A MESSAGE FROM THE SECRETARY OF THE TREASURY

I am pleased to present the fiscal year 2002 *Financial Report of the United States Government* issued pursuant to the Government Management Reform Act of 1994. The Report discusses the government's financial operations for the year and includes financial statements that cover the executive branch, as well as parts of the legislative and judicial branches of the U.S. Government. This is the sixth year that the report has been issued.

For fiscal 2002, the U.S. Government is reporting an accrual-based net operating cost of $365 billion down from $515 billion we reported in fiscal 2001. This also compares to a $158 billion budget deficit for fiscal 2002 reported last October. The most significant change between these accrual financial results and the budget deficit is the accrual recognition of veterans benefit costs beyond those covered by budget outlays.

The drive to produce financial reports that better fulfill our responsibilities to the Congress and the public continues. This year, 21 of the 24 Chief Financial Officers Act departments and agencies received unqualified audit opinions, an increase of three from last year. In addition, the Treasury Department was able to accelerate the issuance of its audited financial statements by over three months thereby complying in fiscal 2002 with the November 15th accelerated reporting dates, which do not go into effect until fiscal 2004. As a result, a total of three major agencies met the future deadline. This is a tremendous achievement that when accomplished by all agencies will significantly improve the timeliness and usefulness of the data.

The significance of these accrual-based reports is that they show the implications of current budgetary decisions over a longer time horizon. The ability to assess such impacts is significantly reduced when analysis is restricted to cash-based budget amounts. This information is therefore an important element of the debate about the real effects of governmental commitments.

I intend to continue the commitment to producing and reporting financial information that meets the highest standards of integrity, and to provide to the American people the accountability and professionalism that they expect from their Government.

John W. Snow

MANAGEMENT'S DISCUSSION AND ANALYSIS

Introduction

We are pleased to present the consolidated *Financial Report of the United States Government* (*Financial Report*), a comprehensive picture of the Government's finances. Transparent presentation of the Federal Government's financial results and condition has never been more important for understanding the fiscal condition of the United States. Our objective is to provide useful, timely reports of financial information to the American public and the world. We are committed to continue our work to improve financial management, modernize the Government's financial management systems, and strengthen financial reporting.

In this our 6th year of issuing financial statements, we are making progress in our quest to report the financial activities of the U.S. Government timely, reliably, and in a format useful to the readers. Although our auditors have disclaimed an opinion again this year, we have seen significant improvements in the underlying data quality. All 24 of the largest departments and agencies completed their combined performance and accountability reports on time, by February 1, 2003, a month earlier than last year. In addition, 21 received an unqualified or clean opinion, as compared with 18 for the previous year, and only two agencies' auditors were unable to render an opinion. The current focus of our attention is to resolve our material weaknesses in internal controls and improve data quality and timeliness. For example, we are implementing a plan to issue this report for fiscal 2004 operations by December 15, 2004.

The accompanying *Financial Report* is required by 31 U.S.C. § 331(e)(1) to be submitted to Congress by March 31, and consists of Management's Discussion and Analysis, Statements of Net Cost, Statements of Operations and Changes in Net Position, Reconciliations of Net Operating Cost and Unified Budget Surplus (or Deficit), Statements of Changes in Cash Balance from Unified Budget and Other Activities, Balance Sheets, Stewardship Information (Unaudited), Notes to the Financial Statements, and Supplemental Information (Unaudited). Each section is preceded by a description of its contents.

Executive Summary

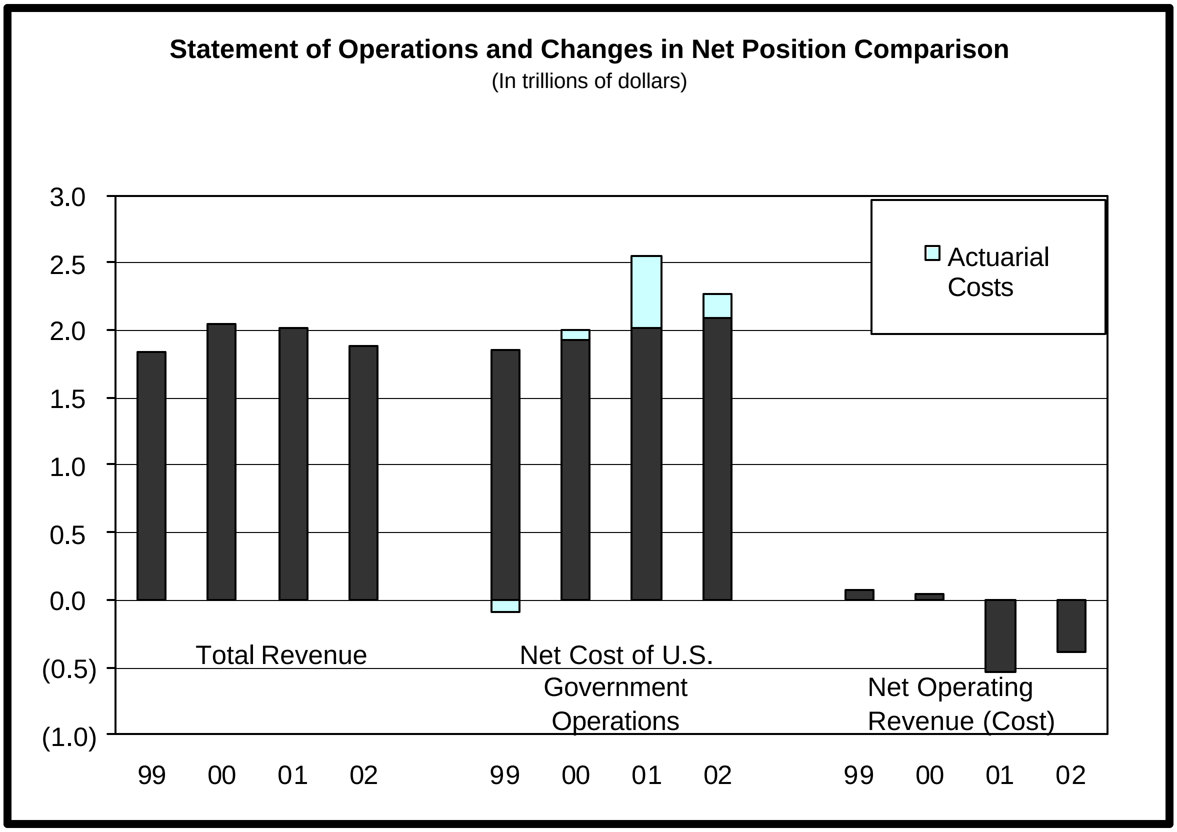
Operating Results Plus Commitments—The Big Picture

Historically, the Government's financial situation has been evaluated primarily from a cash-based budgeting perspective that measures the flow of funds in and out of Government accounts. However, that perspective does not track the many promises made by the Federal Government that translate into future spending. Thus, the first step in examining our financial challenge is to get an accurate snapshot of our current situation by adopting a forward-looking accrual-based accounting system.

In addition to accrual-based results, the larger picture includes many obligations and commitments not captured in accrual-based operating results. An attempt is made here to go beyond the balance sheet to also examine the impact of these other commitments.

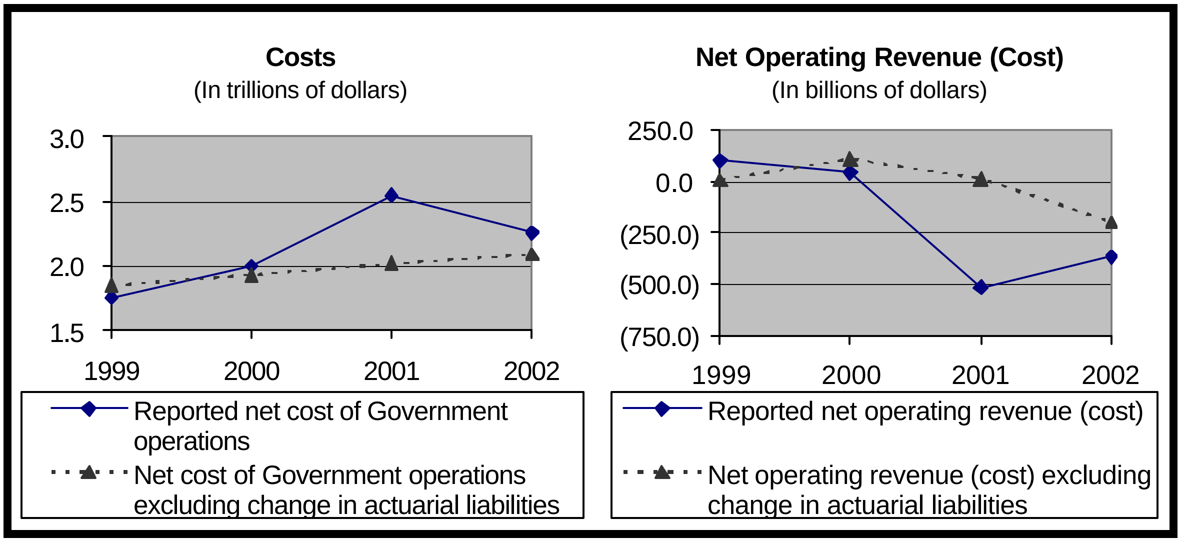
Because the Government traditionally has been viewed from a budget perspective, and because many of the terms used to describe financial events have different meanings when describing budget outcomes, a conscious effort has been made to refer to budget-based amounts by using the term budget in order to eliminate any possible confusion. Net operating revenue (cost) is the term used to represent accrual-based operating results and equates to the balance of revenue less net cost of Government operations.

Financial Summary of Operations



The above chart shows the financial results remained in a net operating cost in fiscal 2002. The net operating cost was $364.9 billion in fiscal 2002, as compared to a net operating cost of $514.8 billion for fiscal 2001. The continued net operating cost contributed to the Government's borrowing a net additional $220.5 billion in debt, excluding related accrued interest, from the public. As is also evident in the chart, revenues decreased in fiscal 2002 by $136.0 billion, with individual income tax and tax withholdings comprising almost all of the decrease. Revenues have now declined 2 years in a row. Also, revenues declined in fiscal 2002 by 7 percent, the largest percentage decline since 1946. The net cost of U.S. Government operations decreased in fiscal 2002 by $286.1 billion when compared to fiscal 2001 costs. The largest reason for the decrease is that fiscal 2001 reflected the initial non-recurring effect of a new law that increased the military retirement health benefits liability by $293.0 billion. Under this legislation, TRICARE benefits were extended to military retirees and their beneficiaries who were eligible for Medicare, and a fund was established to pay these benefits. This change resulted in civilian and military retirement and post-retirement health care becoming the largest liability of the Federal Government, and it remained so for fiscal 2002.

The following chart shows that over the past 4 fiscal years, significant costs associated with certain benefit liabilities have had a major impact on the Government's cost of operations. These incremental costs are the result of changes in interest rates and other actuarial assumptions. Also shown is that absent these adjustments, costs are steadily trending upward and the net operating revenue (cost) has fluctuated from break-even in fiscal 1999 to a $109.0 billion net operating revenue in fiscal 2000, and now to a $196.5 billion net operating cost in fiscal 2002. Actuarial liabilities include Federal employee and veteran benefits payable and are discussed in Note 11 of the Notes to the Financial Statements section.



Obligations and Commitments

Liabilities are defined by the Federal Accounting Standards Advisory Board (FASAB) as a probable and quantifiable future outflow or other sacrifice of resources as a result of past transactions or events. Normally, liabilities result from activity related to a contractual obligation. Some of the obligations and commitments assumed by the U.S. Government (primarily related to social welfare) do not rise to the level where they would be included with liabilities due to the nature of the legislation that created them. They represent, however, some of the most significant fiscal commitments and serious future challenges.

Although we report most of the quantifiable off-balance sheet obligations and commitments throughout this *Financial Report*, the following table presents them as a group for a comprehensive view of the magnitude of the Government's current promises. The social insurance figures in the table are closed-group obligations. These obligations are equal to the present value of net payments (benefits less taxes) expected during the projection period on behalf of program participants over age 15 at the start of the projection period. While a true accrual measure would count only benefits already earned (and taxes already paid) by current workers, the closed-group liability includes future benefit accruals and future taxes of current workers. In this sense, the closed-group numbers are more forward-looking than a strict accrual-based calculation. They represent an estimate of the responsibility, under current law, of future taxpayers to pay benefits to current participants.

A different perspective is provided by estimates of open-group obligations. The open group includes future as well as current participants and is appropriate for assessing sustainability. For that purpose, the open group should be extended to the indefinite future. For example, in the case of the Old-Age, Survivors and Disability Insurance (OASDI) program, the infinite-horizon, open-group obligation is $11.9 trillion in present value dollars (per the *2003 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*). Unlike the Trustees' report, however, the focus of the financial statements and disclosures in this report is on Federal Government obligations made to date for which the accrual-based calculation is appropriate.

Category (In billions of dollars)	**2002**	**2001**
Social Insurance Commitment[1]:		
Federal Old-Age, Survivors and Disability Insurance (Social Security)	11,215.0	10,542.0
Federal Hospital Insurance (Medicare Part A)	6,409.0	6,012.0
Federal Supplementary Medical Insurance (Medicare Part B)	6,487.0	6,471.0
Railroad Retirement	38.0	35.0
Total social insurance commitment	24,149.0	23,060.0
Other Commitments and Contingencies:		
Undelivered orders (contractual commitments) (page 120)	538.8	497.9
Multi-lateral development banks (page 120)	69.8	69.4
Long-term leases (page 120)	50.0	48.7
Other commitments (page 120)	48.8	44.5
Contingencies (page 121)	70.0	48.4
Total other commitments and contingencies	777.4	708.9

[1] Calculation based upon present value of 75-year actuarial projections for the closed group (benefit payments in excess of contributions and earmarked taxes). The closed group represents current participants ages 15 and over at the start of the period. (Page 65)

The Big Picture

When obligations and commitments are added to the traditional accounting liabilities, a more complete picture of the Government's promises is revealed. The following table illustrates the extent of these commitments as of September 30, 2002, by combining items already on the Balance Sheet with the above table.

Summary of Total Governmental Commitments and Assets

Category (In billions of dollars)	**Sept. 30, 2002**
Social insurance commitment	24,149.0
Federal post-retirement liabilities	3,589.4
Federal debt held by the public and accrued interest	3,573.2
Other on-balance sheet liabilities	654.1
Other commitments and contingencies	777.4
Total Governmental obligations	32,743.1
Less balance sheet assets	996.5
Less military equipment (1)	616.0
Total Governmental commitments less Governmental assets (2)	31,130.6

[1] Source: Fiscal Year 2004 Analytical Perspectives, page 37, Defense Fixed Reproducible Capital, Nonfinancial Assets.
[2] The power to tax is not reflected as an asset.

In this context, the ratio of assets to liabilities may not provide a meaningful perspective on the financial condition of the Federal Government, partially since the assets do not value the Government's sovereign ability to tax. A more useful reference for the scale of our liabilities may be in terms of the national economy. To help put the numbers in this perspective, they can be expressed as a percent of annual gross domestic product (GDP). GDP in the final quarter of fiscal 2002 was $10.5 trillion. For fiscal 2002, debt held by the public, excluding accrued interest payable, was roughly $3.5 trillion or 33.7 percent of GDP. Total Governmental liabilities less Governmental assets were more than 295 percent of GDP.

In order to further appreciate this situation, some measure of the Government's assets must be added to the analysis. The Government's most significant asset is its power to tax, which is not valued in an accounting sense. However, assumptions can be made relative to the size of the economy to provide a framework for understanding future revenues and their ability to fund our commitments, as well as the projected costs of planned and expected, but discretionary, Federal Government activities.

The Federal Government's function with respect to programs such as Social Security, Medicare and Medicaid is not unlike that of an insurance provider. A private insurer closely monitors its total liabilities and the combination of assets and future premiums it expects to use in meeting those obligations. Similarly, it is prudent on our part to examine the total exposure of the Federal Government rather than focusing on the current annual impact of these programs, which is currently positive. Under current law, current and past participants would receive benefits with a present value that is approximately $24 trillion in excess of the present value of the revenues that we expect to receive. The policy question to be addressed is how do we pay for those promises and rectify this fiscal imbalance? The answer will probably take a combination of actions, including increasing economic growth, greater societal investments and savings, larger Federal debt, controlling health care costs, and legislative changes involving improved incentives, and possibly benefit changes and tax increases. While retirement and health care insurance are the biggest pieces of this problem, we must also confront the true costs of all Government programs.

As these projections indicate, the country faces a significant challenge to better align its promises with its resources for the future.

Mission and Organizational Structure

No other entity in the world compares in size, scope, and complexity to the U.S. Government. It spent more than $2.0 trillion in fiscal 2002. A civilian Federal workforce of 2.7 million individuals plus 1.4 million Department of Defense (DOD) active duty military personnel serves a diverse Nation of almost 281 million Americans.

To fulfill its constitutional mandates, the U.S. Government undertakes a wide variety of programs to:

- Maintain strong, ready, and modern military forces.
- Provide homeland security.
- Provide critical international leadership.
- Contribute to energy security.
- Protect the environment.
- Boost agricultural productivity.
- Facilitate commerce and support housing.
- Support the transportation system.
- Help economically distressed urban and rural communities.
- Assist States and localities in providing essential education and training.
- Promote health care.
- Foster income security.
- Provide benefits and services to veterans.
- Administer justice.

The form of Government that exists in the United States is a constitutional representative democracy. The following organization chart illustrates the constitutionally mandated separation of powers into the three main branches of Government. It also illustrates the breadth and complexity of the executive branch.

THE GOVERNMENT OF THE UNITED STATES

THE CONSTITUTION

LEGISLATIVE BRANCH

THE CONGRESS

SENATE HOUSE

Architect of the Capitol
United States Botanic Garden
General Accounting Office
Government Printing Office
Library of Congress
Congressional Budget Office

EXECUTIVE BRANCH

THE PRESIDENT
THE VICE PRESIDENT
Executive Office of the President

White House Office
Office of the Vice President
Council of Economic Advisers
Council on Environmental Quality
National Security Council
Office of Administration
Office of Homeland Security (*)
Office of Management and Budget
Office of National Drug Control Policy
Office of Policy Development
Office of Science and Technology Policy
Office of the U.S. Trade Representative

(*) Homeland Security Act of 2002, was signed into law 11/25/02 creating the new Department of Homeland Security. See Note 21 for additional information.

JUDICIAL BRANCH

THE SUPREME COURT OF THE UNITED STATES

United States Courts of Appeals
United States District Courts
Territorial Courts
United States Court of International Trade
United States Court of Federal Claims
United States Court of Appeals for the Armed Forces
United States Tax Court
United States Court of Appeals for Veterans Claims
Administrative Office of the United States Courts
Federal Judicial Center
United States Sentencing Commission

DEPARTMENT OF AGRICULTURE
DEPARTMENT OF COMMERCE
DEPARTMENT OF DEFENSE
DEPARTMENT OF EDUCATION
DEPARTMENT OF ENERGY
DEPARTMENT OF HEALTH AND HUMAN SERVICES
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

DEPARTMENT OF THE INTERIOR
DEPARTMENT OF JUSTICE
DEPARTMENT OF LABOR
DEPARTMENT OF STATE
DEPARTMENT OF TRANSPORTATION
DEPARTMENT OF THE TREASURY
DEPARTMENT OF VETERANS AFFAIRS

INDEPENDENT ESTABLISHMENTS AND GOVERNMENT CORPORATIONS

African Development Foundation
Central Intelligence Agency
Commodity Futures Trading Commission
Consumer Product Safety Commission
Corporation for National and Community Service
Defense Nuclear Facilities Safety Board
Environmental Protection Agency
Equal Employment Opportunity Commission
Export-Import Bank of the U.S.
Farm Credit Administration
Federal Communications Commission
Federal Deposit Insurance Corporation
Federal Election Commission
Federal Emergency Management Agency
Federal Housing Finance Board
Federal Labor Relations Authority
Federal Maritime Commission
Federal Mediation and Conciliation Service
Federal Mine Safety and Health Review Commission
Federal Reserve System
Federal Retirement Thrift Investment Board
Federal Trade Commission
General Services Administration
Inter-American Foundation
Merit Systems Protection Board
National Aeronautics and Space Administration
National Archives and Records Administration
National Capital Planning Commission
National Credit Union Administration
National Foundation on the Arts and the Humanities
National Labor Relations Board
National Mediation Board
National Railroad Passenger Corporation (Amtrak)
National Science Foundation
National Transportation Safety Board
Nuclear Regulatory Commission
Occupational Safety and Health Review Commission
Office of Government Ethics
Office of Personnel Management
Office of Special Counsel
Overseas Private Investment Corporation
Peace Corps
Pension Benefit Guaranty Corporation
Postal Rate Commission
Railroad Retirement Board
Securities and Exchange Commission
Selective Service System
Small Business Administration
Social Security Administration
Tennessee Valley Authority
Trade and Development Agency
U.S. Agency for International Development
U.S. Commission on Civil Rights
U.S. International Trade Commission
U.S. Postal Service

Original source: *U.S. Government Manual 2002/2003*

The United States is impressive in its position as one of the world powers. The following table illustrates several interesting facts about the United States, as compared with other countries.

Item of Interest	Amount for the United States	Information as of	Country Rank	Comments
Land area	9,158,960 square kilometers		4th	Russia, China, and Canada are larger
Population	280.6 million	July 2002 est.	3rd	China and India are greater
Gross domestic product	$10.082 trillion	2001 est.	1st	China was second with $5.6 trillion
Gross domestic product–per capita	$36,300	2001 est.	2nd	Luxembourg was first with $43,400
Infant mortality rate	6.69 deaths per 1,000 live births	2002 est.	41st	Countries with populations > 50 million with lower deaths: France – 4.41 Germany – 4.65 Italy – 5.76 Japan – 3.84 United Kingdom – 5.45
Electricity–production	3.8 trillion kilowatt-hour	2000	1st	China was second with 1.308 trillion
Military expenditures – percent of gross domestic product	3.20 percent	Fiscal 1999 est.	44th	North Korea was first with 31.3 percent
Source: Central Intelligence Agency's *The World Factbook 2002*				

Financial Results

The net operating cost as shown in these financial statements for fiscal 2002 is $364.9 billion, as compared to a budget deficit of $157.7 billion. The primary component of the difference between the budget and accrual numbers is an increase in the liability for veterans compensation and burial benefits of $157.3 billion. For a detailed reconciliation showing the differences, see the Reconciliations of Net Operating Cost and Unified Budget Surplus (or Deficit) in the Financial Statements section.

In fiscal 2001, the financial statements showed a net operating cost of $514.8 billion, as compared to a budget surplus of $127.0 billion. The primary components of the difference were increases in the liability for military health liabilities of $388.6 billion, and an increase in the liability for veterans disability of $115.2 billion.

Revenue and Cost Summary

Revenue

Government revenue comes from two sources: nonexchange transactions and exchange transactions. Nonexchange revenue arises primarily from exercise of the Government's power to demand payments from the public (e.g., taxes, duties, fines, and penalties). Nonexchange revenue is the U.S. Government's primary source of revenue and totaled $1,870.4 billion in fiscal 2002, as compared to $2,001.4 billion in fiscal 2001. More than 98 percent of this total came from tax receipts, with the remainder coming from customs duties and other miscellaneous receipts. This reduction of $131.0 billion, or 6.5 percent, resulted primarily from a drop in individual income tax and tax withholdings and can be attributed to a variety of factors, including a weaker economy, a decline in capital gains realizations, and tax cuts enacted in recent years. Even in the absence of any tax cuts, it is estimated that the receipts would still have declined by 5.7 percent.

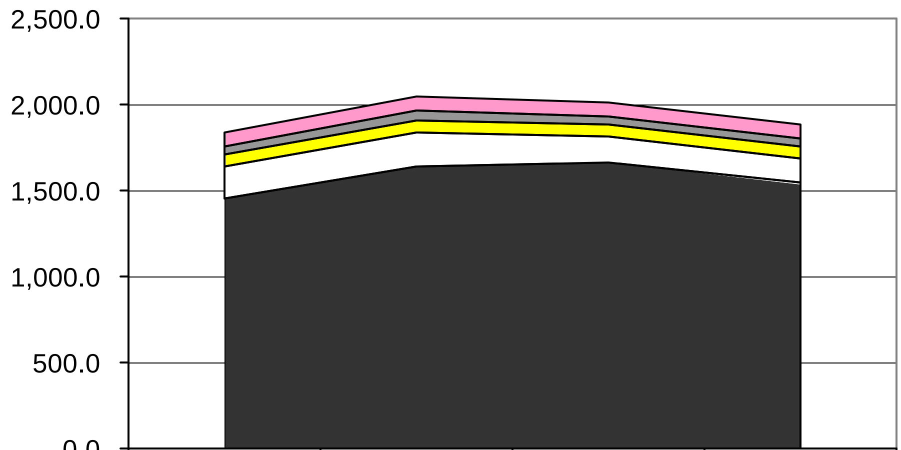
Exchange, or earned, revenue arises when a Government entity provides goods and services to the public for a price. Examples of exchange revenues are the mailing and postage revenue for the U.S. Postal Service and Medicare Part B premiums collected by the Department of Health and Human Services (HHS). During fiscal 2002, the U.S.

Government earned $163.9 billion in exchange revenue, as compared with $172.3 billion in fiscal 2001. Of the fiscal 2002 revenues, $156.6 billion is offset against the gross cost of the related agencies' programs to arrive at the agencies' net cost, as compared with $160.0 billion for fiscal 2001. Also included is $7.3 billion ($12.3 billion in fiscal 2001) that was earned by the U.S. Government but not offset against the cost of any program (e.g., royalties on the Outer Continental Shelf Lands).

The following chart shows the components of revenue by major source.

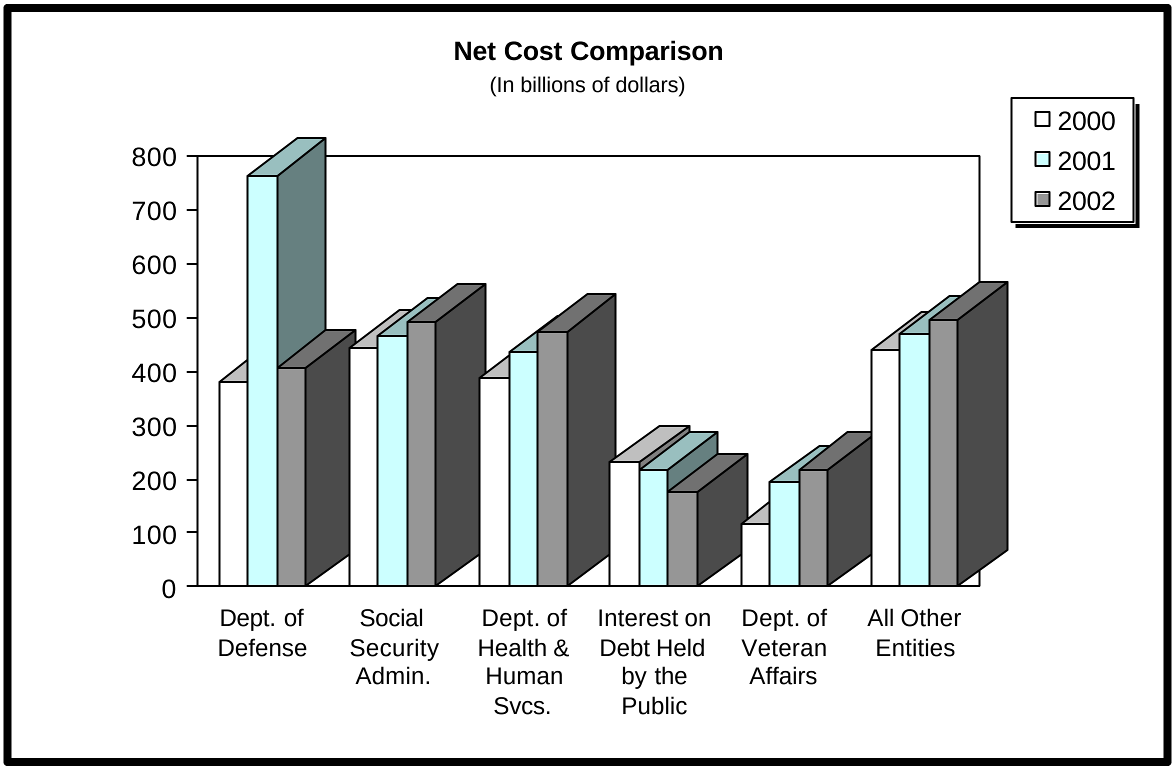
Components of Revenue by Major Source

(In billions of dollars)



	1999	2000	2001	2002
All others	82.2	79.7	86.0	78.2
Other taxes and receipts	42.0	56.3	48.9	49.3
Excise taxes	70.5	69.3	67.3	67.9
Corporation income taxes	182.2	204.3	147.9	143.7
Individual income tax and tax withholdings	1,456.0	1,635.2	1,663.6	1,538.6

Cost



The above chart compares significant elements of net cost by fiscal year. As noted earlier, the significant decrease in DOD cost from fiscal years 2001 to 2002 is because fiscal 2001 reflects the initial non-recurring effect of the extension of medical benefits to retired personnel in the amount of $293.0 billion, plus another $91.3 billion in other actuarial assumption changes. The second largest change was a decrease in the interest on debt held by the public of $42.3 billion. Although the amount of outstanding debt held by the public increased during fiscal 2002, the related fiscal 2002 interest expense on such debt decreased as a result of overall lower interest rates. The net costs of HHS increased by $38.4 billion, primarily due to a $19.7 billion, 15.1 percent, increase in Medicaid and an $11.8 billion, 5.4 percent, increase in Medicare.

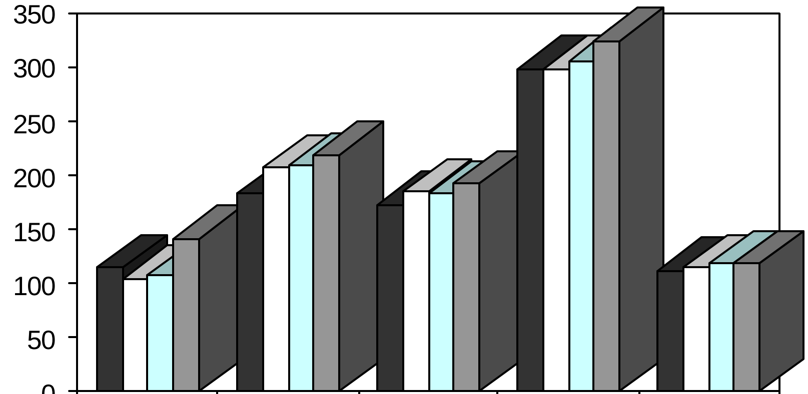
Asset and Liability Summary

Assets

The assets of the U.S. Government are the tangible resources available to pay liabilities or to satisfy future service needs. The accompanying chart depicts a 4-year comparison of the major categories of reported assets as of September 30, for fiscal years 1999 through 2002.

Assets - Key Items Comparison

(In billions of dollars)



	Cash and Other Monetary Assets	Loans Receivable, Net	Inventories and Related Property, Net	Property, Plant and Equipment, Net	All Other Assets
1999	115.2	183.7	173.3	298.8	112.0
2000	104.9	207.6	185.2	298.5	115.3
2001	108.0	208.9	183.8	306.7	118.7
2002	141.6	219.2	192.2	324.7	118.8

As can be seen from the above chart, in fiscal 2002, assets increased in all major categories. Cash and other monetary assets increased by $33.6 billion, or 31 percent, and were mostly due to a $14 billion increase in compensating balances and an increased cash balance required to meet early fiscal 2003 payments. Compensating balances are deposited interest free to compensate commercial banks for services provided on behalf of the Federal Government (such as tax collections, handling over-the-counter deposits for Federal program agencies, providing lockbox services for agency collection programs, etc.). Property, plant and equipment also increased by $18.0 billion, or 5.9 percent, mostly due to an $8.5 billion increase in DOD and a $1.7 billion increase in the Department of Transportation. For fiscal 2001, assets remained relatively constant from the previous fiscal year. It is important to note that the assets presented on the Balance Sheets are not a comprehensive list of Federal resources. Natural resources, stewardship land (national parks, forests, and grazing lands), national defense assets, and heritage assets are examples of resources that are not included in the assets reported on the Balance Sheets. Detailed information about these items can be found in the Stewardship Information section. Additionally, the U.S. Government's most important financial resource, its sovereign power to tax, regulate commerce, and set monetary policy cannot be quantified and is not reflected. It should be noted that pending congressional approval, a new Federal accounting standard will require that national defense assets will be capitalized and, with the exception of the cost of land and land improvements that produce permanent benefits, depreciated, and included on the Government's Balance Sheets.

Liabilities

At the end of fiscal 2002, the U.S. Government reported liabilities of $7.8 trillion, as compared to $7.4 trillion for September 30, 2001. The largest component of these liabilities ($3.6 trillion) is represented by pension, disability, and retiree health care costs for Federal civilian and military employees as well as for veterans, as compared to $3.4 trillion for September 30, 2001. During fiscal 2002, the increase of $157.3 billion for veterans compensation and burial benefits was due to a combination of factors, including overall decreases in interest rates used for discounting future benefits and the number of new compensation awards made for diabetes in fiscal 2001. The second largest increase of $21.7 billion was for military pension liability, which represented a 3.1 percent increase in the liability. See Note 11 in the Notes to the Financial Statements section for a more detailed explanation of these changes. During fiscal 2001, there was an increase of $406.8 billion for military employees benefits, which was mostly due to reflecting the initial non-recurring effect of the National Defense Authorization Act and other actuarial assumption changes. In addition, there was an increase of $139.3 billion for liability for veterans compensation and burial benefits caused by changes in interest rate and other actuarial assumptions.

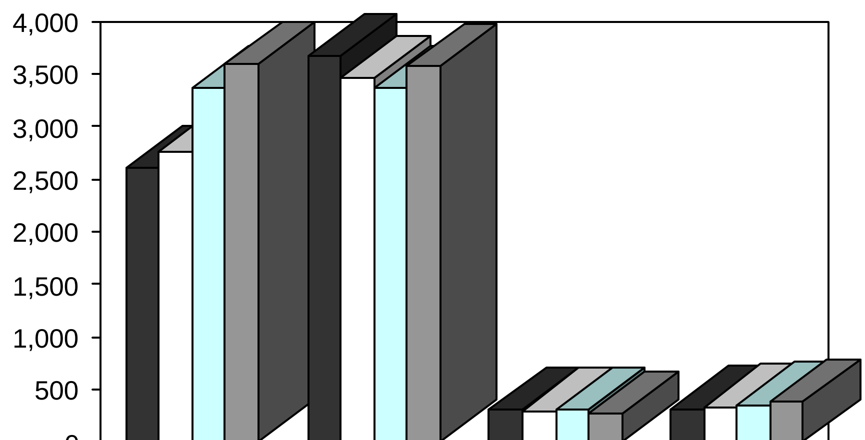
The next largest liability, $3,573.2 billion, relates to Federal debt securities held by the public, as compared to $3,359.3 billion for September 30, 2001; this reflects a $213.9 billion increase in the debt held by the public, including related accrued interest. The fiscal 2002 increase in debt held by the public is primarily due to total Federal spending exceeding total Federal revenues.

Another liability is related to environmental cleanup costs associated with environmental damage/contamination. As of September 30, 2002, the recognized cost of cleaning up environmental damage/contamination across Government programs was estimated to be $273.0 billion, as compared to $306.8 billion for September 30, 2001. A significant component of this reduction relates to the Department of Energy. It reduced its environmental liability by $28.7 billion, mostly due to employing an accelerated cleanup approach resulting from a top-to-bottom review to find efficient and cost-effective ways to achieve greater real cleanup and risk reduction to public health.

The accompanying chart presents a 4-year comparison of the major components of liabilities reported on the Balance Sheets as of September 30, for fiscal years 1999 through 2002.

Liabilities - Key Items Comparison

(In billions of dollars)



	Federal Employee and Veteran Benefits Payable	Federal Debt Securities Held by the Public and Accrued Interest	Environmental and Disposal Liabilities	All Other Liabilities
1999	2,600.7	3,674.2	313.2	321.1
2000	2,764.7	3,454.2	301.2	336.8
2001	3,360.8	3,359.3	306.8	358.0
2002	3,589.4	3,573.2	273.0	381.1

As clearly shown above, Federal employee and veteran benefits payable has been rapidly increasing over the past 2 years. Federal debt securities held by the public, including accrued interest, is now showing an increase, after 3 years of steady reductions. The increase in fiscal 2002 was $213.9 billion, as compared with a $94.9 billion reduction for fiscal 2001.

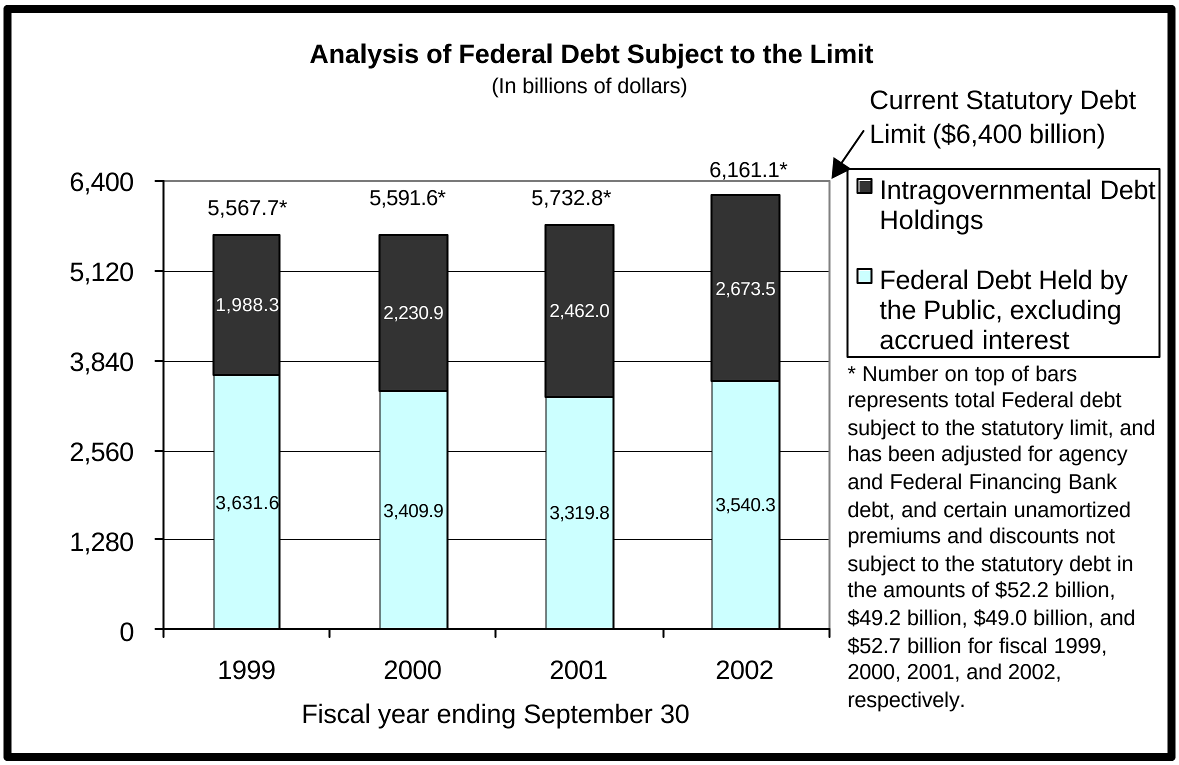
Federal Debt and Budget Surpluses and Deficits

Fiscal 2002 resulted in a budget deficit, following 4 consecutive years of budget surpluses. It is important to understand the composition of budget surpluses and deficits, and the impact that these have on the composition of the Federal debt. There are two components of Federal debt: debt held by the public and intragovernmental debt holdings.

Debt held by the public includes all Federal debt held by individuals, corporations, State or local governments, Federal Reserve Banks, foreign governments, and other entities outside of the U.S. Government. The types of securities held by the public include, but are not limited to, Treasury Bills, Treasury Notes, Treasury Bonds, U.S. Savings Bonds, State and Local Government Series securities, Foreign Series securities, and Domestic Series securities.

Intragovernmental debt holdings generally include nonmarketable securities held by various elements of the Government itself. The laws establishing Government trust funds (such as the Social Security and Medicare Trust Funds) generally require the balances to be invested in these special securities. Although intragovernmental debt holdings are used in the calculation of the Federal debt subject to the statutory debt limit, intragovernmental transactions are eliminated in the consolidation process of preparing this *Financial Report* since they are claims of one part of the Government against another part. However, they are important to an understanding of total debt outstanding because, as the intragovernmental securities are redeemed, other sources of funds will be needed to fund the spending related to the redemptions.

The following chart presents a 4-year comparison of the components of Federal debt subject to the statutory debt limit.

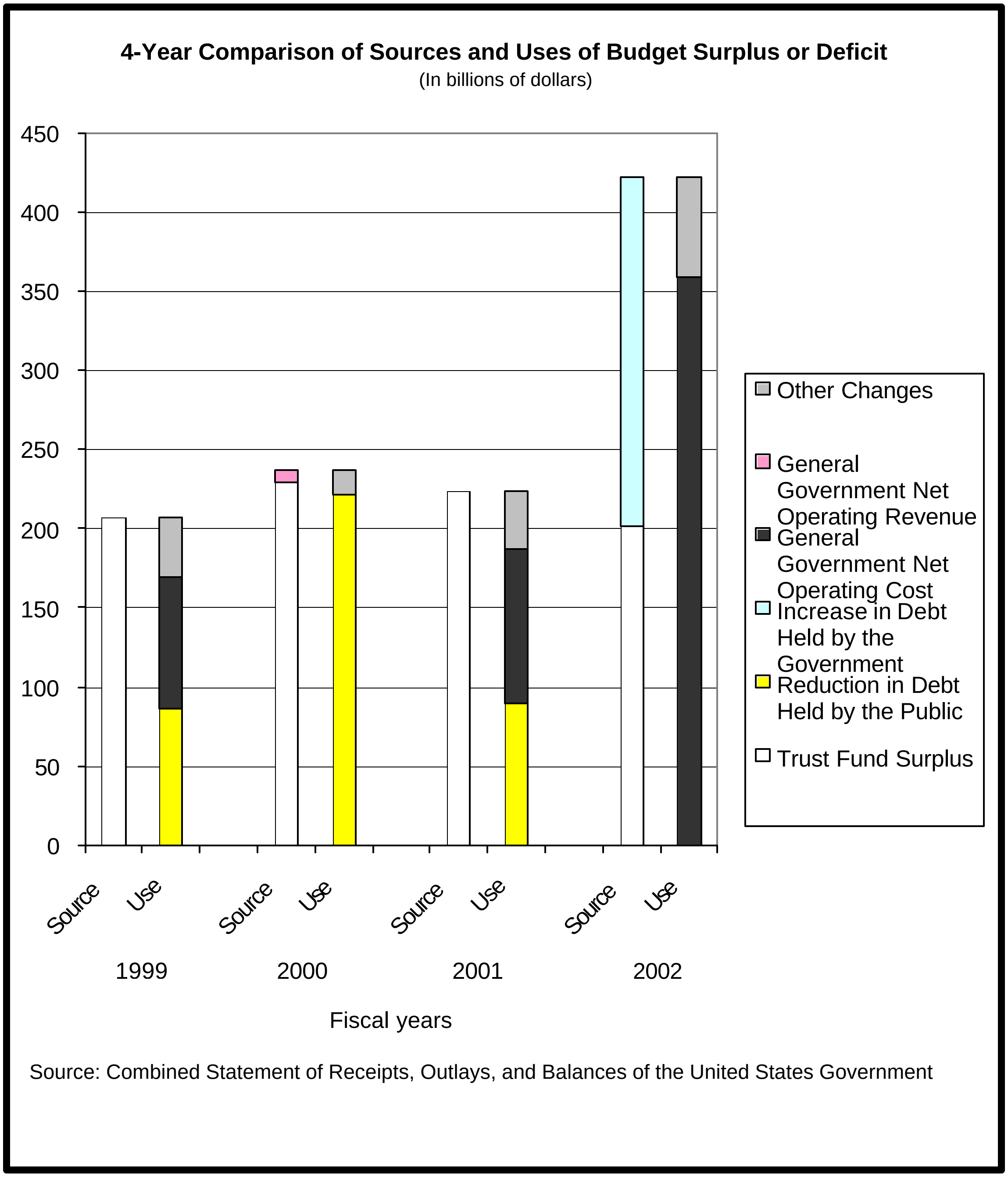


As can be seen from the above chart, total Federal debt subject to the limit increased by $428.3 billion during fiscal 2002, which is primarily comprised of an increase in intragovernmental debt holdings of $211.5 billion and an increase in Federal debt held by the public, excluding related accrued interest, of $220.5 billion. Intragovernmental debt holdings have steadily increased since fiscal 1999 and debt held by the public decreased from fiscal years 1999 through 2001, but increased this fiscal year. The primary reasons for the increases in intragovernmental debt holdings are the annual cash surpluses in the Federal Old-Age and Survivors Insurance, Federal Disability Insurance, Military Retirement, and Civil Service Retirement and Disability trust funds. The fiscal 2002 increase in debt held by the public is primarily due to total Federal spending exceeding total Federal revenues.

The two major components of total Federal debt (or gross Federal debt), debt the Government owes to the public and debt the Government owes to itself, have markedly different interpretations. In a short-run macroeconomic view, only publicly held debt has an impact on the economy. When the Government borrows from the public, it reduces the amount of resources available in the financial markets for private investment. The debt the Government owes to itself, consisting of Federal securities credited to trust funds, has no impact on financial markets. Moreover, while the total debt is often considered a measure of the Government's deferred obligations, the portion held by the trust funds does not reflect what the Government is expected to pay in the future if it is to meet commitments prescribed in programs like OASDI. Essentially, from the perspective of the Federal Government, trust fund holdings represent only reserve spending authority allocated for a particular program. That is, for the Government as a whole, the holdings of trust funds are not assets—they are not resources set aside to support future expenditures. From the perspective of individual programs, however, trust funds are assets of a sort in that the reserve spending authority can be invoked when cash balances are negative. Thus, the total Federal debt is a combination of external and internal debt, representing obligations to the public and to itself through specific programs. But internal debt provides an incomplete picture of future obligations under the programs, and when internal debt needs to be repaid, the expenditure and its financing could have an impact on financial markets.

On December 11, 2001, the Department of the Treasury (Treasury) requested the statutory debt ceiling be raised from $5,950 billion to $6,700 billion. During fiscal 2002, before the debt ceiling was raised, Treasury twice faced debt issuance suspension periods that required it to depart from its normal debt management procedures and to invoke legal authorities provided to avoid breaching the debt limit. Actions taken by Treasury included suspending investment of receipts of the Government Securities Investment Fund (G Fund) of the Federal Employees' Thrift Savings Plan and the Civil Service Retirement and Disability trust fund (Civil Service fund); redeeming Civil Service fund securities early; and suspending the sales of State and Local Government Series securities. In addition, because the debt subject to the limit was so close to the ceiling during these periods, Treasury issued cash management bills to manage short-term financing needs. On June 28, 2002, Public Law 107-199 was enacted, which raised the statutory debt ceiling by $450 billion to $6.4 trillion. Starting in February 2003, Treasury again had to take advantage of available statutory tools to avoid breaching the statutory debt limit. Even with the use of statutory tools, there is a risk that we may hit the statutory debt limit before the collection of April 15 tax receipts.

Federal Government operations are composed of two parts: trust funds, which receive their funding from dedicated collections (including collections from Treasury and other Federal agencies), and general Government, which is funded mainly from general revenues and borrowing. Many of the larger trust funds finance social insurance programs (such as Social Security and Medicare) and Federal military and civilian retirement programs. Other major trust funds finance highway and transit construction and airport development. The following chart illustrates a 4-year comparison of the budget surpluses or deficits of these two parts of Government and how the budget surpluses were used.



Trust fund surpluses (the white area in the chart) are invested in Federal debt securities. The cash invested in Federal debt securities is mainly used for two purposes: to reduce the debt held by the public (the diagonally striped area) and to fund the general Government net operating cost (the black area). Other changes (the gray area) consist primarily of outlays under various loan programs. In fiscal 2002, it was necessary to increase the debt held by the public since the general Government net operating cost exceeded the trust fund surplus.

The budget surpluses, based primarily on a cash basis, are almost entirely due to the trust fund surpluses. General Government operations experienced budget deficits for fiscal years 1999, 2001, and 2002, but had a budget surplus for fiscal 2000.

Future Outlook

National Priorities: (1) Winning the War Against Terrorism, (2) Securing the Homeland, and (3) Generating Long-Term Economic Growth

America is in the opening stages of a long struggle against terrorist groups and the nations that support them. The United States and cooperating nations have brought a wide range of capabilities to bear on terrorism. The diverse activities undertaken illustrate the degree to which we are engaged in a new type of war. The United States and cooperating nations have accomplished the following:

- Built and maintained a global coalition of more than 70 countries to fight terrorism.
- Conducted successful military operations resulting in regime change in Afghanistan.
- Provided freedom and humanitarian relief to oppressed people in Afghanistan.
- Frozen terrorists' assets and restricted the flow of money that enables terror.
- Exploited unprecedented intelligence capabilities to locate, track, and apprehend terrorists on the run.

Achieving these kinds of successes in the years ahead requires a sustained commitment of resources. One measure of our commitment is the funding that has already been dedicated to this effort. The Federal Government has spent or committed to spend $100 billion to respond to terrorism. This includes funding to fight the war on terrorism, to improve homeland security, and to finance recovery efforts in the New York metropolitan area and Washington, D.C.

The creation of the Department of Homeland Security (DHS) was an historic step forward in protecting America. The new DHS began operations to secure the Nation's safety in the biggest reorganization of the Federal Government in a half-century. The cabinet-level department unifies the work of 22 programs and agencies, and will move quickly to better protect Americans from threats here at home. By law, the DHS Secretary has 1 year from the time the Department becomes effective to bring all of the 22 agencies into the organization. As stated in the reorganization plan, most of the components moved into the new Department in March 2003.

On November 26, 2002, President Bush signed into law the Terrorism Risk Insurance Act of 2002. Under the Act, Congress established in Treasury a temporary Terrorism Risk Insurance Program and authorized the Secretary of the Treasury to administer the program and pay the Federal share of compensation for insured losses under the program. The purpose of the program is to provide a transitional transparent system of shared public and private compensation for insured losses resulting from acts of terrorism. The program promotes economic growth by ensuring the continued widespread availability and affordability of property and casualty insurance for terrorism risk. It is structured so as to provide a transitional period for private markets to develop mechanisms for the pricing of terrorism risk insurance, and build capacity and arrangements to diffuse the financial risks of any future losses, with consistent reliance upon State insurance regulation and consumer protections.

Some of the challenges we face will endure for many years and will require great resources. As we look down that path, we will not always get to choose which battles we fight. It is, however, our duty to fight them.

The recession of 2001 likely has been over for a year, but its effects linger. Though the economy has expanded, the rate of growth has not been fast enough and the improvement has been choppy and uneven. Too many Americans remain out of work and are concerned about their economic futures; too many businesses hold back in the face of this economic uncertainty, unwilling to make the investments in new production facilities, new machinery, and new technologies needed to re-ignite the full potential of our economy. To deal with this situation, the Administration proposed a bold jobs and growth program.

The economy has suffered a series of shocks that have cost tens of thousands of jobs. Just as economic recovery was poised to begin, the attacks of September 11, 2001, caused a massive disruption. Flights were cancelled, tourism fell, stock trading was halted, and consumers and businesses retrenched as they sorted through the implications of this new threat to the Nation.

Our economy then faced a new threat from within when Americans discovered serious abuses of trust by some corporate leaders. We learned that a handful of companies across a wide range of industries had engaged in dishonest practices that cost innocent people their jobs and savings. Penalties in the marketplace and the courts were prompt and severe, and new protections and oversight are being put into place, but much damage was done to investor confidence.

To ensure the strongest economy possible, one in which every willing worker can find a job, the Administration is focusing on efforts to clear the way for faster growth and greater prosperity. Its proposed jobs and growth package will operate quickly not only to accelerate recovery, but also to produce a stronger, more resilient economy for years to come. The four key elements of the program are:

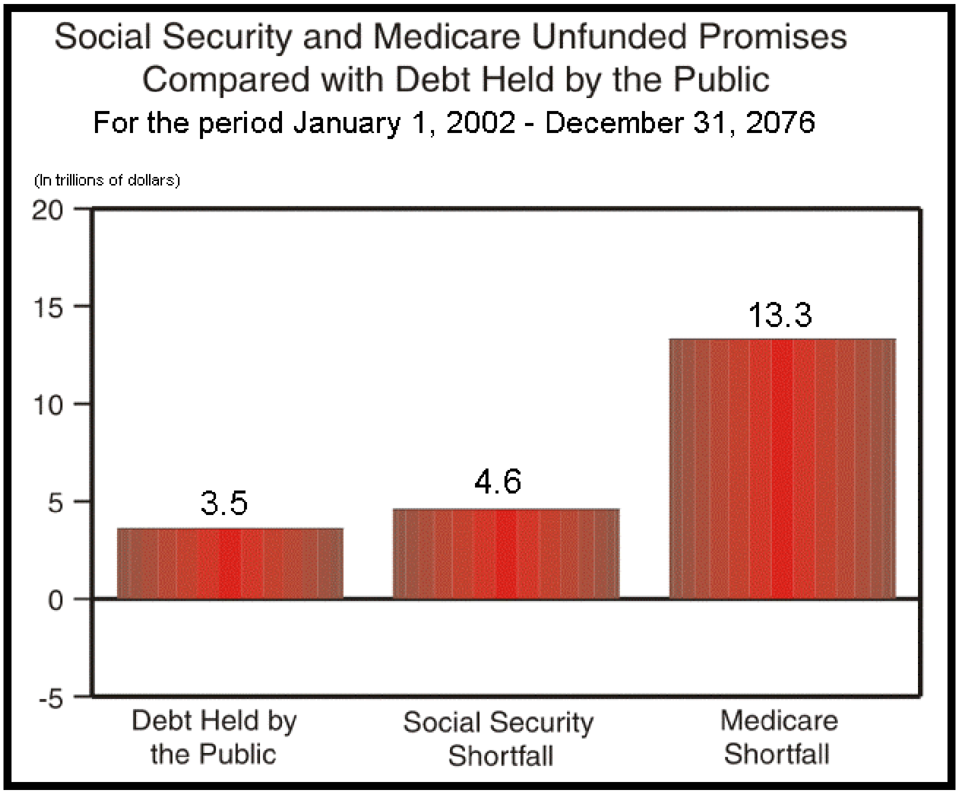
- Accelerating in 2003 certain elements of the Economic Growth and Tax Reform Reconciliation Act of 2001 (EGTRRA), such as the marginal rate reductions and the marriage penalty relief, that would otherwise take effect later.
- Eliminating the unfair double taxation of dividends paid to individuals.
- Increasing immediately the amount that small businesses are allowed to deduct from $25,000 to $75,000.
- Creating new personal reemployment accounts to help unemployed workers search for new jobs and to provide a "reemployment bonus" for those quickly finding work.

Social Security and Medicare: Benefits Will Soon Outstrip Dedicated Revenues

Social Security and Medicare, our largest entitlement programs, combine to provide financial support to 40 million seniors—14 percent of our population—and account for one-third of total Federal spending. As our population ages and health care costs continue to escalate, the costs of these programs will grow enormously, and will rapidly threaten to overwhelm the rest of the budget.

Americans have often heard that Social Security and Medicare are in deep trouble financially, and the simple reason is the benefits provided under current law for these programs will soon far outstrip their dedicated revenues. Over the next 75 years, the actuaries of the Social Security Administration (SSA) project the cost of all benefits paid to current beneficiaries and promised to future beneficiaries will exceed Social Security revenues by almost $5 trillion. The Medicare shortfall over this period is even worse at more than $13 trillion. (In terms defined earlier, these are open group unfunded obligations computed over the traditional 75-year horizon, generally used in the Trustees' Reports.)

Citizens and policymakers rightly monitor and debate the size of the national debt, which stands at $3.5 trillion in public hands, excluding related accrued interest, with another $2.7 trillion credited to various Government trust funds. But in fiscal 2002, the combined shortfall in Social Security and Medicare of nearly $18 trillion was about five times as large as today's publicly held national debt. In other words, it would take an additional $18 trillion in today's dollars to fund the obligations of these systems as they are now constituted. This is roughly the equivalent of the total income Americans will earn over the next year and a half. Expressed yet another way, the combined shortfall in Social Security and Medicare was eight times the amount of total Government spending in fiscal 2002.



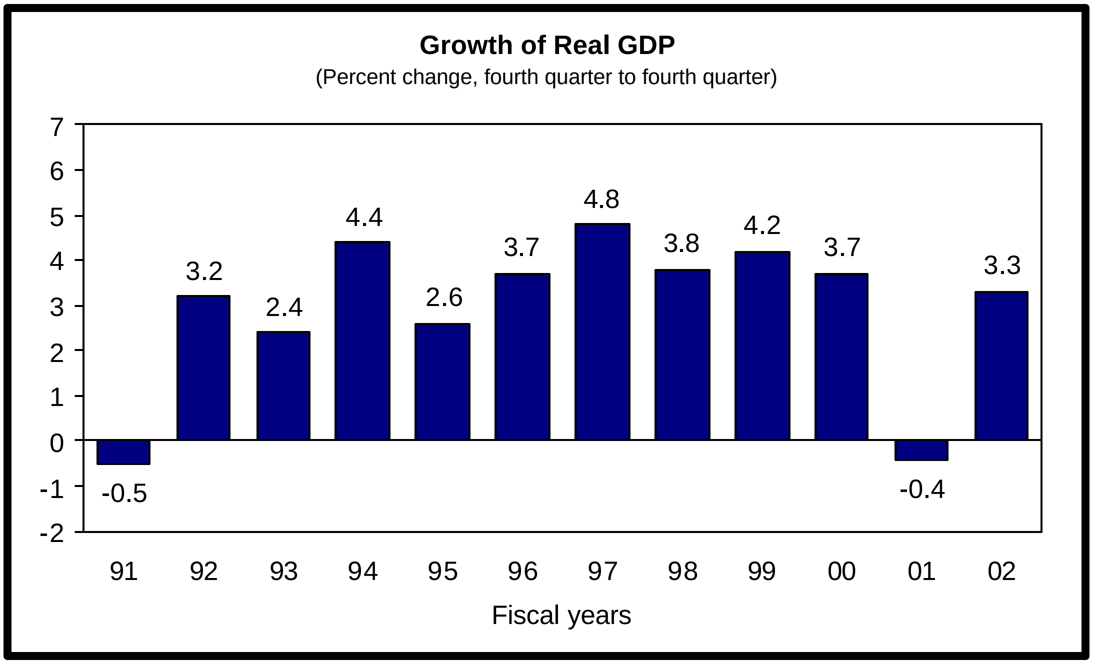
The estimates of Social Security and Medicare's unfunded promises are subject to some variation depending on the underlying assumptions used. However, no conceivable combination of reasonable assumptions can erase the problems in Social Security or Medicare. The Social Security and Medicare shortfalls compel change. The longer the delay in enacting reforms, the greater the danger and the more drastic the remedies will have to be.

Economic and Budgetary Results

The U.S. economy improved significantly in fiscal 2002, spurred by the lagged effects of fiscal and monetary policies put into place earlier. Real GDP increased in each of the four quarters of the fiscal year, after declining in fiscal 2001. Inflation was very low. Productivity growth posted its strongest four-quarter increase in almost 30 years, and real wages rose. Progress in the labor market was less favorable, although employment began to turn around in the second half of the fiscal year. The Federal budget for fiscal 2002 suffered from the impacts of the previous year's recession and the spending requirements following the terrorist attacks, recording a budget deficit of $157.7 billion after 4 years of surpluses.

The Economy in Fiscal 2002

After declining by 0.4 percent in fiscal 2001, real GDP rebounded by a strong 3.3 percent over the four quarters of fiscal 2002. The downturn in fiscal 2001 was relatively mild by historical standards, with the loss in real GDP the smallest among all recessions since the early 1970s. Growth in fiscal 2002 was led chiefly by consumer spending, which rose 3.8 percent over the fiscal year after posting only a 1.8 percent increase the previous year. Low interest rates, engineered in part by the monetary policy actions of the Federal Reserve, and higher disposable personal income, resulting from the EGTRRA and other fiscal policy measures, helped support consumer spending. Those policies offset some of the negative wealth effects on consumer demand that resulted from the decline in the stock market in the last 2 years.



The labor market began to improve in the second half of the fiscal year, but strong job growth has yet to resume. Through the first half of the fiscal year, more than 1 million payroll jobs were cut, mostly in the manufacturing sector. In the second half of the year, employment conditions stabilized and about 130,000 jobs were added. The unemployment rate moved up from 5.0 percent at the start of the year to as high as 5.9 percent in April, then eased to 5.7 percent by the final month. The 5.7 percent average for the fiscal year as a whole compares with 4.4 percent in fiscal 2001.

On the positive side, inflation was well contained in fiscal 2002. Falling prices for petroleum held the increase in the consumer price index to just 1.6 percent over the year. Growth in “core” consumer prices (excluding energy and food) was also moderate at 2.3 percent.

Productivity gains have helped to keep cost pressures down while allowing real output and wages to grow. Productivity in the nonfarm business sector of the economy rose by an extraordinary 5.7 percent over the four quarters of fiscal 2002, the strongest four-quarter performance since 1973.

Budget Results

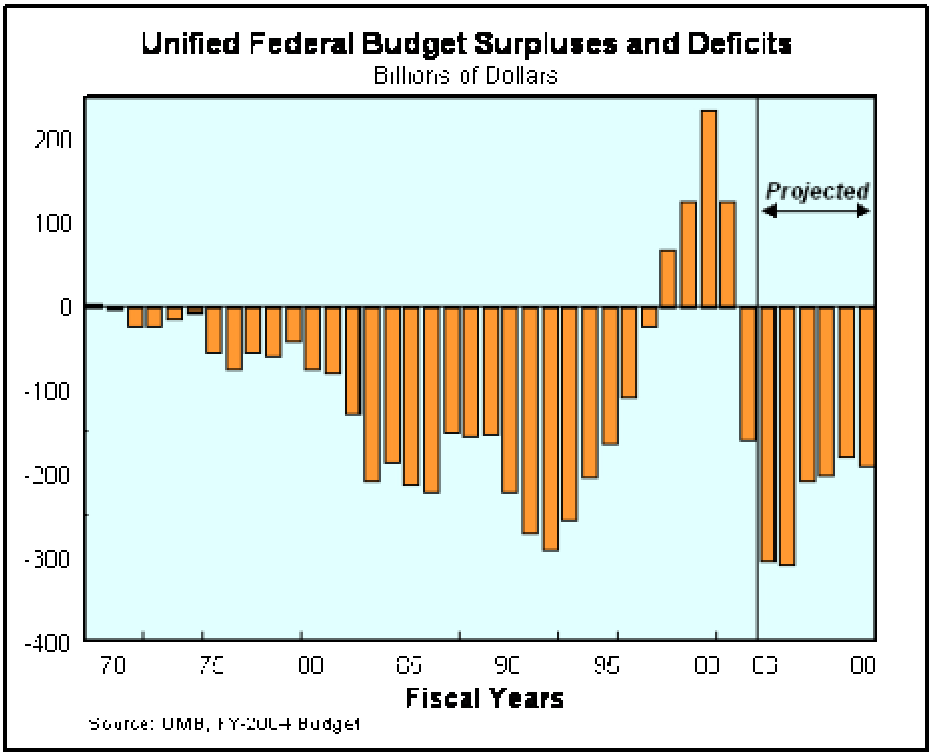
The unified Federal budget was in deficit by $157.7 billion in fiscal 2002. That was the first budget deficit following 4 consecutive years of surpluses, but smaller than the $165.1 billion budget deficit that had been projected in the July *Mid-Session Review*. In relation to GDP, the budget deficit was a modest 1.5 percent, which except for fiscal years 1996 and 1997, was the lowest such share since fiscal 1979. The economic recession and declines in the stock market, estimated to have accounted for nearly two-thirds of the swing from surplus to deficit, were the chief reasons for the deterioration in the unified budget balance. Other factors were the tax cuts and stimulus measures enacted to spur the economy and the increased defense and homeland security spending needed to protect the country from new threats.

Receipts decreased by $138.0 billion, or 6.9 percent, the largest percentage decline since fiscal 1946. Receipts in relation to GDP returned to a more normal 17.9 percent in fiscal 2002, down from 19.9 percent in 2001 and a record high 20.8 percent in 2000. Outlays rose $147.2 billion, or 7.9 percent, and represented a 19.5 percent share of GDP compared with 18.6 percent in the prior fiscal year.

Debt held by the public excluding accrued interest increased by $220.5 billion, or 6.6 percent, in fiscal 2002. That represented a relatively modest 33.7 percent of GDP, however, second only to the 33.1 percent ratio in fiscal 2001, as the lowest since 1984.

Budget Projections

Deficits are projected to increase in fiscal years 2003 and 2004, and then shrink as the economy returns to a stronger growth path. Deficits in relation to GDP are projected to be moderate. The ratio is expected to rise from 1.5 percent in fiscal 2002 to about 2.8 percent in the next 2 years, still well below the 4.0 average in the first half of the 1990s. Thereafter, the ratio of the deficit to GDP declines rapidly, down to 1.4 percent in fiscal years 2007 and 2008.



Significant Performance Accomplishments

Progress on Audited Financial Statements

In fiscal 2002, 21 of 24 major departments and agencies received unqualified opinions on their financial statements. For the first time ever, the Department of Agriculture (USDA) received a clean opinion on its financial statements. The Department of Education (Education), Federal Emergency Management Agency (FEMA) and the National Aeronautics and Space Administration (NASA) received unqualified opinions in fiscal 2002, reclaiming clean opinions that had been lost in recent years. USDA overcame significant financial management challenges in fiscal 2002 to receive its first clean opinion. The U.S. Agency for International Development (USAID) also made substantial progress and received a qualified opinion—an improvement from six consecutive disclaimers.

Audit reports, required for the first time to be combined with agency performance reports, were delivered to the Office of Management and Budget (OMB) by February 1, a month earlier than last year. Treasury and SSA produced audited financial statements in November, implementing 2 years early the Administration’s goal to have audited financial statements 45 days after the end of the fiscal year. The Department of Veterans Affairs (VA) submitted its financial statements in December. In addition, Treasury and the Department of Housing and Urban Development submitted their performance reports 2 to 3 months earlier than they ever had before.

The Small Business Administration (SBA), which had previously received unqualified opinions since 1996, received a disclaimer of an opinion for fiscal 2002. The auditors also issued a disclaimer on the fiscal 2001 financial statements and withdrew the opinion on the fiscal 2000 financial statements. SBA's auditors found material errors in the accounting for loan asset sales, and valuation of the Direct Disaster Loan portfolio. SBA is working on an aggressive corrective action plan to remedy its financial management challenges. While DOD received a disclaimer again this year, it has launched a major initiative to clean up its poor financial management by redesigning its financial management systems.

In addition to more reliable and timely financial reporting, a number of agencies made significant progress in improving their internal controls. USDA, along with the Environmental Protection Agency and SSA, resolved long-standing material weaknesses that had plagued their program and financial operations.

A strong internal control environment mitigates risk and helps achieve effectiveness and efficiency, more reliable performance and financial information, and compliance with laws and regulations. Obviously, one of the greatest barriers to adequate financial management is the fact that some Federal agencies are plagued by repeat material control weaknesses—areas so problematic year after year that they detrimentally affect the reliability of financial information. Through the Executive Branch Management Scorecard, the Administration is monitoring and supporting agencies' efforts to resolve these long-standing weaknesses.

Results of Fiscal 2002 Agency Financial Audits

Five agencies improved audit results:

- USDA received its first clean opinion.
- Education, FEMA, and NASA reclaimed their clean opinions.
- USAID improved from a disclaimer (since 1996) to a qualified opinion for the 1st time.

Only one agency, SBA, deteriorated:

- SBA was downgraded from clean opinion (since 1996) to a disclaimer of opinion for 2002, and prior year clean opinions were withdrawn.
- Auditors discovered material errors in SBA's accounting for loan asset sales and the valuation of the Direct Disaster Loan portfolio.

No change in audit opinions for 18 agencies:

- 17 agencies sustained clean opinions.
- DOD continues to receive a disclaimer of opinion. DOD has launched a major initiative to clean up its poor financial management by completely redesigning its financial management systems, which will take years to implement fully.

Expanding the Question from "How Much?" to "How Well?"

In a results-oriented Government, the burden of proof rests on each Federal program and its advocates to prove that the program is getting results. The burden does not rest with the taxpayers or reformers who believe the money could be better spent elsewhere.

This idea is simple, but does not reflect how things have operated in the Federal Government. Instead, the Washington mentality has generally assumed that program funding should increase steadily with the only question being, "by how much?" This type of thinking has wasted untold billions of dollars and prevented the emergence of results-oriented Government.

The fifth element of the President's Management Agenda—budget and performance integration—seeks to shift budget deliberations from an emphasis on inputs to giving greater attention to program objectives, outcomes, and relevant outputs. To this end, the Administration began to rate program effectiveness and reporting on the results for selected programs in the fiscal 2003 President's Budget.

In the President's fiscal 2004 Budget, the process was formalized for 20 percent of Federal programs using a new rating tool, the Program Assessment Rating Tool (PART). The PART included general questions in each of four broad topics to which all programs selected for review are subjected: (1) program purpose and design, (2) strategic planning, (3) program management, and (4) program results (i.e., whether a program is meeting its long-term and annual goals). Additionally, OMB asked more specific questions depending on the approach used for program delivery. The end result was a profile for each program reviewed and an overall rating assigned on a four-point scale of effective, moderately effective, adequate, or ineffective. Those programs judged to have insufficient information available were given a rating of “results not demonstrated.”

For more detailed information regarding PART guidance and PART worksheets, visit the OMB website at **www.omb.gov**.

The President’s Management Agenda: Significant Accomplishments

In August 2001, President Bush launched the President’s Management Agenda, an agenda that identified the five main challenges that represent “the most apparent deficiencies where the opportunity to improve is greatest.” The Administration harbors no illusions that leaps forward will come easily. Constant effort must be made to find ways to save and stretch taxpayer dollars, many through small improvements. Breakthrough gains may come only after years of dedicated, even tedious, effort.

The Human Capital Initiative aims to attract and retain talented and imaginative people into the Federal Government in order to improve the service provided to our citizens. The Competitive Sourcing Initiative exposes parts of the Government to competition so that they may better focus on what customers want while controlling cost. The Improved Financial Performance initiative enhances the quality and timeliness of financial information so that it can be used to manage Federal programs more effectively, while preventing waste, fraud, and abuse. This initiative also improves how the Government manages its money; reducing, for instance, the billions in erroneous payments the Government makes every year. The E-Gov Initiative harnesses the power of the Internet to make Government more productive. The Budget Performance/Integration Initiative starts the process of linking results with resource decisions—the underlying information needed to hold Government accountable.

Since facing such challenges requires sustained effort, the President’s Management Agenda tracks agencies’ status against established standards for success as well as their progress toward meeting the standards. Status and progress are rated using the familiar symbols of red, yellow, and green. Grades are reported on the Executive Branch Scorecard at the end of this section.

Since the scorecard’s unveiling in the fiscal 2003 Budget a year ago, Federal departments and agencies have been working to upgrade their ratings in those areas most in need of improvement. The good news is that signs of progress outnumber distress signals, as 11 departments or agencies show 17 changes for the better. While NASA and SBA slipped in the management of their finances, the results of the fiscal 2002 audits show that NASA regained lost footing by again earning a clean opinion.

Although effort and management attention have been strong at virtually every agency, progress has been uneven. The Administration will follow closely how and whether agencies put their plans into effect. When shortfalls in results become apparent, corrective action will be taken.

	Explanation of Status Scores
Green	Agency meets all of the standards for success.
Yellow	Agency achieves some, but not all, of the criteria.
Red	Agency has any of a number of serious flaws.
	Explanation of Progress Scores
Green	Implementation is proceeding according to plans.
Yellow	Slippage in implementation schedule, quality of deliverables, or other issues requiring adjustments by agency in order to achieve initiative on a timely basis.
Red	Initiative in serious jeopardy. Unlikely to realize objectives without significant management intervention.

Some real management advances in the Federal Government have been racked up over the past year. For example:

- Both Treasury and SSA met—2 years early—the goal to produce audited financial statements by November 15th, just 45 days after the end of the year, compared with 151 days under previous administrations.
- HHS has reduced its personnel offices from 40 to 7, and will eventually move to just one. This and other consolidations will allow HHS to deploy hundreds of employees to the front lines to deliver services directly to the American people.

- DOD reduced headquarters staff by 11 percent, reducing civilian employees by more than 3,000 in just the last year.
- Rules for conducting public-private competitions have been slashed by almost 12,000 words, cutting the time for conducting competitions from as much as 4 years to a maximum of just 1 year.
- VA is opening up the activities of 52,000 employees to competition over the next 5 years, 25,000 of them in fiscal 2003 alone.
- Government agencies and employees are paying their credit card bills more quickly. The Federal Government began fiscal 2002 with 10 percent of its individually billed travel accounts delinquent. That amount has been reduced to 6 percent, bringing total delinquent dollars for individually billed accounts down by more than $310 million.
- The number of Government-owned vehicles will decline by more than 10,000, from 586,450 in fiscal 2001 to 576,039 in fiscal 2004. (See the Controls section for a further discussion.)
- Citizens are now only three clicks from transactions and services on the redesigned website **www.Firstgov.gov**, which Yahoo!© rated one of the "world's 50 most incredibly useful websites."
- The **www.GovBenefits.gov** website provides, with a minimum of red tape, an online tool for citizens to learn about Federal benefit programs for which they may qualify.
- Free Filing, debuting in fiscal 2003, will enable 60 percent of taxpaying Americans to prepare and file their taxes online and without cost.

While progress to date is encouraging, agencies, by and large, have been moving to address more easily corrected problems. The challenges will undoubtedly increase in fiscal 2003. The coming year will be critical to sustaining the agenda's momentum and achieving the goals envisioned by the President.

The Scorecard

Since July 2002, ratings for each quarter have been posted on the **www.Results.gov** website. The scorecard published here includes ratings for the quarter that ended December 31, 2002, and shows changes in status since the Administration conducted the first evaluation of September 30, 2001. Since then, a single green light has been added to the one that appeared on the original scorecard. The second green score was achieved by the agency that earned the first—the National Science Foundation (NSF). This scorecard includes status scores only for DHS, due to its newness.

Executive Branch Management Scorecard										
	Current Status as of December 31, 2002					Progress in Implementing the President's Management Agenda				
	Human Capital	Competi-tive Sourcing	Financial Perf.	E-Gov	Budget/ Perf. Integra-tion	Human Capital	Competi-tive Sourcing	Financial Perf.	E-Gov	Budget/ Perf. Integra-tion
AGRICULTURE	R	R	R	Y	R	G	Y	G	G	Y
COMMERCE	R	R	R	Y	Y↑	G	G	G	Y	G
DEFENSE	Y↑	R	R	R	R↑	G	Y	G	G	G
EDUCATION	R	R	R	Y↑	R	G	G	G	G	G
ENERGY	Y↑	R	Y↑	Y↑	R	G	G	G	G	Y
EPA	R	R	Y↑	Y	Y	G	G	G	G	G
HHS	R	R	R	R	R	G	G	Y	Y	G
HOMELAND	R	R	R	R	R					
HUD	R	R	R	R	R	Y	Y	G	G	G
INTERIOR	R	R	R	R	R	G	G	G	G	G
JUSTICE	R	R	R	R	R	G	G	G	G	G
LABOR	Y	R	Y↑	Y	Y↑	G	Y	G	G	G
STATE	R	R	R	R	R	G	Y	G	Y	G
DOT	R	R	R	R	Y	G	G	G	G	G
TREASURY	R	R	R	R	R	G	G	G	Y	G
VA	R	R	R	Y↑	Y↑	G	G	G	G	G
AID	R	R	R	R	R	R	R	Y	Y	G
CORPS	R	R	R	R	R	G	R	G	Y	Y
GSA	R	R	Y	R	R	R	G	G	Y	Y
NASA	Y↑	R	R↓	R	Y↑	G	G	G	G	G
NSF	R	R	G	G↑	R	G	R	G	G	Y
OMB	R	R	R	R	R	Y	G	Y	G	Y
OPM	Y	R	Y↑	Y	R	G	G	G	G	G
SBA	R	R	R↓	Y	Y	G	G	R	G	Y
SMITHSONIAN	R	R	R	Y	R	Y	Y	Y	G	Y
SSA	Y	R	Y	Y	Y↑	G	Y	G	G	G

Arrows indicate change in status since baseline evaluation on September 30, 2001.

Legend: R = Red Y = Yellow G = Green

Systems, Controls, and Legal Compliance

Systems

The Federal Government faces agency-specific and Governmentwide challenges in modernizing its financial management systems. Many financial management systems need upgrading or replacing before they can provide information to support efforts to achieve the President's goal of a citizen-centered, results-oriented, and market-based Government. In some cases, progress will take several years.

The success of financial systems modernization efforts is dependent, in part, on standardized financial management across the Government. Towards this end, OMB established two sets of standard business rules for certain transactions conducted between Government agencies. Agencies that do not use these business rules will be downgraded on their progress score for financial management on the Executive Branch Management Scorecard.

Controls

Numerous internal controls exist to ensure that financial reporting, compliance, and operation objectives are met. For reporting purposes, instances where these controls are not functioning as planned are described in the individual agency financial reports. Those deficiencies that materially affect the Governmentwide financial statements are described in the accompanying report prepared by the General Accounting Office (GAO). Each agency is responsible for developing and implementing a corrective action plan. In addition, OMB and Treasury will continue to work with Federal agencies to resolve crosscutting issues. In some cases, however, the resolution of these issues requires reengineering of current processes, which is currently being addressed.

Reducing Erroneous Payments

The Administration has launched a major effort to reduce erroneous payments—in other words, payments the Government makes in error. In most instances, they are overpayments. However, in all cases, taxpayers are shortchanged.

For the first time ever, selected agencies were required to report the extent of erroneous payments made in their major benefit programs. Initially, just a few agencies voluntarily reported erroneous payments in their annual financial statements. Now, 11 agencies have estimated their erroneous payment rates. But programs like Medicaid and School Lunch will have to design from scratch a methodology to examine the integrity of program payments. Eleven agencies reported making more than an estimated $30 billion in erroneous payments.

During the past year, the Administration expended considerable effort to prevent a further erosion of controls over payments from Federal programs. USDA's Food and Nutrition Service, for instance, pursued cash sanctions against States with above-average error rates. During Congress' recent reauthorization of the Food Stamp Quality Control program, attempts were made to dilute the accountability of States and erode the Federal Government's ability to maintain fiscal accountability. The Administration opposed and will continue to oppose efforts to weaken financial controls and program integrity.

Congress endorsed the President's effort to reduce erroneous payments when it passed the Improper Payments Information Act of 2002. This bill requires an estimate of the extent of erroneous payments from all Federal programs. Program-wide erroneous payment estimates can only help stem the loss to the Federal Government in waste, fraud, and abuse—too much of which takes place without an accounting.

Strengthening Asset Management

In another area of deficiency, the Administration will monitor agency asset management practices as part of the Improved Financial Performance initiative. The Federal Government's asset management practices have been shown to be particularly weak.

According to this year's financial statements, the Federal Government owns $325 billion in property, plant and equipment, $219 billion in loans receivable, and $192 billion in inventories and related property. But the assets reported on the balance sheet are only a small portion of the assets actually owned by the Federal Government.

National defense assets and much of the Government's immense land holdings do not show up on Government financial statements. For instance, the Federal Government holds title to 28 percent of the United States' entire landmass. It owns sites and structures, monuments, memorials, cemeteries, as well as the items in its museums and libraries, including major works of art and historical documents. These assets are reported in the supplemental stewardship information.

Agency management of vehicle fleets will also be monitored as part of agency asset management practices. The Government owns more than half a million cars and trucks and spends more than $2 billion annually to operate them. In April 2002, the Administration asked agencies to take a closer look at their motor vehicle fleets and to report any planned reductions and cheaper leasing arrangements by the end of the fiscal year. The military agencies and several civilian agencies, notably the Departments of Energy, HHS, and Interior, and the General Services Administration projected reductions ranging from 5 percent to 15 percent. These reductions were offset, however, by equally significant increases in agencies with expanded law enforcement and security-related missions (DHS and Justice).

Legal Compliance

Federal agencies are required to comply with a wide range of laws and regulations, including appropriations, employment, health and safety, and others. Responsibility for compliance primarily rests with agency management; compliance is addressed as part of agency financial statement audits. Agency auditors tested for compliance with selected laws and regulations related to financial reporting. These auditors found no instances of material noncompliance that affected the Governmentwide financial statements. There were, however, instances that were material to an individual agency, and these were reported in the individual agencies' financial statement audit reports.

Basis of Accounting and Reporting Entity

Accounting Standards

The accompanying financial statements were prepared based on U.S. Generally Accepted Accounting Principles (GAAP) standards developed by FASAB, except as noted in GAO's auditor's report.

GAAP for the Federal Government is tailored to the U.S. Government's unique characteristics and special needs. For example, the Stewardship Information section of this report contains important information about diverse subjects such as land set aside for the use and enjoyment of present and future generations, heritage assets, and social insurance programs such as Social Security.

In fiscal 2002, the Statement of Federal Financial Accounting Standards (SFFAS) No. 24, *Selected Standards for the Consolidated Financial Report of the United States Government*, was implemented at the Governmentwide reporting level. Under the provisions of SFFAS No. 24, two new principal statements are included in the Financial Report: Reconciliations of Net Operating Cost and Unified Budget Surplus (or Deficit) and Statements of Changes in Cash Balance from Unified Budget and Other Activities. These statements reconcile net operating cost with the President's budget surplus (deficit) and explain how the annual budget surplus (deficit) relates to the change in the Government's operating cash.

In addition, SFFAS No. 21, *Reporting Corrections of Errors and Changes in Accounting Principles*, was also implemented at the Governmentwide reporting level for fiscal 2002. SFFAS No. 21 amends SFFAS No. 7 to require that reporting entities restate prior period financial statements for material errors discovered in the current period, if such statements are provided for comparative purposes, and if the effect of the error would be material to the financial statements in either period.

Accrual Basis

GAAP requires that these financial statements be prepared using the accrual basis of accounting, but permits the use of modified cash accounting for taxes and duties. Under the accrual basis, transactions are reported when the events giving rise to the transactions occur, rather than when cash is received or paid (cash basis). Therefore, expenses are recorded when incurred, exchange revenue is recorded when earned, and taxes and duties (the majority of nonexchange revenue) are recorded on a modified cash basis of accounting (generally when received). In contrast, Federal budgetary reporting is generally on the cash and obligation basis in accordance with accepted budget concepts.

The most significant difference between cash and accrual bases involves the timing of recognition and measurement of revenues and costs. For example, GAAP requires recognition of liabilities for costs related to environmental cleanup when the events requiring such costs occur and, among other things, the Government has acknowledged responsibility for the event. By contrast, current budget concepts recognize such costs later, at the time payment is made for the cleanup. In addition, GAAP requires the recognition of depreciation expenses on fixed assets, liability for accrued leave, and total actuarial liabilities for pensions, retired pay, and post-retirement health benefits. These differences are reflected in the Reconciliations of Net Operating Cost and Unified Budget Surplus (or Deficit), which can be found in the Financial Statements section of this *Financial Report*.

Coverage

These financial statements cover the executive branch, as well as parts of the legislative and judicial branches of the U.S. Government. A list of the significant entities included in these financial statements is in the Appendix. Information from the legislative and judicial branches is limited because those entities are not required by law to submit comprehensive financial statement information to Treasury. Due to its private ownership and independence, the Federal Reserve System is excluded. In addition, Government-sponsored but privately-owned enterprises (such as Federal Home Loan Banks and the Federal National Mortgage Association) also are excluded.

Additional Information

Additional details about the information contained in these financial statements can be found in the financial statements of the individual agencies listed in the Appendix. In addition, related U.S. Government publications such as the *Budget of the United States Government*, the *Treasury Bulletin*, the *Monthly Treasury Statement of Receipts and Outlays of the United States Government*, the *Monthly Statement of the Public Debt of the United States*, the *Economic Report of the President*, and the Trustees' Reports for the Social Security and Medicare programs may be of interest.