting & Taxation	Daniel Riordan
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
Congressional and Public Affairs	Tom Hogue
Communications	Barbara Pearson
Strategic Planning and Program Evaluation	Jill Murphy
Chief Counsel	Anthony Gledhill

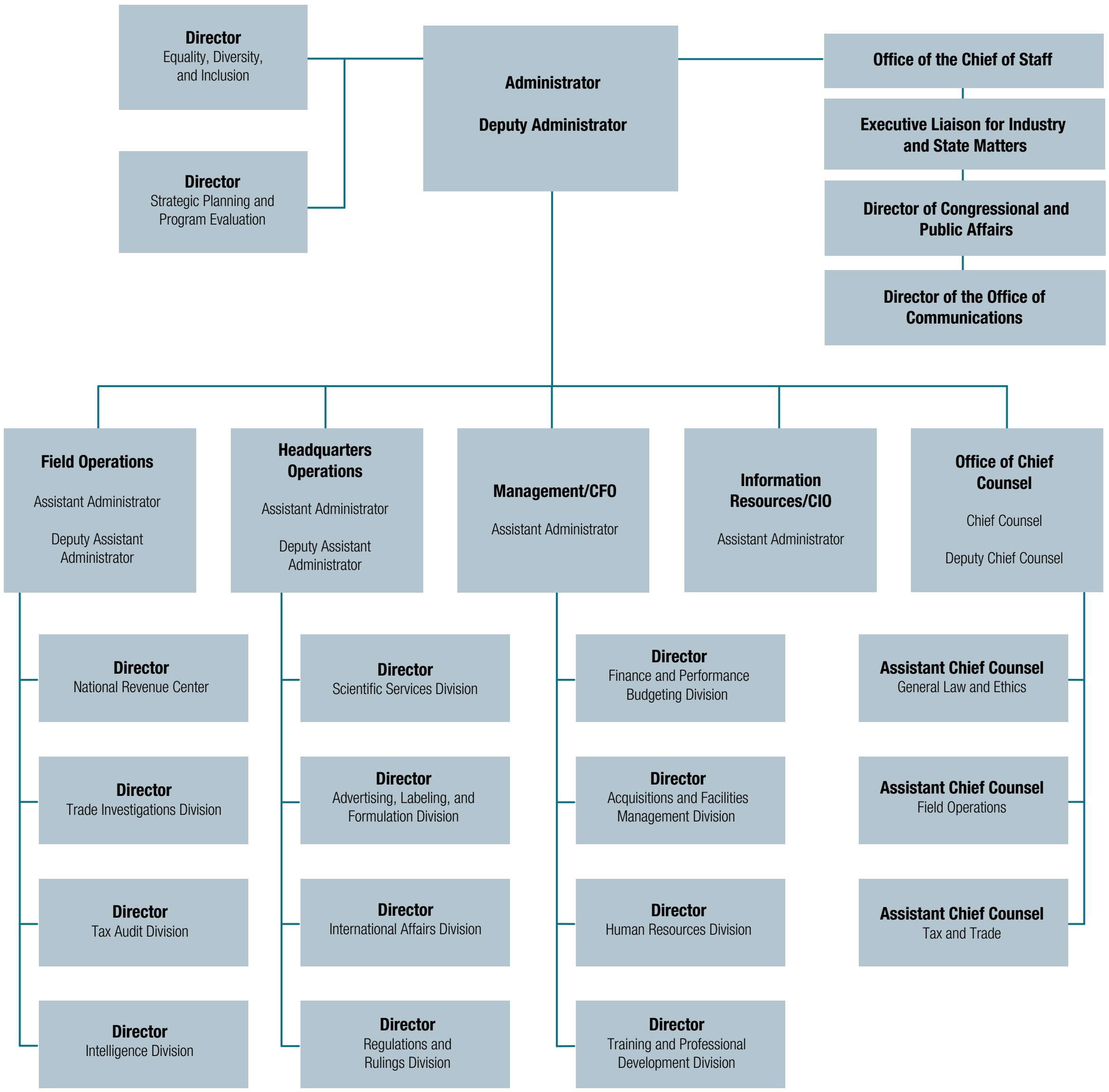
For additional information, contact:

Alcohol and Tobacco Tax and Trade Bureau
1310 G Street, NW, Box 12
Washington, DC 20005

(202) 453-2000

http://www.ttb.gov

4.2 TTB Organization Chart



4.3 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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