

GAO

Report to the Subcommittee on Domestic
and International Monetary Policy, Trade,
and Technology, Committee on Financial
Services, House of Representatives

April 2004

COINS AND CURRENCY

How the Costs and Earnings Associated with Producing Coins and Currency Are Budgeted and Accounted For



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Highlights

Highlights of [GAO-04-283](#), a report to the Subcommittee on Domestic and International Monetary Policy, Trade, and Technology, Committee on Financial Services, House of Representatives

Why GAO Did This Study

The government produces billions of coins and currency notes each year. Coins are made by the U.S. Mint and issued by the Treasury Department. Currency notes are made by the Bureau of Engraving and Printing and issued by the Federal Reserve System (Fed). The Fed buys coins from the Mint at face value but pays the Bureau only the costs of printing currency. Coins on the books of the Fed are assets that are issued by the Mint, and notes are liabilities of the Federal Reserve Banks. In recent years congressional hearings have highlighted the confusion over differences in the budgetary and accounting treatment of coins and currency. In addition, the Treasury Inspector General and others have reported problems with Mint and Bureau operations. GAO was asked to review (1) how the costs and earnings from coins and currency are budgeted and accounted for and (2) whether any operational problems at the Mint and Bureau need further action.

What GAO Recommends

To comply with the purpose of the reporting requirement of the Public Enterprise Fund, GAO recommends that the Secretary of the Treasury ensure that the Mint identifies whether amounts are being retained in excess of the estimated operating costs of the following year and, if so, explains how they will be used. In response to Treasury's comments, GAO revised its recommendation.

www.gao.gov/cgi-bin/getrpt?GAO-04-283.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Bernard Ungar, (202) 512-2834, or ungarb@gao.gov.

COINS AND CURRENCY

How the Costs and Earnings Associated with Producing Coins and Currency Are Budgeted and Accounted For

What GAO Found

The earnings from issuing both coins and currency reduce government borrowing costs; however, how these earnings are budgeted and accounted for differs. Production costs of coins and currency are generally treated the same in the budget and accounting statements. The difference between the face value of coins and the costs of minting them results in earnings, called seigniorage, which is shown in the budget as a reduction in needed borrowing for the government, after the deficit or surplus for the year is calculated. The budgetary impact of seigniorage is interest avoided from the borrowing it displaces and is not visible because it is neither quantified nor shown in the budget. The government also generates earnings by issuing currency, but it is handled differently. The difference between the face value of currency issued and its production cost goes to the Fed. The Fed buys collateral, usually Treasury securities, to back up the currency issued. The interest collected on those Treasury securities is used to pay for Fed costs, and the remainder is returned to Treasury. The budgetary impact of issuing currency comes from the interest returned by the Fed, which is shown as a budgetary receipt and counted in the calculation of the deficit or surplus. Production costs of both coins and currency are shown as costs of operations in Treasury's financial statements. According to the Federal Accounting Standards Advisory Board, seigniorage should be shown as a source of financing in Treasury's statement of changes in net position, whereas interest returned by the Fed for currency is shown as revenue in Treasury's statement of custodial activity. Treasury has not been reporting seigniorage this way but made the correction beginning with its fiscal year 2003 financial statements.

Both the Mint and the Bureau have had operational problems in recent years in contracting and acquiring property and equipment. The Mint has also had problems with forecasting demand, monitoring costs, and reporting to Congress. The Mint and Bureau have generally taken or started to take actions to address the problems. The Mint has clarified its first quarterly report for 2004 to include more information on how retained funds will be used. However, the Mint is still not explicitly stating whether the retained amounts are in excess of the estimated operating costs for the following year and, if so, it is not explaining how the retained earnings will be used, as required by law.

Examples of Currency and Coin



Sources: U.S. Mint and Bureau of Engraving and Printing.

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Abbreviations

BEP	Bureau of Engraving and Printing
FASAB	Federal Accounting Standards Advisory Board
Fed	Federal Reserve System
GSA	General Services Administration
IG	Inspector General
OMB	Office of Management and Budget

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United States General Accounting Office
Washington, D.C. 20548

April 23, 2004

The Honorable Peter T. King
Chairman
The Honorable Carolyn B. Maloney
Ranking Minority Member
Subcommittee on Domestic and International
Monetary Policy, Trade, and Technology
Committee on Financial Services
House of Representatives

The government produces billions of coins and currency notes each year. Coins are manufactured by the U.S. Mint, a bureau within the Department of the Treasury, and issued by the Department of the Treasury. Currency notes are produced by the Bureau of Engraving and Printing (BEP), another bureau of the Department of the Treasury, and issued by the Federal Reserve banks, which are part of the Federal Reserve System (Fed), an independent government entity. Both coins and currency are physically distributed to depository institutions by the Fed. In recent years, the Department of the Treasury Inspector General and others have reported problems with Mint and BEP operations, and congressional hearings have highlighted the confusion over the differences in the budgetary and accounting treatment of coins and currency. Because of these issues, we agreed to review (1) how the costs and earnings from producing coins and currency are budgeted and accounted for and (2) whether there are any operational problems at the Mint and BEP needing further action.

To address these questions, we obtained and reviewed legislation, budgetary guidance, and financial reports for the Mint, BEP, Treasury, and the Fed concerning how funds for the production and issuance of coins and currency are obtained and used. To determine if there are operational problems at the Mint and BEP needing further action, we agreed with your offices to review areas that had been previously identified as having operational problems. These areas included forecasting demand for coins and currency, monitoring production costs, contracting for goods and services, acquiring property and equipment, and reporting operational plans and results to Congress. We obtained and reviewed recent Inspector General, GAO, congressional, and other reports in these areas. Because we did not have the resources to extensively evaluate each issue, we identified a few key measures that are commonly used to evaluate an organization's performance for each of these areas. We obtained information on each

measure from the Mint and BEP and determined how the agencies had addressed or planned to address the problems we identified. We reviewed documentation; interviewed Mint, BEP, and Fed officials; and interviewed current and past congressional staff who worked in Mint and BEP oversight. We performed our work in Washington, D.C., from September 2002 through March 2004 in accordance with generally accepted government auditing standards. Our detailed scope and methodology are contained in appendix I.

Results in Brief

The earnings resulting from issuing both coins and currency reduce the cost of government borrowing; however, how these earnings are budgeted and accounted for differs. The production costs of coins and currency are generally treated the same in the budget and accounting statements. The recognition of the government's earnings from coins—the difference between the Mint's production costs and face value called seigniorage—is shown in the federal budget as a reduction in needed borrowing, after the government's deficit or surplus is calculated. However, the interest avoided from the borrowing displaced by seigniorage is neither quantified nor shown in the budget. Because the operations of the Federal Reserve banks are not subject to the federal budget process, the Federal Reserve banks' earnings from the issuance of currency is treated differently from seigniorage in the federal budget. The Federal Reserve, in conducting monetary policy, in effect uses receipts from the issuance of Federal Reserve notes to buy Treasury securities on the open market. The securities serve as collateral for the Federal Reserve notes issued by the Federal Reserve banks. The Fed normally transfers to Treasury most of its revenues, including its interest earnings from securities that reserve banks hold. For securities, the transfer is net of its operating expenses, which include payments to BEP for producing the Federal Reserve notes. While the reserve banks' payments to Treasury are not subject to some federal budget procedures, these payments are shown as a miscellaneous receipt in the federal budget and are used in the annual calculation of the budget's deficit or surplus. Production costs of both coins and Federal Reserve notes have been accounted for as increases in the net cost of operation in Treasury's consolidated financial statements. However, seigniorage on coins is supposed to be shown on Treasury's consolidated statements as an "other source of financing." During our review, Treasury officials made the correction in the financial reporting of seigniorage beginning with their fiscal year 2003 financial statements.

Although both the Mint and BEP have had problems in recent years in contracting and acquiring property and equipment, they have taken steps to address these problems. The Mint has also addressed problems it has had with forecasting demand for coins and monitoring costs; however, it has not completely complied with the requirement to report annually to Congress on seigniorage. When the Mint's revolving fund was established in 1995, the legislation required the Mint to report annually on the amount of seigniorage transferred to Treasury and the specific purposes for which amounts retained in excess of the estimated operating costs for the following year will be used. However, congressional intent indicated that this reporting requirement was not limited to the following year's estimated operating costs. The Mint has not been identifying whether amounts are being retained in the fund in excess of the estimated operating costs for the following year or how retained amounts will be used. We are recommending that the Treasury Secretary ensure that the Mint Director identifies whether amounts are being retained in excess of the estimated operating costs for the following year and, if so, explains the specific purposes for which retained amounts will be used in reports to Congress each year. In commenting on this report, Treasury noted that it is only required to report additional information on the retained amounts in certain circumstances, and we revised our recommendation accordingly. Treasury said the Mint revised the first quarter report in fiscal year 2004 on the revolving fund to be more responsive to the reporting requirement. However, the Mint still did not explicitly state in that report whether amounts are being retained in excess of the estimated operating costs of the following year. Both Treasury and the Fed also provided technical comments, which we included in the report, where appropriate.

Background

The federal government has issued coins since its inception, but currency was originally issued by private banks that were chartered by the states. The federal government's issuance of currency began during the Civil War. Federal Reserve notes, which constitute virtually all U.S. currency we now use, were first issued in 1914, when the nation's central bank, the Fed, was established. Coins and federal currency other than Federal Reserve notes were distributed by the Treasury Department until 1920, when this function was transferred to the Fed.¹ The Mint produces coins to meet public demand, and the BEP produces currency that the Fed orders. A more

¹The Treasury Cash room in Washington, D.C., and the Puerto Rico Cash Depot, however, continued to distribute currency until the mid-1970s.

complete history of money and banking in the United States is discussed in appendix II.

Evolving Role of the Department of the Treasury

The Constitution gave Congress the power to coin money and regulate its value and prohibited states from coining money, issuing bills of credit, or making anything but gold and silver coin a tender in payment of debts.² The Mint was established in 1792 and delivered coins in 1793. The Mint was originally part of the Department of State and became part of the Department of the Treasury in 1873.

In 1846, the government separated its finances from commercial banks. Government monies were to be deposited in the main Treasury or in one of nine Subtreasuries—branches of the main Treasury—located throughout the United States. By 1863, when the national banking system was established, the government relied more on national banks than on the Subtreasuries, but the Subtreasuries and the main Department of the Treasury in Washington, D.C., were the only channels used to distribute coins and Treasury currency. Congress gave responsibility for designing U.S. currency to the Department of the Treasury and established the Secret Service as a Treasury bureau to guard against counterfeiting. In 1920, the Secretary of the Treasury was authorized to delegate the duties of distributing currency and coin that had been handled by the Treasury and the Subtreasuries to the Fed.

The responsibilities of the Federal Reserve, as the central bank of the United States, fall into four general areas: conducting the nation's monetary policy; supervising and regulating banking institutions; fostering the stability of the financial system; and providing certain financial services to the U.S. government and to financial institutions, including playing a major role in operating the nation's payments system. The Fed's operations are carried out by 12 Federal Reserve district banks that are overseen by the Board of Governors. Federal Reserve notes in circulation are recorded as liabilities of the Federal Reserve district banks that issue them, and they are the banks' largest liabilities. Treasury securities are the largest assets of the Federal Reserve district banks. The Fed forecasts the amount of currency that will be needed to meet demand each year and submits an order to BEP for new Federal Reserve notes. On the basis of the new

²Article 1, Section 8, Clause 5; and Article 1, Section 10, Clause 1.

currency order, BEP establishes a billing rate to be paid by the Fed for the cost of manufacturing Federal Reserve notes. The Fed pays BEP the costs of developing and printing the currency. The Fed, through its district banks, distributes Federal Reserve notes to depository institutions to meet demand throughout the United States and the world.

The Fed has a more limited role with coins than it does with currency. Unlike Federal Reserve notes, coins are not liabilities of the Federal Reserve banks. The Mint determines its annual coin production and monitors Fed coin inventories to identify trends in coin demand. The Fed buys coins from the Mint for face value. Upon receiving coin orders from the Fed, the Mint distributes coins to the Federal Reserve banks from its Philadelphia and Denver production facilities, and the Federal Reserve banks distribute coins to satisfy depository institutions demand. In addition to the Federal Reserve banks and their branches, the Fed also contracts with about 175 coin terminals to distribute coins to the banking system. The terminals are generally operated by armored carrier companies, which may be paid by depository institutions and retailers to wrap coins and perform other services.

The primary mission of the Mint is to produce circulating coins in Philadelphia and Denver for trade and commerce. The Mint also produces and sells numismatic (collectors) coins and medals and gold and silver bullion coins and operates the government's primary gold bullion storage facility in Fort Knox, Kentucky. BEP, which was established in 1862, operates facilities in Washington, D.C., and Ft. Worth, Texas, where it designs and prints the nation's currency, some postage stamps, and other security documents such as military identification cards. The agencies involved in issuing and producing coins and currency are summarized in table 1.

Table 1: Agencies Involved in Production and Issuance of Coins and Currency

	Coin	Currency
Issuer	Treasury	Fed
Producer	Mint	BEP
Distributor	Fed	Fed
Locations produced	Philadelphia, Denver	Washington, D.C.; Ft. Worth
Face value goes to	Mint	Fed
Production costs paid by	Treasury (which receives face value of coins from the Fed)	Fed

Sources: BEP, Fed, and U.S. Mint.

In 2002, the Mint sold about 15 billion coins with a face value of \$1.4 billion that it produced at a cost of \$436 million; BEP produced 7 billion notes with a face value of \$103.5 billion at a cost of \$384 million. The Fed spent about \$30 million to process coins and \$342 million to process currency in 2002. The number and dollar value of coins and currency issued for the last 5 years are shown in table 2.

Table 2: Coin and Currency Production Data for Fiscal Years 1998 through 2002

Dollars in millions (current year dollars)

	Fiscal year				
	1998	1999	2000	2001	2002
Coins					
Face value of circulating coins produced	\$923	\$1,455	\$3,220	\$2,021	\$1,364
Number of circulating coins shipped to the Fed	16,645	20,374	27,187	23,224	14,962
Mint's cost of producing circulating coins	\$330	\$421	\$697	\$564	\$436
Fed's costs of processing coins ^a	\$32	\$24	\$25	\$25	\$30
Currency^b					
Face value of Federal Reserve notes produced	\$173,930	\$285,490	\$67,460	\$45,740	\$103,520
Number of notes produced	9,200	11,357	9,030	7,005	7,005
BEP's cost of producing currency	\$370	\$501	\$409	\$327	\$384
Fed's costs of processing currency ^c	\$261	\$287	\$304	\$330	\$342

Sources: BEP, Fed, and U.S. Mint.

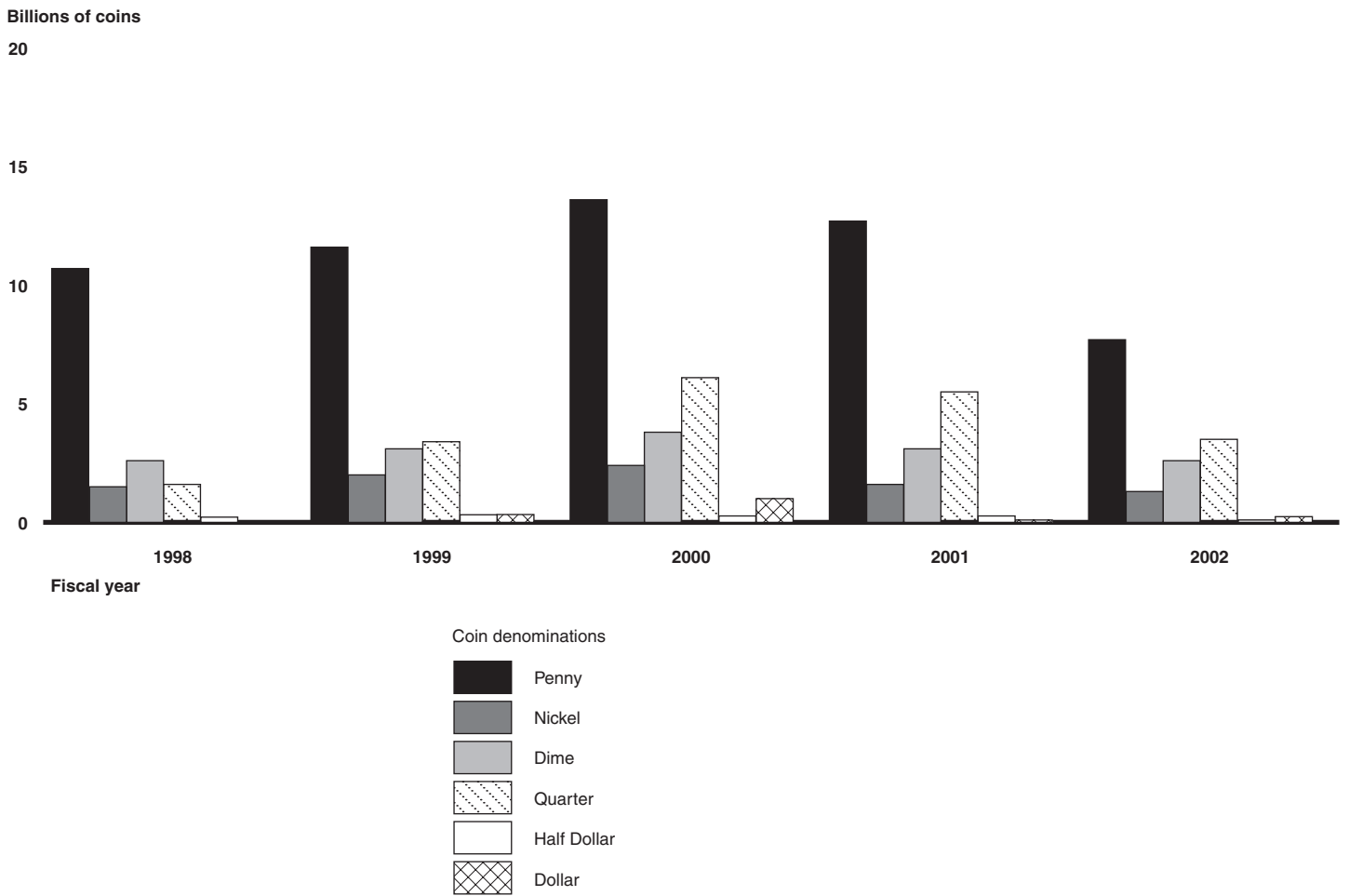
^aFed cost data are on a calendar year basis and include expenses for wrapping and paying and receiving coins.

^bStatistics for currency in 1999 reflect unusual demand from the century date change.

^cFed cost data are on a calendar year basis and include expenses for transportation, distribution, paying, receiving, and verification and destruction of currency.

The penny represents more than half of the Mint's yearly production of coins, as shown in figure 1. Figure 2 shows that BEP generally produces more \$1 notes than other denominations; however, in 1999, more \$20 notes were produced than \$1 notes as precautionary inventory for the century date change.

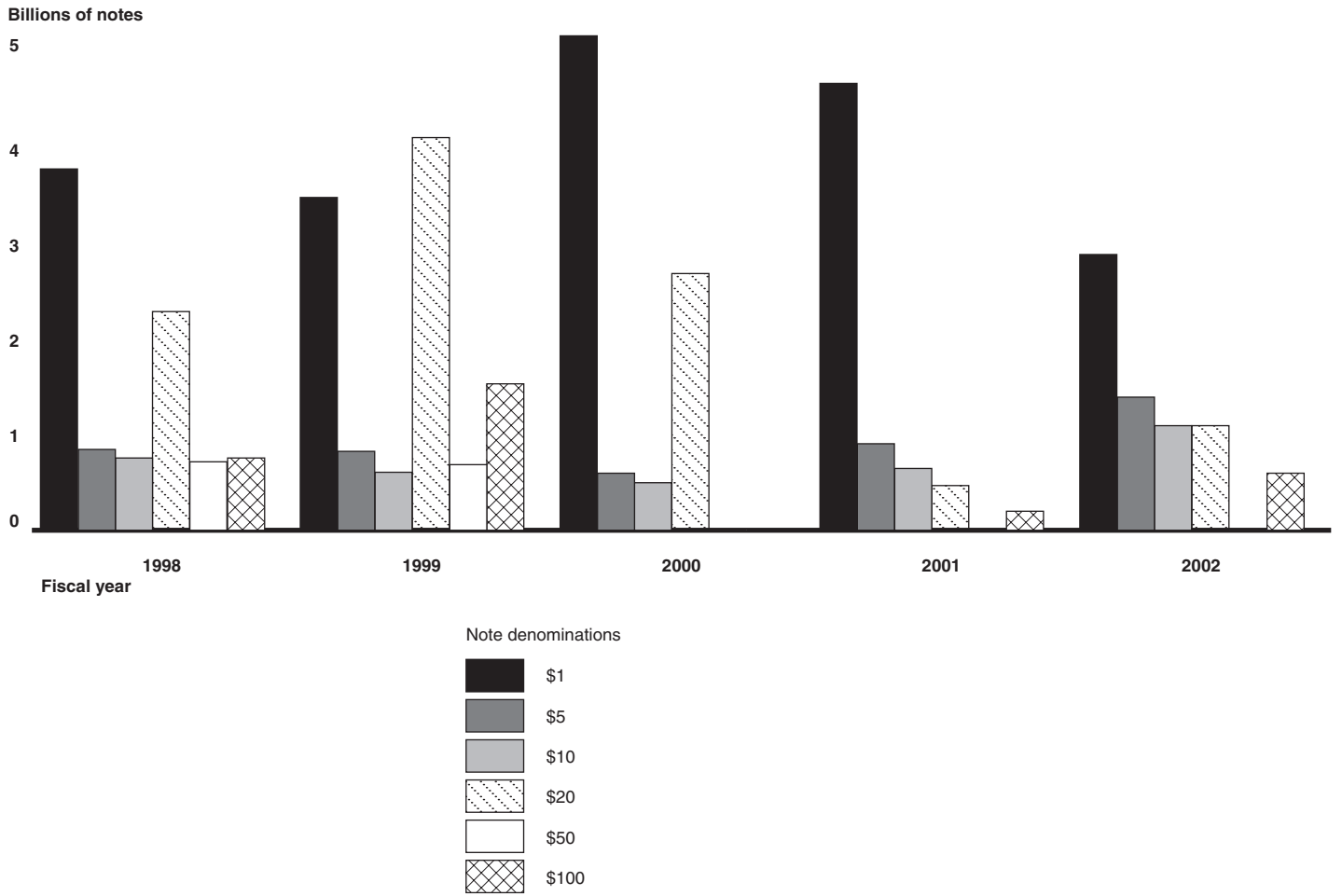
Figure 1: Mint's Coin Production for Fiscal Years 1998 through 2002



Source: U.S. Mint.

Note: In fiscal year 1998, the Mint did not produce the dollar coin. The number of half-dollar coins produced in fiscal year 2002 and the number of dollar coins produced in fiscal year 2001 are too small to depict on our scale.

Figure 2: BEP Currency Production for Fiscal Years 1998 through 2002



Source: BEP.

Note: The volume for 1999 reflects the century date change. In fiscal year 2000, BEP did not produce \$50 and \$100 notes. In fiscal years 2001 and 2002, the \$50 note was not produced.

Budgeting and Accounting for the Costs of Production and Earnings from Coins and Currency Are Different

The Mint's circulating coinage operations and BEP's currency operations are financed solely by payments from the Fed. Coins and Federal Reserve notes are treated differently in the budget, reflecting the entities that issue them. The Fed has never been included in the federal budget due to judgments that fiscal and monetary policy should be kept separate. The federal budget, by definition, proposes future amounts of revenues and outlays. Because the Mint, a part of Treasury, is included in the budget, the recognition of the earnings from coins—the difference between production costs and face value, called seigniorage—is shown in the federal budget as a reduction in needed borrowing for the government, after the deficit or surplus for the year is calculated. Earnings from Federal Reserve notes are realized by the nonbudgetary Fed. The Federal Reserve district banks use receipts from the issue of Federal Reserve notes to buy Treasury securities on the open market.³ The securities serve as collateral for the Federal Reserve notes issued by the banks. The Fed transfers to the Treasury its interest earnings on those securities, net of its operating expenses, including payments to BEP for producing Federal Reserve notes. The transferred interest earnings are shown as a miscellaneous receipt in the federal budget under “deposit of earnings, Federal Reserve System,” and are counted in the federal budget's annual calculation of the deficit or surplus.

Production costs of both coins and Federal Reserve notes are accounted for as increases in the net cost of operations in Treasury's consolidated financial statements. Federal accounting standards provide that seigniorage be accounted for as a source of financing in Treasury's statement of changes in net position, whereas interest earned by the Fed for its open market operations is accounted for as revenue received on Treasury's statement of custodial activity. Treasury has not been reporting seigniorage correctly in its consolidated financial statements but corrected its misclassification beginning in fiscal year 2003.

³The Federal Reserve System buys and sells securities in the course of implementing monetary policy. The Federal Reserve's purchase and sale of Treasury securities are influenced by, among other things, increases and decreases in currency in circulation. In particular, as more currency is placed into circulation, reserves are drained from the banking system as depository institutions pay for the additional notes. The Federal Reserve increases its holdings of Treasury securities to offset this drain on reserves.

Budgeting for Coin and Currency Production Costs

The costs of producing coins by the Mint and currency by BEP are treated the same in the federal budget. Both the Mint and BEP have revolving funds⁴ that receive collections from the Fed. The Fed pays Treasury the full face value of coins that it buys, and Treasury then allocates the payments to the Mint. When Congress established the Mint's Public Enterprise Fund in 1996, the Senate Appropriations Committee noted that the production of coins was driven by demand and that the variability of annual appropriations placed a burden on production operations, so the Mint was allowed to operate without annual appropriations. All Mint revenues are deposited into its Public Enterprise Fund, including receipts from the Fed from the sale of circulating coins at face value, and all expenses for making coins are paid out of the Public Enterprise Fund. However, only the revenue sufficient to cover the Mint's costs of producing coins is included as a collection from the Fed in the federal budget, not the full face value of the coins. At least once a year, any amount that is determined by the Mint to be in excess of the amount required by the Public Enterprise Fund is to be transferred to Treasury's general fund.

The Fed pays BEP the production costs of Federal Reserve notes rather than the full face value. All BEP receipts are deposited into the Bureau of Engraving and Printing Fund and are used to pay for BEP's operating and capital equipment costs. BEP was authorized to establish reimbursement prices from customer agencies at a level intended to cover the costs of services provided and to provide funding for the acquisition of capital equipment and future working capital. Similar to the Mint, BEP operates without annual appropriations. At the beginning of each year, BEP establishes a billing rate for currency production, based on the annual Fed currency order, past costs, expected increases, capital needs and working capital needs.

Although the expected costs of Mint and BEP operations and collections from the Fed are both included in the Treasury budget submission, as a practical matter, the inclusion of the expected outlays and collections in the budget is only a notification to Congress that collections deposited in the revolving funds will be expended to produce the coins and currency in the amounts estimated. If outlays during the year are higher than what is in the budget, the Mint and BEP must notify Treasury and request an

⁴The Mint's revolving fund is set forth at 31 U.S.C. 5136, and BEP's revolving fund is set forth at 31 U.S.C. 5142.

apportionment from the Office of Management and Budget (OMB), but congressional approval of the request is not necessary. An apportionment is a plan, approved by OMB, to spend resources provided by law.

Budgeting for Coin and Currency Earnings

The profit earned from making coins, or seigniorage, is shown in the budget as a means of financing the government's borrowings and is not counted as revenue in calculating the deficit or surplus for the annual budget.

Seigniorage reduces the government's requirement to borrow money from the public to finance the debt. Although the profit earned from making coins adds to the government's cash balance, it does not involve a payment from the public, which is considered a receipt.⁵

The use of seigniorage by governments to raise revenues goes back hundreds of years in world history. In the Middle Ages, for example, authenticated coinage made payment of debts convenient. Because of their convenience, coins commonly had a substantial premium—more than enough to cover the costs of minting—to pay for the authentication. Kings could turn this premium into personal profit, and to maximize the earnings, they recalled coinage every few years even if the coins were not worn.

The Federal Reserve banks' issuance of currency is treated differently in the federal budget. The Fed is not subject to the appropriations process and, aside from the recording of transfers of Fed earnings from its open market operations, its operations are excluded from the federal budget. This special budgetary status stems from the desire to protect the flexibility and independence of the central bank. On a weekly basis, the Fed transfers its interest earnings on government securities, net of its expenses such as payments to BEP for Federal Reserve note production, to the Treasury. Because the Fed is not included in the federal budget, these payments from the Fed to Treasury are treated as budgetary receipts, as if they were from the public, when the annual deficit or surplus in the budget is calculated.⁶

⁵Because it is not considered a receipt, seigniorage is not counted, or scored by the Congressional Budget Office or the Office of Management and Budget, for purposes of determining the budgetary effects of legislation.

⁶Because the interest payments from the Fed are considered receipts, they are scored by the Congressional Budget Office and the Office of Management and Budget when determining the budgetary effects of legislation.

Interest paid by Treasury on all government securities is included in the Treasury budget as an outlay.

A report from the House Banking and Currency Committee in September 1913, during its consideration of the bill that eventually established the Federal Reserve, gave two reasons why the government should share in the earnings that the Federal Reserve banks would make. First, the federal government gave the Fed the sole and exclusive function of note issuance, from which all other banks were prohibited. Second, the government's deposit of public funds with the Fed was larger than that of any other depositor. The committee anticipated that after the national bank notes that were in existence at that time had been replaced with Federal Reserve notes, the function of issuing currency would result in large earnings for the Fed that it could not earn were it to share this privilege with other banks. The committee believed the public was entitled to these earnings.

In summary, although the production of money by the government through both coins and currency generates earnings and saves interest costs, the recognition of the interest is different and less visible for coins. For coins, an increase in the cash available to Treasury because of seigniorage reduces borrowing and the interest that would have otherwise been paid. However, the interest avoided from the borrowing displaced by seigniorage is neither quantified nor shown in the budget. For currency, interest earnings generated from Fed open market operations are actually paid to the Fed, and earnings in excess of Fed expenses are then returned to the Treasury and recorded as a receipt in the budget.

In 2002, the Mint transferred \$1 billion in seigniorage from coins and the Fed transferred about \$24.5 billion in excess earnings, derived largely from holdings of U.S. government securities, which are attributable, in part, to the value of currency in circulation. Seigniorage transferred from Mint operations and interest earnings returned from open market operations for the last 5 years are shown in table 3.

Table 3: Seigniorage Transferred and Interest Earnings Returned from the Fed for Currency, Fiscal Years 1998 through 2002

Dollars in millions

	Fiscal year				
	1998	1999	2000	2001	2002
Seigniorage from the Mint transferred to Treasury	\$562	\$1,020 ^a	\$2,280 ^b	\$1,380	\$1,000
Interest earnings returned to Treasury from the Fed for open market operations ^c	\$26,561	\$25,410	\$25,344	\$27,089	\$24,495

Sources: Fed and U.S. Mint.

^aThe 50-State Quarters Program was introduced in 1999, accounting for most of the increase from 1998 to 1999.

^bThe Sacagawea dollar coin was introduced in 2000, accounting for most of the increase from 1999 to 2000.

^cFed interest data is on a calendar year basis.

Accounting for Coin and Currency Production Costs

For the consolidated financial statements of the Department of the Treasury, the Mint's coin production costs and BEP's currency production costs are both accounted for as costs in the "net cost of operations" in Treasury's Consolidated Statement of Changes in Net Position and as a decrease in the net position (equity) in the Consolidated Balance Sheet.

Accounting for Earnings Made on Coins and Currency

Seigniorage on coins should be shown as "other source of financing" in Treasury's Consolidated Statement of Changes in Net Position, as provided for in the Federal Accounting Standards Advisory Board (FASAB).⁷ However, Treasury has been accounting for seigniorage as a reduction in the net cost of operations in its Consolidated Statement of Changes in Net Position. Although Treasury's net cost of operations has included seigniorage as a reduction in costs, seigniorage had not been separately labeled in the statement. During our review, Treasury officials corrected the financial reporting treatment of seigniorage beginning with the fiscal year 2003 statements and reclassified the fiscal year 2002 statements. The effect of the reclassification of the 2002 statements was an increase in the

⁷The Mint shows the earnings from circulating coins, by denomination, in its annual reports as a supplementary schedule.

net cost of operations by about \$1 billion. However, there was no effect on the reported net position.

The earnings from interest on government securities the Fed returns to Treasury are reported as “deposit of earnings, Federal Reserve System,” on the Statement of Custodial Activity for Treasury’s financial statements.

Summary of Budgeting and Accounting Treatments of Producing and Issuing Coins and Currency

Table 4: Summary of Budgeting and Accounting for Coin and Currency Production and Issuance

	Coin	Currency
Budgeting		
Production costs	Costs of production and the offsetting revenues from the Fed in the same amount are included in the Treasury’s budget submission for information purposes.	Costs of production and the offsetting revenues from the Fed in the same amount are included in the Treasury’s budget submission for information purposes.
Issuance/earnings	Seigniorage is treated as a means of financing the deficit, resulting in a reduction in borrowing. The interest avoided by seigniorage is not quantified or shown in the budget.	Fed interest earnings paid to the Treasury are treated as a budgetary receipt.
Accounting		
Production costs	Treasury shows production costs in the net cost of operations and a decrease in the net position (equity) of Treasury.	Treasury shows production costs in the net cost of operations and a decrease in the net position (equity) of Treasury.
Issuance/earnings	Seigniorage is shown as a source of funding in Treasury’s consolidated net position.	Interest earnings exceeding Fed operating expenses that are returned by the Fed are reported as revenue in Treasury’s Statement of Custodial Activity.

Sources: BEP, Fed, U.S. Mint, and Treasury.

Operational Problems Identified at the Mint and BEP

As agreed with your offices, we looked at the following areas of Mint and BEP operations: forecasting public demand for coins and currency, monitoring production costs, contracting for goods and services, acquiring plant and equipment, and reporting operational plans and results to

Congress. These areas had been previously identified by the Treasury Inspector General or others as having problems. We did not have the resources to extensively evaluate each area. Therefore, for each area, we applied commonly used performance indicators as measures that addressed such issues as cost/efficiency, quality/effectiveness, customer satisfaction, and financial reporting. We also reviewed previous reports conducted by the Treasury Inspector General, GAO, and others and followed up with the agencies to see what action had been taken since the reports were issued.

In recent years, both the Mint and BEP have had some problems in contracting for and acquiring property and equipment. In addition, the Mint has had problems with forecasting demand, monitoring costs, and reporting plans and results to Congress. The Mint and BEP have generally taken action or have begun to address the problems identified. In addition, in commenting on a draft of this report, the Treasury Department said that the Mint began reporting on how seigniorage not transferred to Treasury will be used in the first quarterly report to Congress in fiscal year 2004.

Forecasting Demand

To gauge whether the Mint and BEP have had any operational problems in forecasting demand for coins and currency, we determined (1) whether there have been any shortages in coins and currency in the last 3 years and (2) whether the agencies used validated models to forecast demand. We also reviewed a Treasury Inspector General report on addressing demand for the dollar coin.⁸

The Mint was not able to fill some orders for pennies, dimes, and nickels it received from the Fed from August 1999 to February 2000. Fed officials said that during 1999, the Fed experienced exceptional demand for all denominations of coins. In several regions, the demand for pennies (and later in the year, for all other denominations) at times exceeded the Fed's ability to meet orders. The average number of coins flowing out of reserve banks during 1999 was nearly 30 percent higher than it was in 1998. That number, in turn, was about 27 percent higher than 1997. The Fed said the strong economy and the public's interest in collecting state quarters were likely contributing factors to the higher coin demand. The Mint said the

⁸U.S. Department of the Treasury, Office of Inspector General, *Manufacturing Operations: The Mint Suspends Its FY 2002 Planned Production of Golden Dollar Coins*, OIG-02-066 (Washington, D.C.; March 19, 2002).

shortages were caused by an unanticipated increase in coin demand beginning in 1999; the requirement to produce the 50 state quarters beginning in 1999; and the Fed not consolidating all of its coin orders during this period, which resulted in some Fed branches ordering coins when other Fed branches had a surplus of coins.

The Mint has recently added additional capacity to produce coins and has worked with the Fed to consolidate its coin orders. The Mint and Fed have also implemented new statistical long-range and short-range forecasting models. There have been no shortages of currency or coins during the last 3 years.

Statistical models are used for predicting future demand for both coins and currency. The models have been validated by a process in which past coin and currency demand data are tested with the model to see how well the model forecasts compare with the actual demand that occurred. For coins, both the Fed and Mint now use statistical models to estimate future coin demand and combine the results to predict demand. Fed and Mint officials said there are limits to statistical models, and there is always some risk the models will not be accurate for coin demand, given the volatility in coin use and demand. Because the new statistical models have been in use for a short time period, their accuracy in predicting changes in demand has not been fully tested.

In March 2002, the Treasury Inspector General (IG) recommended that the Mint suspend production of the new dollar coin during the balance of fiscal year 2002 because even though the Mint had about 42 months of inventory of dollar coins, it was still planning to produce 40 million new coins. Mint officials said they based their production plans primarily on demand for the new dollar coin the previous year. However, once they realized demand had declined considerably, they decided to suspend production, even before the IG provided the Mint with a copy of its findings.

Monitoring Production Costs

We used three performance indicators to evaluate whether the agencies effectively monitor production costs: (1) Can the Mint and BEP track production costs by plant, denomination, and cost element and compare actual costs with standard costs? (2) Did nonmaterials⁹ costs increase more than the rate of inflation for the last 5 years? and (3) Did the agencies use productivity measures for equipment efficiency and labor productivity? We also reviewed a Treasury IG report on the Mint's cost accounting system.¹⁰

Both the Mint and BEP have implemented cost accounting systems that track production costs by location, denomination, and cost element and compare actual costs with targeted costs. From fiscal year 1998 through 2002, the Mint's production cost per thousand coins, excluding metal costs, increased 31 percent after adjusting for inflation, and BEP's cost to produce a thousand notes, excluding paper and ink costs, increased 4 percent after adjusting for inflation. BEP said the primary reason for its increased cost was a 25 percent decrease in note volume during that period, and fixed costs had to be allocated to a lower number of notes in fiscal year 2002.¹¹ The Mint said its increased cost per thousand coins was due to higher depreciation costs and a change in the mix of coins produced from fiscal year 1998 through 2002. Mint officials provided documentation showing that during this period, new machinery and equipment were bought to replace old equipment and to increase coin production capacity. The Mint said that depreciation costs also increased because it found the expected life of coin manufacturing equipment was shorter than what had been estimated. According to Mint data, depreciation expenses were \$9.5 million in 1998 and \$19.8 million in 2002. The Mint also provided data that showed a 17.5 percent increase in the number of full-time staff from 1998 through 2002, and that the mix of coins changed during that period. More quarters were produced in 2002, and they are more costly to produce than other coins that were produced in 1998. The Mint data also showed that while the number of full-time staff rose 17.5 percent from 1998 through 2002, the number of coin equivalents produced per employee changed only slightly (a 1 percent decrease).

⁹We excluded materials costs because they are generally not controlled by the Mint or BEP.

¹⁰U.S. Department of the Treasury, Office of Inspector General, *Review of the Results Act Implementation through the Consolidated Information System at the United States Mint*, OIG-00-123 (Washington, D.C.; Sept. 15, 2000).

¹¹Note production was 7 billion in 2002 and 9.1 billion in 1998, a decrease of 23.2 percent.

Both the Mint and BEP have procedures and automated tools for assessing equipment efficiency and labor productivity. For example, the Mint collects data on each press for the number of coins produced and the number of coins scrapped. These data, along with standard production numbers and the amount of time the machine is operating, are used to compute an efficiency measure. The Mint measures labor productivity by collecting data on the number of coins produced per shift. It also uses data from maintenance logbooks and an online maintenance system to monitor failure rates and downtime of presses. BEP tracks machine efficiency, the amount of ink needed to produce notes, and the number of notes that have to be destroyed because of spoilage. In addition, BEP collects data on the number of currency sheets produced by each shift.

The Treasury IG reported in September 2000 that the Mint's newly installed automated information system was not able to provide all the data needed for its performance reporting requirements, including the average unit cost of producing 1,000 coins. The Mint generally agreed with the IG's recommendations to better define its performance measures, refine its cost allocations, and improve controls over data collection and reporting. However, it said that some of the findings were to be expected because the Mint had just implemented the new information system and a temporary degradation of reporting capabilities was common after the implementation of a complex system. Subsequent to the report, the Mint showed us that it had completed actions to correct some of the deficiencies noted by the IG and told us that the Mint is in the process of implementing activity-based costing. Mint officials said they anticipated that activity-based costing will be operational next year.

Contracting for Goods and Services

To evaluate contracting at the Mint and BEP, we used three performance indicators: (1) Was competition used in the 10 largest procurements during the last 3 years? (2) Did the agencies document that prices paid were fair and reasonable for those procurements? and (3) Were reviews made in the last 5 years to determine if it would be advantageous to outsource some operations? We also reviewed a Treasury assessment of the Mint's procurement system¹² and our 1998 report on BEP's procurement of currency paper.¹³

Although the Mint and BEP are both part of the Treasury Department, the Mint has more flexibility in adhering to government procurement rules than BEP has. When Congress established the Mint's Public Enterprise Fund in 1995, the Mint was exempted from the provisions of federal law governing procurement or public contracts for goods and services necessary for carrying out Mint programs and operations. According to a House Appropriations Committee report issued in connection with the 1995 legislation, the Mint was one of the federal government's last true production operations. The committee thought that Mint operations should use more basic business practices.

The Mint and BEP used competition for a majority of the 10 largest contracts at each agency. At the Mint, 6 contracts were open to competition, 2 contracts were competed between two metals suppliers, and 2 sole-source contracts had a justification for not using competition. BEP issued 7 contracts open to competition; 2 sole-source contracts that had justification for not using competition; and 1 contract issued noncompetitively under the Javits Wagner-O'Day Act, which requires agencies to purchase selected products and services from nonprofit organizations employing individuals who are blind or have other disabilities.

Government contracting officers are responsible for ensuring that the government obtains fair and reasonable prices. This is done by either cost or price analysis. Cost analysis is an evaluation of the separate cost

¹²U.S. Department of the Treasury, Office of Procurement, *Acquisition Management Assistance Review (AMAR) Report: U.S. Mint*, AMAR-02-01-Mint (Washington, D.C.; Dec. 10, 2001).

¹³U.S. General Accounting Office, *Currency Paper Procurement: Meaningful Competition Unlikely under Current Conditions*, GAO/GGD-98-181 (Washington, D.C.: Aug. 28, 1998).

elements and proposed profit contained in an offerer's proposal. Price analysis is the process of examining and evaluating a prospective price without performing cost analysis. An example of price analysis is comparing one offer with other offers. Of the 10 Mint contracts we reviewed, 8 contained documentation that prices or costs had been analyzed, and 2 had little or no documentation describing how prices or costs were analyzed. When we asked the Mint about the lack of supporting documentation that the prices paid were fair and reasonable, Mint officials said that the contracting officers were knowledgeable about the prices paid in previous years on similar purchases for 1 of the 2 contracts, had reviewed catalog prices issued for equipment in the other contract, and were comfortable that the prices paid on the 2 contracts were fair. However, this information was not included in the contract files. Mint officials provided new guidance dated September 2002 regarding contracting matters, including price analysis. The 2 contracts with inadequate documentation of cost and price analysis were awarded before the new guidance was issued. All of the 10 BEP contracts contained documentation describing how price or cost analysis was conducted.

In December 2001, Treasury's Office of Procurement reported on an Acquisition Management Assistance Review that it had made of the Mint. Treasury reported that the Mint did not always perform adequate research to help identify other sources in the competitive selection process and did not always ensure that the proper sole-source justifications were prepared and placed in files for simplified acquisitions. The report also noted that some Mint procurement files lacked evidence of cost or price analysis. In response to the Treasury report, the Mint said it had developed new procedures to conduct market research and hired additional procurement staff, including a cost/price analyst. In subsequent communications with the Mint, Treasury confirmed that the Mint had addressed these problems. Treasury officials in the Office of Procurement said that they planned to review BEP's acquisition system in the future; however, due to a loss of staff who were transferred to the Department of Homeland Security, they did not know specifically when the BEP review would be scheduled.

In August 1998 we reported that because of statutory restrictions and the unique market for currency paper, there was no competitive market in which a number of responsible sources could compete for BEP's currency paper requirements. BEP said that for the most recent paper contract, it took steps to obtain more competition, such as offering multiyear contracts instead of contract options and allowing offerers more time to gear up for

production; nevertheless, only one proposal was received for the most recent solicitation.

The Mint and BEP both conducted reviews from 1999 to 2003 to determine if it would be advantageous to outsource selected operations. The Mint provided data showing that 13 areas were identified for review and, as of February 9, 2004, 4 Mint reviews were in progress, 5 were on hold or canceled, 3 had not been started, and 1 was completed. The completed review resulted in 2 custodial positions at the West Point Mint being outsourced. The reviews in progress involve Mint-wide human resource, accounting, and finance functions, and coin blanking/annealing/upsetting and forklift operations at the Philadelphia and Denver Mints. BEP provided data showing that 16 areas were identified for public-private competition review from 1999 to 2003 and, as of February 12, 2004, 13 studies were completed and 3 were in progress. Of the 13 completed studies, 11 resulted in 115 full-time equivalent (FTE) positions going to private-sector sources and 2 resulted in 40 FTE positions remaining in-house. Operations that went to private-sector sources included tour operations, personnel administrative support, law enforcement support services, and pest control. The reviews not yet completed involve ink production and custodial services.

Acquiring Property and Equipment

We used two performance indicators to evaluate the Mint's and BEP's acquisition of property and equipment: (1) Did the agencies have a systematic process to determine when equipment should be replaced and if property is no longer needed? and 2) For all property and equipment purchases made over the last 7 years that individually cost more than \$1 million, was the final amount of property or equipment acquired the same amount as originally planned? We also reviewed two Treasury IG reports concerning the acquisition of property and equipment at the Mint and BEP.

Both the Mint and BEP have systems in place to monitor the efficiency of machines and detect machine problems and to determine if property is no longer needed. Each quarter, plant managers at the Mint production facilities review and report on excess personal property to Mint headquarters. They report on excess, damaged, and obsolete equipment that has not been disposed of, as well as assets that are being used and not performing up to specifications. The Mint's Office of Management Services prepares a monthly space utilization report to track vacancy statistics for each floor of the Mint headquarters. BEP prepares an annual status report

on the utilization and disposal of excess personal property. BEP also performs annual reviews and semiannual updates to identify use and needs of all capital assets used in currency production, production support, facilities, information technology, and security. BEP also has a policy to annually update a master space plan and a 5-year space utilization plan. In addition, the Treasury Department reviews major Mint and BEP capital projects. A major project is generally the acquisition of land, structures, or equipment that have an estimated life of 2 or more years, require an investment of \$1 million or more each year, or have a total life-cycle cost of \$10 million or more. For these projects, the Mint and BEP are required to submit to Treasury's Capital Investment Review Board a description of the project, an explanation of how the project meets organizational objectives, a description of how performance will be measured, an explanation of project costs, and a description of what alternatives were considered.

The Mint made eight acquisitions of property and equipment that cost more than \$1 million each in the period we reviewed. For seven of the eight, the Mint acquired the same amount of property and equipment that it had originally planned to acquire. In one acquisition, the amount of equipment ultimately acquired was only 3 percent more than originally planned. Mint officials said the increase was due to an accelerated requirement for equipment needed to produce the new dollar coin, and they had not taken the time to revise the requisition. BEP made seven acquisitions of property and equipment that cost over \$1 million each during this period. For five of the seven, BEP acquired the same amount of property and equipment that it originally planned to acquire. In one, BEP had planned to acquire four offset presses but actually acquired five, and in another it had planned to upgrade two currency inspection systems but actually made six upgrades. BEP said that the additional presses and additional upgrades were added because the Fed's needs for the new currency with anti-counterfeiting features increased while the procurements were under way, and BEP exercised options to meet that demand. In addition, BEP noted that the currency inspection upgrades were set up as a pilot project to minimize risks, and that additional upgrades were ordered after the successful completion of the pilot project. Fed officials said they encouraged BEP to improve its automated currency inspection system capacity, and BEP acquired an additional press to satisfy production requirements.

In March 2002, the Treasury IG reported that the Mint leased about 257,000 more square feet of space for its headquarters in Washington, D.C., than it had originally requested. The IG recommended that the Mint Director analyze space needs for headquarters to identify excess space and develop a plan to use the space. The IG also recommended that the Mint Director improve record keeping for space acquisitions; make more use of competition; train staff in procurement; and develop a policy to use the expertise of other agencies, such as the General Services Administration, when making future space acquisitions. Mint officials showed us a revised space needs analysis and revised procedures. The Mint also said that it had leased out space it did not need. The space analysis showed that of the 381,647 square feet of space the Mint has leased in the two headquarters buildings, 139,910 square feet, or 36.7 percent, has been subleased to other agencies. The Mint also provided a report showing that as of February 1, 2004, 14,217 square feet of the total square feet in the two headquarters buildings, or 3.7 percent, was vacant.¹⁴ The leases and subleases showed that the Mint was recouping its leasing costs in its charges to the other tenants. In addition, the General Services Administration (GSA) provided data showing that a 2002 GSA lease rate for space in one of the buildings occupied by the Mint was \$4.39 per square foot higher than the 1999 lease rate that the Mint had negotiated for space in the same building. Mint officials said they did not develop a policy to use other agencies in future space acquisitions because the Mint would not be leasing additional space.

In June 1999, the Treasury IG reported that BEP had purchased four intaglio currency presses and three overprinting and packaging machines costing about \$50 million that were unnecessary and subsequently had to be placed into storage.¹⁵ The IG said that BEP had acquired the presses before it completed a study of the use of the new presses and had not analyzed the labor union opposition to the presses. After the audit was completed, the IG noted that demand for currency increased, and the least expensive option would be for BEP to install the presses in the Washington, D.C., facility. The IG recommended that the BEP Director improve its evaluations of equipment needs, perform pilot studies before making major manufacturing operations changes, better protect the stored equipment,

¹⁴In commenting on a draft of this report, Treasury said that no permanent excess office space would exist once existing planned moves are complete.

¹⁵U.S. Department of the Treasury, Office of Inspector General, *The Bureau of Engraving and Printing Placed \$43 Million of New Equipment in Storage*, OIG-99-091 (Washington, D.C.; June 9, 1999).

and reconsider where to use the presses. In response to the report, BEP established a capital investment committee to evaluate equipment requirements and justify the need for future equipment; agreed to perform pilot studies, when applicable; and installed the presses in the Washington, D.C., facility. The IG concurred with BEP's actions.

Reporting Plans and Results to Congress

We used two performance indicators to measure the adequacy of Mint and BEP reporting to Congress: (1) Were congressional staff satisfied with the reporting by Mint and BEP? and 2) Have the Mint and BEP submitted all required reports for the last 5 years? We also reviewed problems that were identified in congressional hearings regarding the Mint's reporting of the advertising campaign for the new dollar coin and in the independent auditors' reports for the Mint's 1998 to 2002 financial statements.

We interviewed six current and former congressional committee staff involved with coin and currency matters on their satisfaction with reporting done by the Mint and BEP. In general, staff were satisfied with BEP's reporting of budget and program information, but some said the Mint had not provided timely information on significant programs and activities in the past. An example cited was the Mint's failure to give Congress advance notice of closing the Philadelphia Mint in February 2002 for repairs. However, the staff also stated that the Mint's reporting had improved in the last 2 years under the new Director of the Mint.

The Mint and BEP are both required to disclose the results of their operations in a number of reports to Congress and have done so. For example, they are required to estimate costs and revenues in the Treasury budget submissions annually and to issue financial statements that are subsequently audited. The Mint and BEP have historically prepared financial statements that comply with generally accepted accounting principles set forth by the Financial Accounting Standards Board, the body that sets accounting standards for private sector entities. The Federal Accounting Standards Advisory Board, which sets accounting standards for federal entities, has stated that federal government corporations and certain other federal entities, such as the Mint and BEP, can continue to follow the Financial Accounting Standards Board guidance.

When Congress established the Mint's Public Enterprise Fund in 1996 and exempted the Mint from government procurement rules, the House Appropriations Committee noted that Congress was not abdicating its oversight of Mint operations. The committee report stated that the Mint was required to submit quarterly reports on the implementation of the fund and its impact on operations.¹⁶ The law stated that the Mint was required to provide an annual report on the amounts it transferred to Treasury for deposit as miscellaneous receipts, a statement of the amount in the fund that exceeds the estimated operating costs for the following year, and an explanation of the specific purposes for which amounts were being retained.¹⁷ In explaining this requirement, the House report accompanying the legislation did not refer to the following year and stated that the report submitted to Congress shall include an explanation of the specific purposes for which the excess amounts in the fund shall be used.¹⁸ Mint officials said the annual reports required by the act have not been filed separately, but the information is provided in the Mint's annual reports on operations and that any seigniorage collected that was not transferred to Treasury was retained for future operational costs. In reviewing the annual Mint reports, we noted they included the amount of seigniorage collected and the amount that was transferred to Treasury, but they did not include information on how retained amounts will specifically be used. Mint officials agreed that the total amount of seigniorage collected could be better reconciled with how seigniorage was used.

¹⁶H.R. Rep. No. 104-183, at 24 (1995).

¹⁷31 U.S.C. 5134 (c) (4).

¹⁸H.R. Rep. No. 104-183, at 24 (1995).

The annual Mint and BEP reports also include opinions on their financial statements from their independent auditors and reports on their internal controls and compliance with laws and regulations. The Mint and BEP both issued annual reports containing financial statements for fiscal years 1998 through 2002, and both received unqualified (clean) audit opinions from their independent auditors. The reports for all 5 years contained the auditors' reports on internal controls and compliance with laws and regulations for the Mint and BEP. BEP audit reports had no reportable conditions¹⁹ and no reported instances of noncompliance with laws and regulations. The Mint, however, had one reportable condition of internal controls in the 1998, 1999, and 2000 audit reports and three reportable conditions in the 2001 and 2002 reports. Most of the reported problems at the Mint dealt with various information system controls, such as inadequate disaster recovery plans, inadequate access controls, unclear definitions of business processes, and inadequate system documentation. In addition, because of these internal control weaknesses, the independent auditor reported that the Mint did not comply with Office of Management and Budget (OMB) circulars on federal financial management in 1998, 2001, and 2002. Mint officials said they have taken action to correct each of the reported weaknesses and believe they were all mitigated by the end of fiscal year 2003. The Mint provided copies of directives, procedures, risk assessments, and other documentation of actions it has taken or started that, if effectively implemented, should address the problems that have been reported. The Mint also provided a copy of the independent auditor's report for the fiscal year 2003 audit that stated no material internal control weaknesses were found.

As we reported in September 2002,²⁰ the act that authorized the new dollar coin required Treasury to report to Congress by March 31, 2001, on the progress of the new dollar coin marketing program. The Mint submitted a report to Congress on March 30, 2001. In reports accompanying the 2002 Treasury and general government appropriations bill, the Senate and House Committees on Appropriations expressed concern that the Mint's 2001

¹⁹Reportable conditions are matters coming to the auditor's attention that, in the auditor's judgment, should be communicated because they represent significant deficiencies in the design or operation of internal control that could adversely affect the entity's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements.

²⁰U.S. General Accounting Office, *New Dollar Coin: Marketing Campaign Raised Public Awareness but Not Widespread Use*, [GAO-02-896](#) (Washington, D.C.: Sept. 13, 2002).

report to Congress did not adequately describe the nature and extent to which the new dollar coin was being used. The House report directed the Mint to submit a new report by March 31, 2002. In addition, the Senate report accompanying the 2002 Treasury appropriations expressed concern that the committee had not received information on the contracts and agreements between the Mint and others mentioned in the Mint's 2001 report. The Mint submitted its second report on March 29, 2002. We reported that the 2002 report gave much more information on the marketing efforts for the dollar coin and the barriers to increasing use of the new coin that the 2001 report had failed to provide, but the 2002 report did not address what would be done to overcome the barriers or how efforts to overcome the barriers would affect circulation. Mint officials said that they had contracted for a study of the barriers to the dollar coin and expected the study to be done later this year. We reviewed the Mint's budget submission for fiscal year 2004 and saw that no expenditures were planned for promoting the dollar coin that year, consistent with our prior recommendation.

Conclusions

Although revenues associated with the issuance of coins and currency reduce the amount of borrowing from the public to finance government operations, the budgetary and accounting treatment of the revenues differs. The issuance of coins results in an avoidance of government borrowing, but the amount of borrowing displaced by coins and the interest avoided through reduced borrowings are not quantified or visible in the federal budget. In contrast, the issuance of currency results in the Fed holding securities that would otherwise be held by the public. The amount of interest paid to the Fed, and subsequently returned by the Fed to Treasury, is quantified and visible in the budget. The net effect on the budget of the treatment of costs and revenues associated with the issuance of either coins or currency is basically the same.

The Mint and BEP have generally taken action to address the operational problems identified in the past few years by Treasury's Inspector General and others. The exception is the requirement that the Mint report each year on the specific purposes for which seigniorage retained will be used. Congress intended for the Mint to report this information when it established the Mint's Public Enterprise Fund in 1995 and did not receive all of the required information until 2004. We believe the Mint should report this information each year in its annual report to Congress on operations.

Recommendation for Executive Action

To comply with the purpose of the reporting requirement of the Public Enterprise Fund, we recommend that the Secretary of the Treasury ensure that the Director of the Mint identifies whether amounts are being retained in excess of the estimated operating costs of the following year and, if so, explains how they will be used in reports to Congress each year.

Agency Comments

We provided a draft of this report to the Secretary of the Treasury and to the Chairman of the Federal Reserve Board for their review and comment. We received written comments, reproduced in appendix III, from the Acting Chief Financial Officer of the Department of the Treasury. We also received technical comments from the Director of Reserve Bank Operations and Payment Systems of the Federal Reserve, which we incorporated, where appropriate.

The Treasury Department stated that the Mint generally agreed with the information in the report related to the budgetary, accounting, and reporting treatment for coins and currency and expressed appreciation for the report's discussion of its operational improvements. With respect to our recommendation, the Mint started providing additional information in its first quarter report for fiscal year 2004 on the Public Enterprise Fund. We reviewed that report and agreed that it responded to our recommendation to provide a more complete explanation of specific purposes for which retained earnings will be used by the Mint. The Treasury official also stated that the law only required a report on the amount of funds retained that exceeded the following year's estimated operating costs. We revised the report to be more clear as to the law's requirements and added the legislative history that does not refer to the following year's estimated operating costs. We also revised our recommendation to reflect this. The Treasury official also provided some clarifying language from BEP that we included in this report.

We are sending copies of this report to the Chairmen and Ranking Minority Members of the Senate Committee on Banking, Housing, and Urban Affairs and the House Committee on Financial Services; the Chairman of the Board of Governors of the Federal Reserve System; the Secretary of the Treasury; the Directors of OMB, the Mint and BEP; and other interested parties. We will also make copies available to others upon request. In addition, the report will be available at no charge on the GAO Web site at <http://www.gao.gov>.

Major contributors to this report were John Baldwin, Christine Bonham, Tonnye Conner-White, Brad Dubbs, Fred Lyles, Susan Michal-Smith, Jose Oyola, Paula Rascona, and Kathleen Scholl. If you have any questions, please contact me at (202) 512-2834 or at ungarb@gao.gov.



Bernard L. Ungar
Director

Objectives, Scope, and Methodology

To better understand how the nation's coins and currency are produced and issued, we reviewed (1) how the production costs of and earnings from coin and currency are budgeted and accounted for and (2) whether there are any operational problems at the Mint and BEP needing further action.

To determine how production costs and earnings from coin and currency are budgeted and accounted for, we reviewed the history of coins and currency in the United States and the agencies involved in producing and distributing coins and currency; legislation and accompanying hearings and reports concerning coins and currency; the U.S. budget for the last 5 years; financial reports of the Fed; the consolidated financial statements of the Department of the Treasury for the last 5 years; annual reports for the last 5 years issued by the Federal Reserve System (Fed), the Mint and the Bureau of Engraving and Printing (BEP); accounting guidance issued by the Financial Accounting Standards Board and the Federal Accounting Standards Advisory Board; and budgeting guidance issued by the Office of Management and Budget (OMB). We traced the transactional flows of the budgetary and accounting treatment for coins and currency issuance through the 2002 U.S. budget and Treasury's consolidated financial statements. We interviewed officials at the Fed, OMB, Treasury, BEP, and the Mint.

To determine whether any operational problems at the Mint and BEP warrant further action, we agreed with your staffs to concentrate our work in the following operational areas: forecasting demand for coins and currency, monitoring production costs, contracting for goods and services, acquiring property and equipment, and reporting operational plans and results to Congress. For each operational area, we obtained and reviewed relevant GAO, Treasury Inspector General, Treasury Office of Procurement, financial audit, and other reports to Congress. Because we did not have the resources to extensively review all areas, we also selected commonly used measures of performance and obtained information from BEP and the Mint to determine how they performed for each measure. In selecting the performance measures, we judgmentally selected indicators that would generally address the cost/efficiency, quality/effectiveness, customer satisfaction, and financial reporting. For example, in contracting, we selected as performance measures the agencies' use of competition for major acquisitions and how they determined that the prices paid were fair and reasonable. Because of resource constraints, we used judgmental samples for some of the measures. For forecasting demand, we selected a 5-year period to determine if there were any coins or currency shortages. We selected 5 years as the period to review for monitoring production

costs. For contracting, we looked at the 10 largest procurements made by the Mint and BEP during the last 3 years. We looked at property and equipment purchases made over the last 7 years that individually cost over \$1 million. For reporting to Congress, we selected reports issued in the last 5 years.

In determining how the Mint and BEP performed for the indicators, we obtained and reviewed documents from the Mint, BEP, and the Fed regarding coin and currency orders and deliveries, models used to forecast demand, cost accounting reports, procurement solicitations, justifications for sole-source contracts, cost and price analysis, lease agreements, annual performance reports for the Mint and BEP, and audit reports of Mint and BEP financial statements. We analyzed the documentation to determine how the Mint and BEP performed for each of the measures and to determine the possible causes. We discussed the performance of the Mint and BEP measures with BEP, Mint, Fed, Treasury, and OMB officials.

We performed our work in accordance with generally accepted government auditing standards from September 2002 through March 2004 in Washington, D.C.

History of Money in the United States

Money came about to replace bartering in the buying and selling of goods and services. Money serves as a convenient way to exchange goods and services by creating a medium of exchange, establishing a common unit of account, and creating a store of value that allows transactions to be deferred into the future. Money is what people will accept to carry out these functions.

Before the United States declared its independence from Great Britain in 1776, the United States followed the British monetary system. British money, as a medium of exchange, was scarce, and the individual colonies began to issue their own currency. Public warehouses in some of the colonies issued certificates representing that a specified amount and quality of commodities, such as tobacco, had been weighed and graded. These certificates, as well as certificates for other commodities, circulated from hand to hand. These bearer certificates were an early form of paper money and avoided the need for each owner to sign over a note for the payment of debts. The commodity backing the certificates became a reserve currency that did not pass from hand to hand, but could be delivered on demand if required. The colonies tried a variety of paper money arrangements, but in many cases the paper money was a promise to pay in coin at a future date or was backed by land. Also, foreign coins were used. In 1764, the British completely banned paper money in the colonies because some colonies had issued excessive quantities of paper money, which caused inflation. The constitutional struggle between Britain and the colonies over the right to issue paper money was a factor in provoking the American Revolution. To finance the Revolutionary War, the Continental Congress issued paper continental dollars, as well as some coins. The continental dollar, as well as paper money issued by the colonies, depreciated rapidly during the war.

Although under the Constitution the federal government has the exclusive right to issue coins,¹ most money used until the Civil War was in the form of paper promissory notes, known as banknotes, issued by private banks that were chartered by the states. Banknotes were generally issued in a bearer form, promising to pay to the holder gold or silver on demand. Individuals with surplus stocks of gold deposited, or lent, their commodity to banks, which paid interest. Banks created both assets and liabilities by creating and issuing bearer notes, or money, to borrowers, who in turn issued interest-bearing notes back to the bank in the form of a loan agreement.

¹Article 1, Section 8, Clause 5.

For the bank, the notes became a liability and the loan agreement an asset. Generally, banks were allowed to create paper money on their physical reserve of about 5 times greater than they actually possessed. Therefore, the total amount of money in the system became much larger than the gold used for monetary purposes.

The banknotes were supposed to be convertible, on demand, to gold or silver. State bank examiners were to assure and certify that banks had enough gold or silver on hand to redeem their outstanding currency. However, this was not always done and many banknote holders found themselves stuck with worthless paper. Each state-chartered bank could issue currency with its own design. Because designs were not consistent and there was no central control over the issuance of currency, counterfeiters saw opportunities to deceive the public. By 1860, as much as one-third of currency in circulation may have been counterfeit, leading to the creation of the U.S. Secret Service.

Partly because of the counterfeit problem and partly to obtain financing, four different laws were enacted during the Civil War: (1) an 1862 act establishing Treasury notes, (2) an 1863 National Banking Act, (3) an 1864 National Banking Act, and (4) an 1865 act imposing a 10 percent tax on state banknote issues. The 1862 act authorized the Treasury to issue currency notes in such form as the Secretary directed; the notes were printed in green ink and commonly referred to as greenbacks. Greenbacks were not backed by gold or silver but by the federal government, which put the U.S. on a fiat monetary standard.

The 1863 National Bank Act established a system of federally chartered national banks, each of which was given the power to issue standardized national banknotes secured by the deposit of United States bonds. It also established the Comptroller of the Currency, whose job was to supervise the new banking system through regulations and periodic bank examinations. For each \$90 of notes they issued, national banks were required to purchase \$100 in government bonds to be deposited for safekeeping. In contrast to the banknotes issued by the private banks supervised by the states, the national banknotes were uniform in design.

The 1864 National Banking Act required banks to hold reserves of gold or, in some cases, deposits at other banks as a fraction of their liabilities. Government bonds continued to be required to back note issues.

The 1865 act imposed a 10 percent tax on state-chartered banknotes and assured that state banks could no longer deprive the federal government of potential revenues from bond sales to federally chartered banks. However, checking accounts were developed around this period, substantially reducing the need for banknotes and allowing to a great extent the state-chartered banks to avoid the banknote tax.

By 1866, the U.S. currency supply consisted of legal tender money issued by the federal government in the form of greenbacks and banknotes issued by national banks and secured by U.S. government bonds. From the Civil War to 1879, Congress made greenbacks and national banknotes redeemable in gold and silver coin. The Coinage Act of 1873 set the terms of convertibility and moved the U.S. from a bimetallic (gold and silver) standard to a gold standard. Another type of paper currency, the silver certificate, was authorized in 1878 when the country's economy was booming and the demand for silver coins in daily business surpassed the supply. A silver certificate certified to the holder that there was a specified amount of silver on deposit in the United States Treasury that would be paid to the bearer of the bill on demand.

In 1913, the Federal Reserve Act established the Federal Reserve Board of Governors, as well as Federal Reserve banks as the nation's central bank and gave the Fed authority to issue Federal Reserve notes as currency for the United States. National banks became members and shareholders of the Federal Reserve System.² At that time, the law stipulated that Federal Reserve notes were obligations of the United States and were redeemable in gold on demand at the Treasury Department, or in gold or lawful money at any Federal Reserve bank. Initially, Federal Reserve notes were not legal tender in private debts. The Federal Reserve banks were required to maintain reserves in gold of not less than 40 percent of Federal Reserve notes in circulation.³ Today, each Federal Reserve bank must hold collateral equal to at least 100 percent of the value of the currency it issues. The reserve banks back up the notes primarily with Treasury securities. Therefore, the Fed issues noninterest bearing obligations (currency) and uses the proceeds to acquire interest-bearing assets.

²State-chartered banks may become members and shareholders at the discretion of the Fed.

³The reserve requirement for gold was reduced to 25 percent in 1945.

Before the Federal Reserve Act was passed, currency in circulation could not always accommodate changes in demand that arose from changes in seasonal and cyclical factors and periods of financial crisis. For example, in the economic panic of 1907, national banks were not able to issue more currency because they were not able to obtain further bonds until the government issued more bonds tied to the backing of the currency, but the Treasury at the time had a surplus of currency and did not need to borrow money. The Federal Reserve Act remedied this problem by mandating an elastic currency that would expand and contract based on public demand. As public demand changed, depository institutions would either order currency from or deposit surplus currency with the Federal Reserve banks.

In 1920, Federal Reserve notes constituted about half of the currency in circulation. The other half was made up of gold certificates and national banknotes (which were retired in the 1930s), silver certificates (which were retired in the 1960s), and U.S. notes (which were last produced in 1971). Since 1971, the Federal Reserve has been the sole note-issuing authority in the United States.

During the 19th century, many countries introduced laws to regulate the activities of commercial banks and restrict some of their freedoms due to bank panics and failures. The appearance of government-issued banknotes reflects these changes.

The National Emergency Banking Act of 1933 declared that Federal Reserve notes were to be considered legal tender for all public and private debts. The dollar was no longer tied to any commodity, such as gold. In 1934, the Gold Reserve Act stipulated that all gold coin be withdrawn from circulation and formed into gold bars. The Coinage Act of 1965 restated earlier legislation making all coins and currencies of the U.S., regardless of when coined or issued, legal tender for all debts, public and private, public charges, taxes, duties, and dues. The law was intended to eliminate silver as a component of our coinage system. In 1971, the federal government stopped supplying gold to foreign central banks, and in 1973 the U.S. officially abandoned the gold standard.

Comments from the Department of the Treasury



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

MAR 18 2004

Mr. Bernard L. Unger
Director, Physical Infrastructure Issues
U.S. General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Unger:

The Department of the Treasury has received for comment a copy of the draft report (GAO-04-283), entitled, "Coins and Currency: How the Costs and Earnings Associated with Producing Coins and Currency Are Budgeted and Accounted For." We circulated your report to the United States Mint (Mint) and the Bureau of Engraving and Printing (BEP) for their comments. The following comments are forwarded for your consideration.

In addition to comparing how coins and currency are budgeted and accounted for, the GAO was asked to report on operational problems that were identified in Congressional hearings, Treasury Office of Inspector General audits, and other reports. The Mint has made improvements to address these operational problems, and appreciates that the GAO reported on many of these improvements in its draft audit. For example, the GAO report credits the Mint with developing new procedures for goods and services contracting, and reports that the Mint subsequently received Treasury confirmation that the contracting issues mentioned in a December 2001 Acquisition Management Assistance Review had been addressed.

The report addresses difficulties the Mint had in forecasting demand for circulating coinage, and notes that the Mint was unable to fill some orders it received from the Federal Reserve from August 1999 to February 2000. The report correctly states that, while some individual orders could not be filled, this was because of distribution difficulties and supply imbalances. In an effort to improve coin forecasting and ordering, the Mint and the Federal Reserve have implemented new statistical long-range and short-range forecasting models. The Mint is also working with the Federal Reserve to consolidate coin orders, and to facilitate interbank transfers and system efficiency.

The report indicates that excess space was acquired by the Mint for its Headquarters facility, as reported by the Treasury Office of Inspector General within a March 2002 report. Even before the March 2002 report, the United States Mint had begun efforts to recoup its leasing costs by aggressively marketing the excess space to other Government agencies. Since then, a significant amount of the excess space has been subleased to two agencies, and the Mint is in the process of subleasing additional space to two other agencies. No permanent excess office space will exist at its Headquarters once the planned moves are completed.

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Increased costs per thousand coins are reported for Fiscal Years 1998 through 2002. As the report indicates, increased costs reflected the purchase of new machinery and equipment in response to increased coin demand and the resulting increased depreciation costs. Increased demand was fueled in part by the introduction of the 50 State Quarters[®] program and the Golden Dollar.

As indicated above, the Mint appreciates that the GAO incorporated the information they provided on operational improvements into the "Operational Problems" section of the draft report. The Mint generally agrees with the information contained in the other section of the report, which discusses budgeting, accounting, and reporting on coin and currency expenses. However, the Mint would like to comment on the recommendation to report planned usage of excess earnings.

The legislation that established the Mint's nonappropriated revolving fund (Public Enterprise Fund - PEF) requires that certain information be reported to Congress. The Mint reports this information in its Annual Report to Congress and in its annual budget submissions. The Mint thought that this reporting was sufficient to meet the intent of the legislation and, until issuance of the GAO's report, had not heard otherwise from Congressional recipients of these documents. However, in order to be more responsive to the reporting requirement cited by the GAO, the Mint started providing this information in the PEF report, beginning with the first quarter FY 2004 report. It should be noted, however, that the GAO is recommending that the Mint provide information on the specific purposes for which retained amounts of earnings will be used. The PEF legislation requires reporting if earnings are retained that exceed the following year's estimated operating costs (i.e., "the amount on deposit in the PEF at the end of the period covered by the report exceeds the estimated operating costs of the PEF for the 1-year period beginning at the end of such period"). 31 U.S.C. § 5134(c)(5)(B)(ii). In prior years, the Mint retained some earnings, but these earnings were retained to cover the following year's anticipated operating costs, including existing and contingent liabilities. The Mint understands that they did not constitute amounts on deposit that exceeded the agency's estimated operating costs. Thus, the Mint believes the reporting requirement is being fulfilled.

In addition, the Bureau of Engraving and Printing (BEP) offers the following changes to clarify your report:

Page 24. Third paragraph, line 8, sentence beginning with "The BEP" and forward to page 25 should be revised to read as follows. The changes are bold and underlined.

The BEP provided data showing that 16 areas were identified for **public-private competition** review from 1999 to 2003 and, as of February 12, 2004, 13 studies were completed and 3 were in progress. Of the 13 completed studies, 11 resulted in 115 **full-time equivalents (FTE's) going to private-sector sources** and 2 resulted in 40 **FTE's** remaining in-house. Operations that **went to private-sector sources** included tour operations, personnel administrative support, law enforcement support services, and pest control.

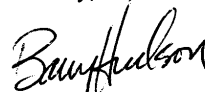
Now on p. 21.

Appendix III
Comments from the Department of the
Treasury

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Thank you for the opportunity to respond to this draft GAO report. If you have any questions or wish to discuss these comments further, please contact Tom Moschetto (Mint, Assistant Director for Management Services) at (202) 772-7705 or Gregory Boutin (BEP, Chief - Office of Management Control) at (202) 874-2097.

Sincerely,



Barry K. Hudson
Acting Chief Financial Officer

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