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List of Social Insurance Charts

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A MESSAGE FROM THE SECRETARY OF THE TREASURY

It is my privilege to issue the 2006 *Financial Report of the U.S. Government*. The objective of this report is to provide to the Congress and the American people timely, useful data on the operating costs and financial condition of the government and a discussion of the nation's long-term fiscal outlook. To make this information available early enough to inform the budget process, Treasury has issued this report on December 15 in each of the past three years rather than on the statutory deadline of March 31.

As announced in October, a strong economy and the recent surge in tax revenues has driven the budget deficit down to $248 billion, achieving the President's 2009 target of cutting the deficit in half as a percent of GDP well ahead of schedule. Consistent with the improved budget results, this report shows a lower accrual-based net operating cost of $450 billion. The improvement over 2005 results primarily from lower actuarial costs in certain agencies. There is a difference in the amounts reported for the budget deficit and the net operating cost because of the distinct methods of accounting used. The actuarial costs also account for most of the difference between the budget deficit and the net operating cost reported here.

In addition to reporting the progress in reducing the deficit, this report highlights the biggest long-term economic issue facing our country--the future claim on spending for our major entitlement programs: Medicare and Social Security. Without fundamental reform to ensure the sustainability of these programs, by the year 2080, the cost to the federal government of Social Security and Medicare together will nearly triple as a percentage of the U.S. economy, growing to 17 percent. The present value cost of net expenditures for current participants in these two programs over the next 75 years amounts to $44 trillion. These long-term challenges do not lend themselves to quick fixes, but given our expanding economy, we can approach these issues from a position of strength, and now is the time.

Treasury is committed to resolving the financial management challenges that have led to the Comptroller General of the United States being unable to express an opinion on the financial statements. These include long-standing problems at particular agencies and unique issues related to the preparation of governmentwide statements. As noted in the audit letter, progress continues to be made, but there is still much to be done to meet the highest standards of transparent, reliable financial reporting.

Through this report, we hope to inform and support the decision making so critical to the nation's fiscal future.

Henry M. Paulson, Jr.

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EXECUTIVE SUMMARY

> **"We might hope to see the finances of the Union as clear and intelligible as a merchant's books, so that every member of Congress and every man of any mind in the Union should be able to comprehend them, to investigate abuses, and consequently to control them."**
> President Thomas Jefferson to Treasury Secretary Albert Gallatin, 1802

Financial Condition of the U.S. Government: An Overview

The *Fiscal Year 2006 Financial Report of the United States Government (Report)* provides the President, Congress, and the American people a comprehensive view of the Federal Government's finances, i.e., its financial position and condition, its revenues and costs, assets and liabilities, and other obligations and commitments. The *Report* also discusses important financial issues and significant conditions that may affect future operations.

For the tenth consecutive year, GAO has issued a disclaimer of opinion on the consolidated financial statements. A disclaimer of opinion is not an indication of the validity or accuracy of the Government's financial information; it means that sufficient information was not available for the auditors to determine whether the information was reliable. Material weaknesses in internal control and other limitations on the scope of its work resulted in conditions that prevented GAO from forming and expressing an opinion on the Government's consolidated financial statements for the fiscal years ended September 30, 2006 and 2005. Eighteen of 24 CFO Act agencies and 24 of 31 major agencies earned unqualified opinions on their individual audits on their fiscal year 2006 financial statements.

Table 1 below provides an overview of several key indicators of the U.S. Government's financial health.

Table 1: Key Financial Indicators: FY 2004 - FY 2006

billions of dollars	2004		2005		2006	
Gross Costs	**$ 2,732.0**		**$ 3,174.6**		**$ 3,127.7**	
Less: Earned (Program) Revenue	**$ 207.1**		**$ 224.8**		**$ 226.4**	
Less: Taxes & Other Revenues:	**$ 1,912.7**		**$ 2,185.5**		**$ 2,440.8**	
Individual Income Tax		$ 1,512.3		$ 1,690.1		$ 1,846.1
Corporate Income Tax		$ 183.8		$ 271.8		$ 350.0
Other		$ 216.6		$ 223.6		$ 244.7
Net Operating Cost [1]	**$ (615.6)**		**$ (760.2)**		**$ (449.5)**	
Assets	**$ 1,397.3**		**$ 1,447.9**		**$ 1,496.5**	
Less: Liabilities, comprised of:	**$ 9,107.1**		**$ 9,914.8**		**$ 10,412.9**	
Debt to the Public		$ 4,329.3		$ 4,624.2		$ 4,867.5
Federal Employee & Veterans Benefits		$ 4,062.1		$ 4,491.8		$ 4,679.0
Other Liabilities		$ 715.7		$ 798.8		$ 866.4
Net Position (Assets Net of Liabilities)	**$ (7,709.8)**		**$ (8,466.9)**		**$ (8,916.4)**	
Social Insurance Responsibilities (off-balance sheet): [2]						
Closed Group (current participants) [3]		$ 37,279.0		$ 40,038.0		$ 44,147.0
Open Group (current + future participants) [4]		$ 33,363.0		$ 35,689.0		$ 38,851.0
Budget Results						
Budget Deficit (net of):	**$ (412.3)**		**$ (318.6)**		**$ (247.7)**	
Receipts		$ 1,879.8		$ 2,153.4		$ 2,406.7
Outlays		$ 2,292.1		$ 2,472.1		$ 2,654.4

[1] Total Net Operating Cost includes 'Unmatched Transactions and Balances' not shown in this table.

[2] present value of 75-year actuarial projections of benefit payments under current law for Social Security, Meidcare, and other social insurance programs in excess of their scheduled contributions and earmarked taxes. Not considered liabilites on the balance sheet.

[3] includes current participants (i.e., receiving and/or are eligible to receive benefits) ages 15 and over at the start of the period.

[4] includes all current and future projected participants (i.e., individuals receiving and/or are eligible to receive benefits ages 15 and over at the start of the period, PLUS participants estimated to receive and/or be eligible to receive beneifts over the 75-year horizon).

Two Sets of Books? - - Absolutely Not - - Comparing the Financial Report to the Budget Deficit

Each year, the Administration issues two reports that detail financial results for the Federal Government:

- the *President's Budget*, the Government's primary financial planning and control tool, reports "actual" budget results to inform that public that the government spent taxpayer money in accordance with applicable laws;
- the *Financial Report of the United States Government* provides the President, Congress, and the American people a broad, comprehensive overview of the cost of the Government's operations, the sources used to finance them, its balance sheet, and the outlook for its social insurance programs.

The following illustrates how the two reports complement each other.

President's Budget	Financial Report of the U.S. Government
Prepared on a '*cash basis*' • Initiative-based: focus on current and future initiatives planned and how resources *will be used* to fund them. • Receipts ('cash in'), e.g., federal income tax received, National Park fees collected. • Outlays ('cash out'), e.g., defense spending, benefit checks sent.	Prepared on an '*accrual basis*' • Retrospective: focus on how resources *have been used* to implement initiatives. • Revenue: recognized when earned, but not necessarily received.[1] • Costs: recognized when owed, but not necessarily paid.

The Financial Report has as its base ALL the transactions that form the budget results. Adjustments to convert costs and revenues from the cash basis to the accrual basis are shown in the ***Statement of Reconciliations of Net Operating Cost and Unified Budget Deficit*** in this report. The amounts itemized on this statement are intended to represent the difference between the two bases for reporting. There is no magic, no sleight of hand; just cost accruals to adjust for the timing of the cash outlay versus the portion of non cash-based cost attributable to the current period.

In 2006, for the first time, the ***Statement of Social Insurance*** has been reported and audited as a principal financial statement. The statement provides a perspective on the Government's long-term responsibilities and costs. It should be noted, however, that even with this addition, the financial statements do not reflect future costs implied by current policy, such as national defense, the global war on terrorism, and hurricane cleanup efforts.

Outstanding Revenue Growth Narrows the Gap between Costs and Revenues

As shown in Table 2, 2006 marked the third consecutive fiscal year of substantial revenue growth. A combination of solid economic growth and improved corporate tax yields have contributed to revenue growth of over 35% since 2003. In 2006, revenues grew to $2,440.8 billion establishing a new record high. Nearly $600 billion in increased cash was collected over the last three years over the $1.8 trillion base level of 2003 (an average of nearly $200 billion per year). This has contributed to a reduction of both the budget deficit and net operating cost.

Table 2: Revenue Growth: 2003-2006

billions of dollars	Total Revenue	Change from Prior Year	% Increase	Change from 2003	% Increase from 2003
2003	$ 1,796.0	$ (81.7)	-4.4%		
2004	$ 1,912.7	$ 116.7	6.5%	$ 116.7	6.5%
2005	$ 2,185.5	$ 272.8	14.3%	$ 389.5	21.7%
2006	$ 2,440.8	$ 255.3	11.7%	$ 644.8	35.9%

Costs Decline Slightly

Costs decreased to $3,127.7 billion from 2005's level of $3,174.6 billion. This is mostly made up of two contrasting items: (1) an inflationary and programmatic increase in outlays of $182 billion; and (2) a $242.5 billion reduction in actuarial costs from last year's record level of $429.7 billion to $187.2 billion in 2006, offsetting the spending increase. This unusual result stems from the methodology used to calculate the liabilities for post-

[1] Under GAAP, U.S. Government revenues are recognized on a 'modified cash' basis, or when they become measurable. Exchange revenue is recognized at the time the government provides goods or services to the public or to another Government entity. Nonexchange revenue (e.g., taxes, fines, donations) is recognized to the extent that the collection is probable and the amount is measurable.

employment benefit programs such as employee pensions, health, and veteran's compensation. Actuarial calculations of future outlays by year for these programs are made; then all years are discounted back to the present. Interest rate levels are among the most significant assumptions about the future that can impact these estimates.

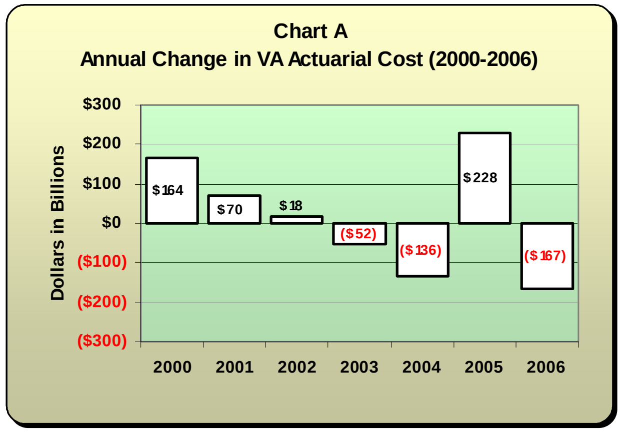


Chart A shows the fluctuation in VA's actuarial costs over the past several years. Interest rate changes have a significant role in these variations. VA reported a substantial decrease in actuarial costs (calculated as the annual change in actuarial liabilities) of $166.6 billion. This followed both significant actuarial cost increases and decreases in 2005 and 2004, respectively. These fluctuations stem mainly from the use of interest rates at year-end to discount future benefits and estimate a current liability amount. Most federal actuarial liabilities are calculated through the use of average future interest rates, not spot rates as of September 30th of the current period. Because a small change in interest rate assumptions produces the large actuarial cost fluctuations shown in Chart A, reported annual VA actuarial costs are not useful in predicting future annual costs. The change in VA's actuarial costs from year to year accounts for the majority of the change in the Government's net cost in most years (54 percent in 2006). Moreover, in 2006, the change in these and other actuarial (e.g., pension) costs accounted for nearly 80 percent of the $310 billion decrease in total net operating cost. Finally, total actuarial costs in 2006 of $187.2 billion, as in most recent years, account for most of the annual differences (93 percent in 2006) between the Government's budget deficit and net cost, and ostensibly, between the cash and accrual bases of accounting in the Federal Government.

Assets & Liabilities – What We Own and What We Owe

The Government's year-end net position can be derived by netting its assets against its liabilities on the ***Balance Sheet***. It is important to note that the balance sheet excludes the financial impact of the Government's sovereign powers to tax, regulate commerce, and set monetary policy. It also excludes its control over nonoperational resources, including national and natural resources, for which the Government is a steward. Moreover, the Government's responsibilities are broader than the liabilities presented on the balance sheet, including its future social insurance responsibilities (e.g., Social Security and Medicare), as well as other programs and contingencies.

The Government's largest liability has been the Federal debt held by the public and accrued interest, which increased $243.3 billion to $4,867.5 billion in fiscal year 2006 from $4,624.2 billion in 2005. The sharp increase in tax revenues enabled the Government to borrow a smaller amount of cash from the public this year as compared to the previous year to finance its operations. The Government increased its net borrowings from the public by a combined $529.5 billion since fiscal year 2005 to help finance more than 90 percent of budget deficits in both 2005 and 2006. However, the Government's debt operations are much more complex than this would imply. Each year, trillions of dollars of debt matures and new debt takes its place. For example, in fiscal year 2006, new borrowings were $4.5 trillion and maturing debts were $4.2 trillion.

Federal employee and veteran benefits payable, 45% of the Government's total reported liabilities, have increased dramatically in recent years, from $2,600.7 billion at fiscal year-end 1999, to $4,679.0 billion as of September 30, 2006.

Social Insurance and Other Responsibilities

Information reported on social insurance programs addresses fundamental questions about their current and future financial sustainability, i.e., the extent to which the Government could meet future program demands under current laws and conditions. For the programs listed as social insurance (e.g., Old Age, Survivors' and Disability Insurance (OASDI) or Social Security, Medicare (Parts A, B, and D)), the Statement of Social Insurance (SOSI) shows the estimated future excess of scheduled benefit expenses over contributions, premiums, and tax income (excluding interest), based on each program's actuarial trust fund report (see Table 3).

In concert with other financial statements and reports, this information gives both a short- and long-term view of significant financial issues facing the Government. For financial reporting purposes, the ***Balance Sheet*** presents a ‘snapshot’ at a point in time of the Government’s *current* financial condition, emphasizing how current and prior actions and events have impacted its assets and liabilities. By contrast, the ***SOSI*** presents an assessment of the extent to which the programs are unfunded under current financing arrangements relative to scheduled benefit obligations, based on the calculated net present value of future estimated revenues and expenditures over an extended period.

Table 3: Social Insurance Responsibilities

billions of dollars	2002	2003	2004	2005	2006
This table shows the present value of 75-year actuarial projections of the benefit payments under current law for Social Security, Meidcare, and other social insurance programs in excess of their scheduled contributions and earmarked taxes for current participants ages 15 and over at the start of the period.					
Social Insurance Responsibilities, Net (closed group) [1]					
Social Security (OASDI)	$ (11,216)	$ (11,742)	$ (12,552)	$ (13,583)	$ (14,976)
Medicare	$ (12,896)	$ (15,007)	$ (24,615)	$ (26,339)	$ (29,040)
Other [2]	$ (107)	$ (109)	$ (112)	$ (116)	$ (131)
Total Social Insurance Responsibilities, Net, (closed group)	**$ (24,219)**	**$ (26,858)**	**$ (37,279)**	**$ (40,038)**	**$ (44,147)**
Total Social Insurance, Net (open group) [2]	**$ (17,887)**	**$ (20,825)**	**$ (33,363)**	**$ (35,689)**	**$ (38,851)**

[1] The 'closed group' includes current participants (i.e., receiving and/or are eligible to receive benefits) ages 15 and over at the start of the period. The 'open' group' (shown below for comparative purposes), includes all current and future projected participants (i.e., individuals receiving and/or are eligible to receive benefits ages 15 and over at the start of the period, PLUS participants estimated to receive and/or be eligible to receive beneifts in the future over the 75-year horizon).

[2] For the 'closed' group, 'Other Social Insurance Programs' = Railroad Retirement Program. The 'open' group includes both the Railroad Retirement and Black Lung Programs. The SOSI presents only 'open group' totals for Black Lung (i.e., does not identify 'closed' group amounts separately). Therefore, Black Lung is only reflected in the 'open' group amounts above.

Since these estimates are not liabilities, and therefore do not impact either an entity’s current assets or liabilities, they are considered ‘off-balance sheet’ items; according to Federal accounting standards. This distinction substantially limits the comparability of the Government’s current net liabilities to future net social insurance responsibilities. Their significance can, however, be measured in other contexts. Table 4 shows how the two compare. Fiscal year 2006 total assets of $1,496.5 billion and total liabilities of $10,412.9 billion combine to derive the Government’s current net liability of $8,916.4 billion. By comparison, SOSI reports net present value expenditures of $44,147 billion in net social insurance responsibilities. [2] The net social insurance responsibilities (scheduled benefits in excess of estimated revenues) indicate that those programs are on an unsustainable fiscal path and difficult choices will be necessary in order to address their large and growing long-term fiscal imbalance. Delay is costly and choices will be more difficult as the retirement of the 'baby boom' gets closer to becoming a reality with the first wave of boomers eligible for retirement under Social Security in 2008

Table 4. Comparing Current Net Liabilities to Future Social Insurance Responsibilities

billions of dollars	2002	2003	2004	2005	2006
Liabilities Net of Assets (balance sheet)	$ (6,820)	$ (7,094)	$ (7,710)	$ (8,467)	$ (8,916)
	The balance sheet presents a 'snapshot' of an entity's **current** financial position (net of assets and liabilities as of the end of the current fiscal year.				
Social Insurance Responsibilities, Net (closed group - - off-balance sheet)	$ (24,219)	$ (26,858)	$ (37,279)	$ (40,038)	$ (44,147)
	The Statement of Social Insurance presents the present value of estimated **future** revenues and expenditures under current law.				
Combined Net Liabilities (current) and Social Insurance Responsibilities (future)	**$ (31,039)**	**$ (33,952)**	**$ (44,989)**	**$ (48,505)**	**$ (53,063)**

Looking Ahead – The President’s Management Agenda

Fiscal responsibility requires the sound stewardship of taxpayer money. Once the Congress and the President decide on overall spending levels, taxpayer dollars should be managed to maximize results. The President’s Management Agenda (PMA) is creating a results-oriented Government where agencies and programs are managed professionally and efficiently to achieve the results expected by the Congress and the American people.

The PMA’s broad goal is to make the Government more results-oriented with a focus on achievement, efficiency, and accountability. It emphasizes improving Government operations by setting clear goals and action plans, and then following through on those plans. Agencies continue to manage to achieve better results. PMA standards for success are used to measure agencies’ progress and achievement in meeting overall goals. The chart above summarizes Federal agencies’ current status as of September 30, 2006. Agencies are also rated on their progress. These ratings and other related information are discussed later in this report and are available at: www.whitehouse.gov/results/agenda/standards.pdf

[2] Tables 3 and 4 both focus on closed-group obligations, 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, making the closed-group numbers more forward-looking than a strict accrual-based calculation.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Introduction

The *2006 Financial Report of the United States Government (Report)* provides the President, Congress, and the American people a comprehensive view of the Federal Government's finances, i.e., its financial position and condition, its revenues and costs, assets and liabilities, and other obligations and commitments. The *Report* also discusses important financial issues and significant conditions that may affect future operations.

Pursuant to 31 U.S.C. § 331(e)(1), the Department of the Treasury must submit the *Financial Report*, which is subject to audit by the Government Accountability Office (GAO), to Congress no later than six months after the September 30 fiscal year-end. In order to encourage more timely and relevant reporting, the Office of Management and Budget (OMB) accelerated both the individual agency and governmentwide reporting deadlines to 45 days and 75 days after year-end, respectively, beginning with fiscal year 2004 reporting cycle.

For each of the past ten years, GAO has issued a disclaimer of opinion on the consolidated financial statements. A 'disclaimer' means that sufficient information was not available for the auditors to determine whether the information was reliable. Material weaknesses in internal control and other scope limitations resulted in conditions that prevented GAO from forming and expressing an opinion on the Government's consolidated financial statements for the fiscal years ended September 30, 2006 and 2005. However, eighteen of the 24 most significant Federal agencies earned unqualified opinions on their FY 2006 financial statement audits. Table 5 summarizes agency audit results.

Table 5
FY 2006 Agency Audit Results

Unqualified			Qualified	Disclaimer
USDA	Treasury	SBA	Energy [1]	Defense
Commerce	VA	SSA	Transportation	DHS [2]
Education	USAID	Ex/Im Bank	Smithsonian[3]	State
HHS	EPA	FCC		NASA
HUD	GSA	PBGC		
Interior	NSF	RRB		
Justice	NRC	SEC		
Labor	OPM	USPS		

[1] Balance Sheet Audit Only
[2] Balance Sheet and Custodial Statement Audit Only
[3] GFRS Audit Only

The fiscal year 2006 *Financial Report* consists of:

- Management's Discussion and Analysis (MD&A), which provides management's perspectives on and analysis of information presented in the report, such as financial and performance trends;
- The principal financial statements and the related footnotes to the financial statements;
- Stewardship and Supplemental Information; and
- GAO's Audit Report.

FY 2006 marks the first year that agencies' Statements of Social Insurance (SOSI) have been audited as a separate, principal statement. These statements are based on the Trustee Reports for such programs as Social Security and Medicare. All agencies reporting on the SOSI earned unqualified opinions on their FY 2006 audits.

Mission & Organization

The Government's fundamental mission is derived from the original mission in the Constitution: ***"…to form a more perfect union, establish justice, insure domestic tranquility, provide for the common defense, promote the general welfare and secure the blessings of liberty to ourselves and our posterity."*** The Congress authorizes and agencies implement new or changed programs as missions and initiatives evolve over time in pursuit of key public services and objectives, such as providing for national defense promoting health care, fostering income security, boosting agricultural productivity, providing veteran benefits and services, facilitating commerce, supporting housing and the transportation systems, protecting the environment, contributing to the security of energy resources, and helping States provide education. The following chart provides an abbreviated overview of how the U.S. Government is organized.

THE UNITED STATES GOVERNMENT

THE CONSTITUTION

LEGISLATIVE BRANCH

THE CONGRESS
SENATE HOUSE

Architect of the Capitol
United States Botanic Garden
Government Accountability 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 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

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 HOMELAND SECURITY *
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
Broadcasting Board of Governors
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 System Insurance Corporation *
Federal Communications Commission *
Federal Deposit Insurance Corporation *
Federal Election Commission
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 the Director of National Intelligence
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 *

*Indicates a significant entity included in the *Financial Report*.
Original source: *U.S. Government Manual 2005/2006*

Economy, Federal Budget, & Federal Debt

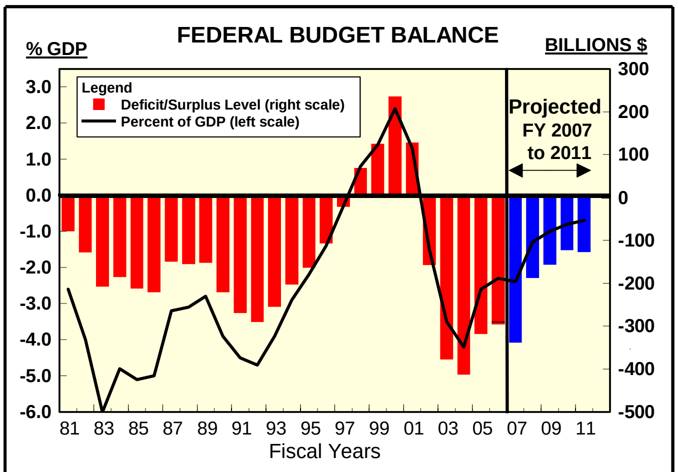
Growth in the U.S. economy remained favorable and well balanced through fiscal year 2006. Real GDP and real hourly compensation increased, job creation was solid, and the unemployment rate averaged 4.7 percent, down from 5.2 percent in the previous year. Productivity growth continued through 2005 to the first half of 2006. The deficit outlook through 2012 is for steady deficit declines due to a growing economy, tight controls on discretionary spending, and continued strong economic growth.

The Economy in Fiscal 2006

After rising at an annual average rate of 3.2 percent over the four quarters of 2005, growth in real GDP continued to increase through the first three quarters of 2006 - - rising at annual rates of 5.6 percent in the first quarter of the year; 2.6 percent in the second quarter; and 2.2 percent in the third quarter of 2006. Holding growth down in the third quarter was a sharp 18.0 percent annual rate decrease in residential fixed investment, extending a string of declines to four quarters in this sector as housing demand weakened. The quarterly pattern of GDP growth and consumer spending in 2005 and 2006 was also affected by last fall's hurricanes. Consumer spending growth averaged a 3.6 percent annual rate in the first three quarters of 2005 before slowing to 0.8 percent in the fourth quarter. Consumer spending rebounded in the first three quarters of 2006, rising 4.8 percent in the first quarter, 2.6 percent in the second, and accelerating to 2.9 percent in the third for an average rate of 3.4 percent over that period. In the third quarter of 2006, consumer spending on durable goods picked up to a 6.0 percent annual rate in the third quarter as purchases of motor vehicles moved higher and contributed 0.29 percentage points to real GDP growth.

Outside of residential building, fixed investment was strong. Real investment in equipment and software expanded by an average of 7.0 percent in the four quarters of 2005 followed by a 15.6 percent hike in the first quarter of 2006, a 1.4 percent decline in the second quarter, and a 7.2 percent increase in the third -- for an average of 7.1 percent over the three quarters of 2006. Investment in nonresidential structures shot up at a 12.0 percent annual rate in the final quarter of 2005 and rose at annual rates of 8.7 percent in the first quarter of 2006, 20.3 percent in the second quarter, and 16.7 percent in the third for an average pace of 15.2 percent over the three quarters -- the largest gain for this sector since a 24.7 percent spike in the second quarter of 1994. Labor markets continue to be robust. Nonfarm payroll employment expanded at an average rate of 147,000 jobs per month through the first ten months of 2006, and since the employment trough of August 2003, the economy has created more than 6.0 million new jobs.

An upcoming benchmark revision announced by the Bureau of Labor Statistics will be incorporated into the jobs totals next February, and may imply that the economy has actually generated closer to 7 million jobs since August 2003 or about 180,000 per month. The unemployment rate declined to 4.6 percent in September 2006 from 4.7 percent in the previous month, and dipped further to 4.4 percent in October. Core inflation remains relatively benign. Inflation rose in the first three quarters of the year, but appears contained. The overall consumer price index (CPI) fell 0.5 percent in September and October as energy prices turned down. The "core" CPI (excluding food and energy) was up 2.7 percent in the year ending September 30, 2006.



Source of Projections: FY 2007 Mid-Session Review

Budget Results

The deficit improved in fiscal year 2006. Receipts totaled $2,407 billion, up $253.4 billion from a year earlier. Increases in receipts are the main reason the deficit picture has improved, with growth in receipts fueled by increased employment and corporate profits, which contributed to growth in both individual income tax revenue and in corporate tax revenue Outlays rose to $2,654 billion, $182 billion more than last year. The deficit in 2006 came in at $248 billion, $71 billion less than the deficit in 2005.

Federal Debt

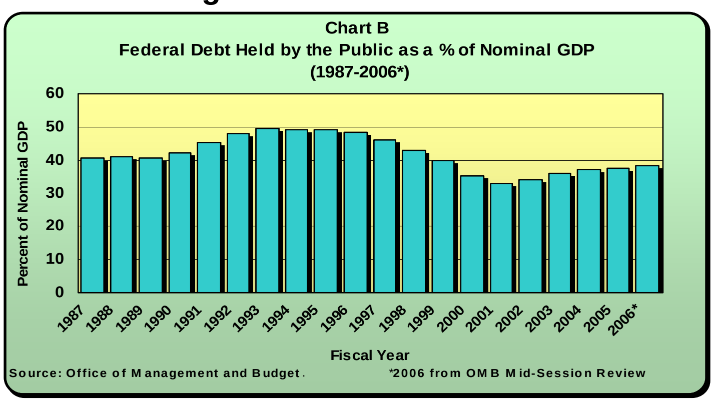
There are two kinds of Federal debt: debt held by the public and intragovernmental debt (i.e., debt the Government owes to itself). At the end of fiscal year 2006, the total of these two kinds of debt was $8,529.6 billion. Debt held by (or owed to) the public is included as a liability on the balance sheet and includes all Treasury securities (bills, notes, bonds, inflation-protected, and other securities) held by individuals, corporations, Federal Reserve banks, foreign governments, and other entities outside the.Government. Intra-governmental debt is primarily held in the form of special nonmarketable securities by various parts of the Government. The laws establishing Government trust funds generally require the excess trust fund receipts to be invested in these special securities. This debt is not included on the balance sheet because these payments are claims of one part of the Government against another and are eliminated for consolidation purposes (see Financial Statement Note # 10).

Federal debt is subject to a statutory ceiling known as the debt limit. Prior to 1917, the Congress approved each issuance of debt. In 1917, to facilitate planning in World War I, the law established a dollar ceiling for Federal borrowing, which has been periodically increased over the years. On March 20, 2006, legislation became effective raising the current limit from $8,184.0 billion to $8,965.0 billion. Gross debt, excluding some adjustments, is the measure subject to the Federal debt limit. At the end of fiscal year 2006, the amount of debt subject to the limit was $8,420.3 billion, leaving a margin of $544.7 billion until the debt ceiling is reached.

How the Federal Budget is related to the Federal Debt

The budget surplus or deficit is the difference between total Federal spending and receipts in a given year. The Government borrows from the public to finance a budget deficit. A budget surplus occurs when the Government accumulates excess funds that are used to reduce debt held by the public. In other words, deficits or surpluses are related to the annual net change in the amount of debt held by the public, while the debt held by the public generally represents the total of all cash-based deficits minus all cash-based surpluses built up over time.

Federal Debt Held by the Public as a Percentage of GDP



The Federal debt held by the public as a share of GDP reflects how much of the Nation's wealth is absorbed by the Federal Government to finance its obligations. Chart B shows the Debt/GDP ratio trend from 1987 through 2006. Starting in the late 1970s, increasing budget deficits spurred a corresponding increase in debt held by the public, which essentially doubled as a share of GDP over a 15-year period throughout the mid-1990s and reached about 50 percent in 1993. The budget controls instituted by the Congress and the President, together with economic growth, contributed to the budget surpluses at the end of the 1990s. These surpluses led to a decline in the debt held by the public, and from fiscal years 1998 through 2001, the debt-to-GDP measure declined from about 43 percent to about 33 percent. In fiscal years 2002 through 2004, the debt-to-GDP ratio started to rise slightly, due to many factors, including increased spending for homeland security and defense commitments, the decline in receipts owing to the recession and lower stock market value, as well as tax cuts, and the expiration of the budget controls that once helped instill spending discipline. The ratio has increased each year since 2001, but has risen only slightly since 2004 to 37.6 percent in 2006, still far below the roughly 50 percent ratio of the mid-1990s.

Financial Condition and Results of Operations

This *Report* provides the results of the Government's financial operations, including its financial condition, revenues and costs, assets and liabilities, and other obligations and commitments. This information, when combined with the President's Budget, collectively provides a valuable tool for managing current operations and planning future initiatives.

Accrual-Based Results and Basis of Accounting

Each year, the Administration issues two reports that detail financial results for the Federal Government: the *President's Budget*, whose main purpose is to provide a prospective discussion of future initiatives and the resources needed to support them; and this *Financial Report*, which provides the President, Congress, and the American people a broad, comprehensive overview of the cost of the Government's operations, the sources used to finance them, its balance sheet, and the outlook for its social insurance programs.

President's Budget	Financial Report of the U.S. Government
Prepared on a '*cash basis*' • Initiative-based: focus on current and future initiatives planned and how resources *will be used* to fund them. • Receipts ('cash in'), e.g federal income tax received, National Park fees collected , • Outlays ('cash out'), e.g., defense spending, benefit checks sent.	Prepared on an '*accrual basis*' • Retrospective – prior and present resources used to implement initiatives. • Revenue: recognized when earned, but not necessarily received. • Costs: recognized when owed, but not necessarily paid.

Treasury prepares the financial statements in this *Report* primarily on an accrual basis of accounting (i.e., recognizing revenues when earned, not received; and costs when incurred, not paid) as prescribed by U. S. generally accepted accounting principles (GAAP) for Federal entities.[1] These standards are tailored to the Government's unique characteristics and circumstances. For example, agencies prepare a uniquely structured 'Statement of Net Cost,' which is intended to present net Government resources used in its operations, instead of an 'Income Statement,' which private sector companies typically use to focus on profits earned. Also unique to Government is the preparation of separate statements, to reconcile differences and articulate the relationship between budget and accrual accounting results (e.g., Statement of Reconciliation of Net Operating Revenue (or Cost) and Unified Budget Deficit).

Reporting Entity

These financial statements cover the three branches of the Government (legislative, executive, judicial). Legislative and judicial branch reporting focuses primarily on budgetary activity. Only executive branch entities are required, by law to prepare audited financial statements. Some legislative branch entities do, however, voluntarily submit financial reports.

A number of Government entities and organizations are excluded due to the nature of their operations, including the Federal Reserve System (an independent entity that serves both public and private purposes); the Federal Retirement Thrift Investment Board; fiduciary funds owned by Federal employees; and government-sponsored but privately-owned enterprises, including the Federal Home Loan Banks, the Federal National Mortgage Association, and the Federal Home Loan Mortgage Corporation. A list of the significant agencies and entities contributing to this report is included in the Appendices.

Limitations of the Financial Statements

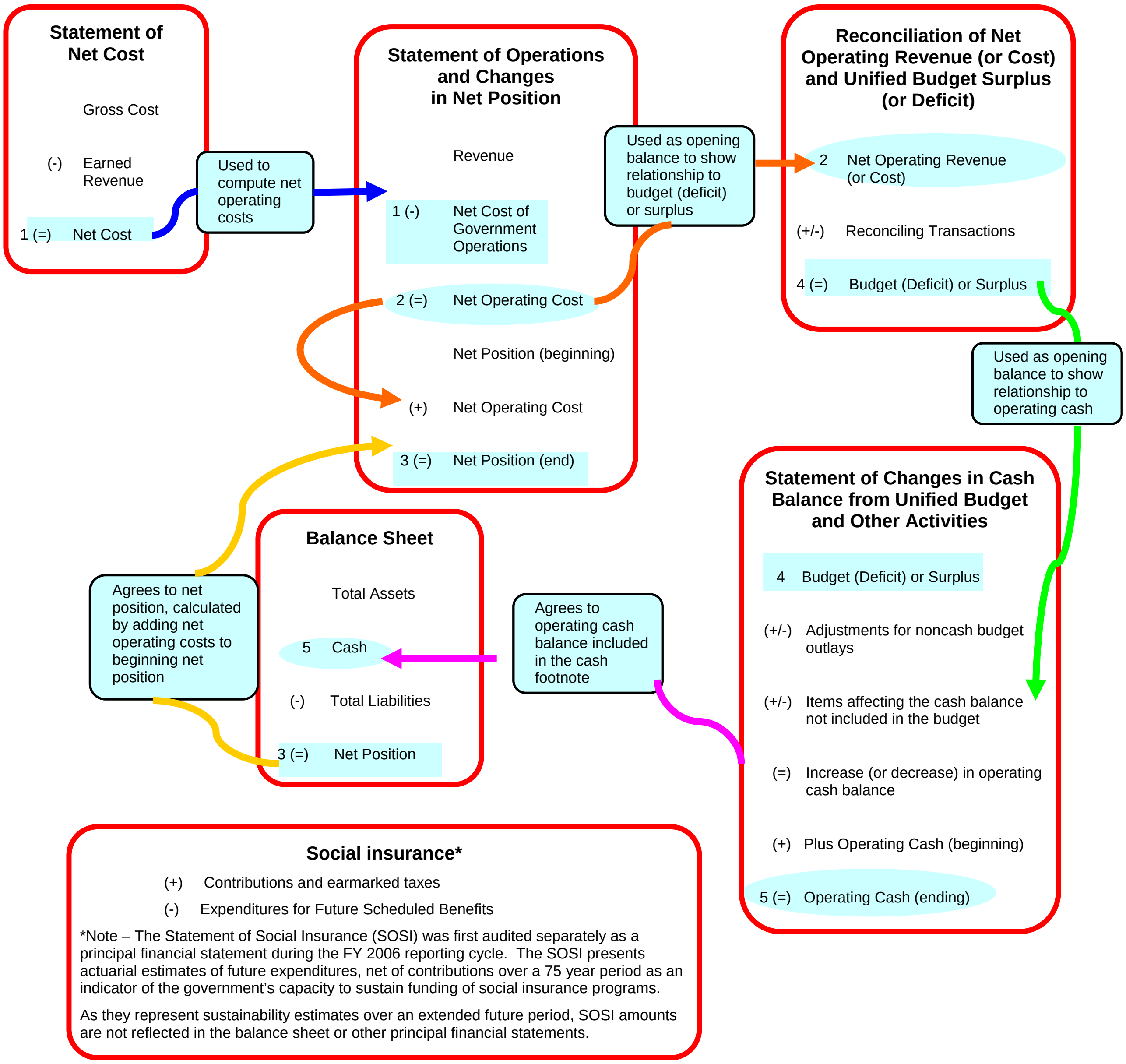
The principal financial statements have been prepared to report the financial position and results of operations of the Federal Government, pursuant to the requirements of 31 U.S.C. § 331(e)(1). While the statements have been prepared from the books and records of the entity in accordance with U.S. GAAP for Federal entities and the formats prescribed by OMB, the statements are in addition to the financial reports used to monitor and control budgetary resources that are prepared from the same books and records.

[1] Under GAAP, U.S. Government revenues are recognized on a 'modified cash' basis, or when they become measurable.

How the Federal Government's Financial Statements are Related to Each Other

The Government's financial statements share relationships that, in combination, provide a comprehensive, integrated view of the Nation's finances. The following graphic illustrates these relationships.

How the Federal Government's Financial Statements are Related to Each Other



Notes
1 The total operating expense, called Net Cost, presented in the Statement of Net Cost is used in the Statement of Operations and Changes in Net Position to determine whether the Federal Government's financial operations (revenue less expenses) resulted in net operating cost or net operating revenue for the year.
2 The operating result from the Statement of Operations and Changes in Net Position explains the change in the Federal Government's net position. It is also the beginning balance in the Reconciliation of Net Operating Revenue (or Cost) and Unified Budget Surplus (or Deficit).
3 The Net Position from the Statement of Operations and Changes in Net Position agrees to the Net Position on the Balance Sheet, which is based on the difference between the Federal Government's reported assets and liabilities.
4 The unified budget result is used in the Reconciliation of Net Operating Revenue (or Cost) and Unified Budget Surplus (or Deficit) and the Statement of Changes in Cash Balance from Unified Budget and Other Activities to show how the Federal Government's financial operations and changes in operating cash are connected to the unified budget results.
5 The Federal Government's ending operating cash balance from the Statement of Changes in Cash Balance from Unified Budget and Other Activities is the same as the operating cash component of the "Cash and other monetary assets" line on the Balance Sheet. The operating cash amount can be found in the Balance Sheet note for Cash and other monetary assets.
Source: Government Accountability Office.

Determining the Government's Net Position: "Where We Are"

The Government's financial position and condition have traditionally been expressed through the Budget, focusing on the impact of surpluses and deficits. However, this primarily cash-based discussion of the Government's net outlays (deficit) or net receipts (surplus), tells only part of the story. The Government's net position is driven simultaneously by the Government's revenues and expenses, as well as the changes in its assets and liabilities.

Revenues and Costs: What Came In & What Went Out

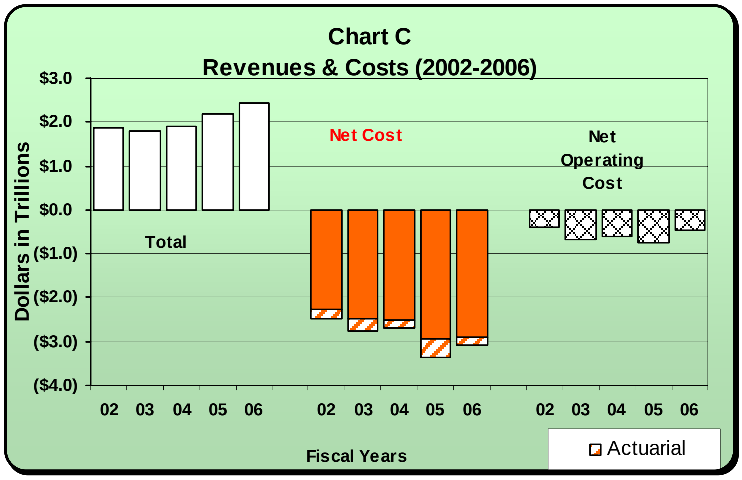


Chart C
Revenues & Costs (2002-2006)

The Government's ***Statement of Operations and Changes in Net Position***, much like a corporation's income statement, shows the Government's 'bottom line' (i.e., its net revenues and costs). Chart C shows that the Government has incurred a total net operating cost (i.e., costs have exceeded its revenues) over the past several years. In 2006, net operating costs decreased more than 40 percent from $760.2 billion in fiscal year 2005 to $449.5 billion. 2006 net operating costs accounted for the 5.3 decrease in net position from $8,466.9 billion to $8,916.4 billion during the year. The Government last generated net operating revenue (i.e., revenues exceeded costs) in fiscal years 1999 and 2000 in the amounts of $101.3 billion and $39.6 billion, respectively, in concert with the budget surplus. Since then, the government has incurred average net operating costs of $562.1 billion per year.

The Government nets its costs against both earned revenues from Government programs (e.g., Medicare premiums, national park entry fees) and taxes and other revenue. Taxes account for the vast majority of total revenues. The government's 'bottom line' is its net operating cost, or those costs that cannot be supported by earned, program revenue. Table 6 illustrates the derivation of the government's net cost and net operating cost for 2004, 2005, and 2006. The Government must finance any costs as they are paid that cannot be covered by revenues with federal debt, subject to the statutory debt limit. Beginning in fiscal year 2006, the ***Statement of Operations and Changes in Net Position*** identifies resources that have been earmarked for specific activities or operations.

Table 6: Net Cost of the Federal Government

billions of dollars	2004	2005	2006
Gross Costs:			
HHS	$ 583.9	$ 623.4	$ 678.8
DoD	$ 672.1	$ 703.9	$ 658.0
SSA	$ 534.9	$ 572.1	$ 593.1
Interest on Federal Debt	$ 158.3	$ 181.2	$ 221.5
VA	$ 51.1	$ 276.6	$ 117.3
Other Federal Agencies	$ 731.7	$ 817.4	$ 859.0
Total Gross Costs	**$ 2,732.0**	**$ 3,174.6**	**$ 3,127.7**
Less: Earned Revenue (revenue generated by programs)	(207.1)	(224.8)	(226.4)
Net Cost	**$ 2,524.9**	**$ 2,949.8**	**$ 2,901.3**
Less: Taxes & Other Revenue	1,912.7	2,185.5	2,440.8
Total Net Operating Cost[1]	**$ 615.6**	**$ 760.3**	**$ 449.5**

[1]Total Net Operating Cost includes 'Unmatched Transactions and Balances ' not shown in this table.

Net operating costs are comparable, but not identical, to the budget deficit. The ***Reconciliation of Net Operating Cost and Unified Budget Deficit Statement*** shows how the government's net operating cost relates to the more widely-known budget deficit. As indicated in Table 7, the main differences between the two for fiscal years 2005 and 2006 are:

- o changes in actuarial expenses related to employee and veteran benefits are included in net operating cost, but not in the budget deficit;
- o purchases of capitalized fixed assets are included in the budget deficit (recorded in the year outlay(s) are made), but not in net operating cost, offset by depreciation over the life of the asset.

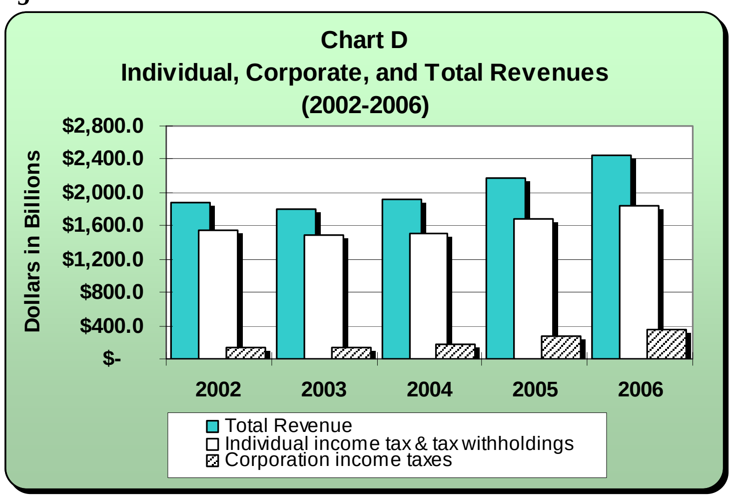
Table 7: How Net Operating Cost Relates to the Budget Deficit			
billions of dollars	2004	2005	2006
Total Net Operating Cost	**$ 615.6**	**$ 760.3**	**$ 449.5**
Net Change: Federal Employee and Military Benefit Liabilities	(212.1)	(232.0)	(156.0)
Net Change in Veterans Benefits Liabilities	30.0	(197.8)	(31.2)
Net Change - Other Costs	(21.2)	(11.9)	(14.6)
Budget Deficit	**$ 412.3**	**$ 317.6**	**$ 247.7**

As noted earlier, Treasury primarily uses the 'accrual method' of accounting in preparing the Government's financial statements, recognizing revenues when earned, not collected, and costs when incurred, not paid. Chart C shows that the Government's total net cost includes an 'actuarial' element (e.g., the present value of an employer's expected long-term cost of paying postemployment pension benefits that have been earned by the employee at the time the employee is eligible). Changes in assumptions used to project actuarial costs, such as interest rates and VA's annual estimates of veterans compensation and burial benefits can cause those projections, and consequently total costs, to fluctuate year to year. Further, these actuarial costs, in recent years, have accounted for the vast majority of the difference between the primarily cash-based budget and the primarily accrual-based financial reports. Chart C shows the impact that actuarial costs have on total costs.

Revenue: "What Came In"

The ***Statement of Net Costs*** reports 'earned' revenue generated by Federal programs. In fiscal year 2006, the Government's total earned revenues increased $1.6 billion to $226.4 billion. Nearly one-fourth of these revenues are attributable to Medicare premiums paid by program participants.

The ***Statement of Operations and Changes in Net Position*** shows the Government's taxes and other revenues (i.e.., revenues other than 'earned'). Fiscal year 2006 marked the third consecutive year of substantial revenue growth. A combination of solid economic growth and improved corporate tax yields have contributed to revenue growth of over 35 percent since 2003. Personal income and corporate profits before tax rose 6.3 percent and 14.1 percent, respectively in 2006 [2], and have increased by an average of 5.0 percent and 16.4 percent per year, respectively, since fiscal year 2001, including revenue decreases in 2001and 2002. These trends, in part, contributed to an increase in taxes and other revenues for 2006 of $255.3 billion to $2,440.8 billion, establishing a new record high. Chart D shows that individual and corporate income tax revenues, which increased 9.2 percent and 28.8 percent, respectively during 2006, account for the majority (nearly 90 percent) of total revenues. Similarly, nearly $600 billion in increased cash was collected over the last three years over the $1.8 trillion base level of 2003 (an average of nearly $200 billion per year). This recent growth in revenues has contributed to a reduction of both the budget deficit and net operating cost.



Cost: "What Went Out."

The ***Statement of Net Cost*** shows how much it costs to operate the Federal Government, recognizing expenses when they happen, regardless of when payment is made (accrual basis). It shows the derivation of the Government's net cost of operations or the difference between costs of goods produced and services rendered by the Government during the fiscal year, and the corresponding earned revenues, as described above. This amount, in turn, is offset

[2] Personal income and corporate profit statistics sources: National Income and Products Account Tables, Bureau of Economic Analysis, Department of Commerce.

against the Government's taxes and other revenue in the ***Statement of Operations and Changes in Net Position*** to calculate the 'bottom line' or net operating costs.

In fiscal year 2006, the Government's total gross cost decreased $46.9 billion to $3,127.7 billion. Offsetting gross cost against the $226.4 billion in earned revenue described earlier yields a total net cost of operations of $2,901.3 billion. Further reducing this amount by the $2,440.8 billion in taxes and other revenues results in the Government's 'bottom line' accrual net operating cost of $449.5 billion, a decrease of more than $300 billion (more than 40 percent) from 2005 net operating costs of $760.2 billion.

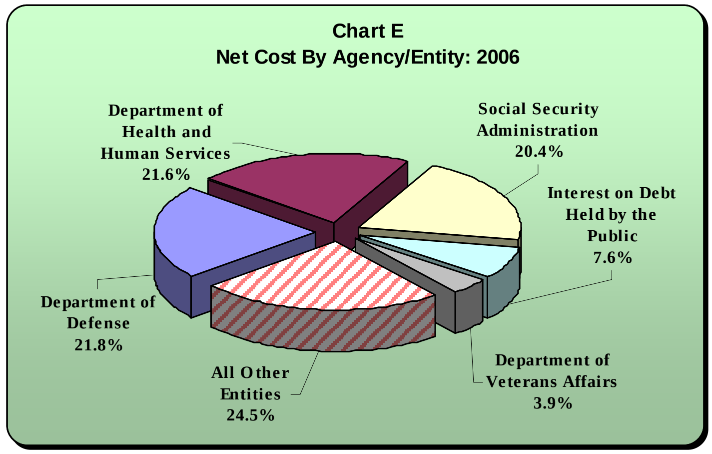


Chart E
Net Cost By Agency/Entity: 2006

Chart E shows that, along with interest on debt held by the public, the source of over three-quarters of the Government's fiscal year 2006 net cost of operations comes from four Federal entities: the Departments of Defense (DoD) and Health and Human Services (HHS), the Social Security Administration (SSA), and the Department of Veterans Affairs (VA). Chart F shows that DoD has incurred the largest agency share of the Government's total net cost of operations in recent years, mostly attributable to the continued global war on terror and changes in actuarial liabilities related to its Military Retirement Fund and Health Benefits. HHS and SSA combine to make up nearly half of the 2006 total net cost of operations. The bulk of these agencies' costs are attributable to their administration of the Government's major social insurance programs, e.g., Old Age, Survivors', and Disability Income (Social Security), and Medicare. The Statement of Social Insurance and the supplemental information in this report, as well as the social insurance discussion in this section discuss the current costs and future sustainability of these programs in greater detail.

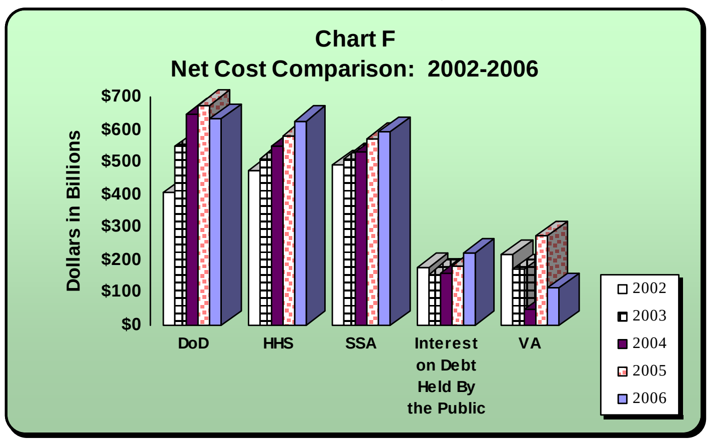


Chart F
Net Cost Comparison: 2002-2006

Among cabinet agencies, the Department of Energy (Energy) experienced the greatest percentage increase in its net cost (+ 52.7 percent), while VA experienced the greatest cost decrease (- 58.3 percent). Both changes resulted from each agency's need to estimate future costs and liabilities based on complex assumptions and cost models. As reported in Energy's 2006 Performance and Accountability Report, Energy's cost increase, in large part, stems from revised estimates of currently unfunded environmental clean-up liabilities. By comparison, VA considers several variables (e.g., number of eligible recipients, discount rates, and life expectancy) in estimating its actuarial liability for future veterans' compensation benefits, which experienced a slight increase of $31.2 billion (2.8 percent) from $1,122.6 billion in fiscal year 2005 to $1,153.8 billion in 2006. A liability balance increase during the year represents the actuarial cost amount for that year. Because a small change in interest rate assumptions produces the large actuarial cost fluctuations shown in Table 8, reported annual VA actuarial costs are not useful in predicting future annual costs. VA's 2006 decrease of nearly $170 billion followed a more than $200 billion actuarial cost increase in 2005 and a nearly $140 billion decrease in 2004. These fluctuations are caused primarily by changes in interest rate assumptions. The change in

Table 8: Change in VA's Total Actuarial Cost: 1999 - 2006

billions of dollars	Estimated Liability (as of Sept. 30)	Liability Change = Actuarial Cost	Change in Actuarial Cost
1999	$483	($95)	–
2000	$553	$69	$164
2001	$692	$139	$70
2002	$849	$157	$18
2003	$955	$106	($52)
2004	$925	($30)	($136)
2005	$1,123	$198	$228
2006	$1,154	$31	($167)

Note: Source: Treasury analysis of VA's 2000-2006 net cost statements. Totals may not add due to rounding.

VA's actuarial costs from year to year accounts for the majority of the change in the Government's net cost in most years (54 percent in 2006). Moreover, in 2006, the change in these and other actuarial (e.g., pension) costs accounted for $242.5 billion of the $310 billion decrease (nearly 80 percent) in total net operating cost. Finally, total actuarial costs in 2006 of $187.2 billion, as in most recent years, account for most of the annual differences (93 percent in 2006) between the Government's budget deficit and net cost, and ostensibly, between the cash and accrual bases of Government accounting.

2006 marks the first fiscal year in which the Government's Statement of Social Insurance (SOSI), which provides perspective on the Government's long term estimated responsibilities and costs, has been prepared and audited as a principal financial statement. It should be noted, however, that even with the addition of the SOSI, the financial statements do not reflect future costs implied by current policy, such as national defense, the global war on terrorism, and hurricane cleanup efforts.

Hurricane Katrina – One Year Later

September 2006 marked the one year anniversary of Hurricane Katrina's assault on the Gulf Coast. Katrina was the most destructive natural disaster in U.S. history. The Federal Government has responded by providing more than $110 billion in resources, plus an additional $8 billion in tax relief – to support the region's reconstruction and renewal. Recovery has proved to truly be a multi-faceted effort, requiring contributions from several Federal agencies, including:

- The Federal Emergency Management Administration has funded more than $5 billion to repair and replace damaged public infrastructure, such as roads and bridges, schools, water systems, public buildings, and public utilities;
- The U.S. Department of Housing and Urban Development (HUD), through its Community Development Block Grants program, as awarded nearly $17 billion in State grants to help rebuild damaged housing and other infrastructure.
- The Department of Education has released nearly $2 billion to help reopen schools and educate students.
- The U.S. Small Business Administration (SBA) has approved more than $10 billion in disaster recovery loans to homeowners, renters, and businesses. More than 22,000 loans totaling more than $2 billion have gone to small business owners.

Source: White House fact sheet, released August 24, 2006. http://www.whitehouse.gov/news/releases/2006/08/print/20060824.html.

Assets and Liabilities: What We Own and What We Owe.

Net Position at the end of the year can also be derived by netting the Government's assets against its liabilities, as presented in the ***Balance Sheet***. It is important to note that the balance sheet does not include the financial impact of the Government's sovereign powers to tax, regulate commerce, and set monetary policy. It also excludes its control over nonoperational resources, including national and natural resources, for which the Government is a steward. However, as was the case with the ***Statement of Operations and Changes in Net Position***, 2006 marks the first fiscal year in which the balance sheet separately does include a presentation of the portion of net position attributable to earmarked fund activities. Moreover, the Government's responsibilities are broader than the liabilities presented on the balance sheet, including such 'off-balance sheet items as the Government's future social insurance responsibilities (e.g., Social Security and Medicare), as well as other programs and contingencies. These responsibilities are discussed in this section's Social Insurance and Other Responsibilities discussion, later in this section, and in the supplemental disclosures of this *Report*.

Assets – "What We Own."

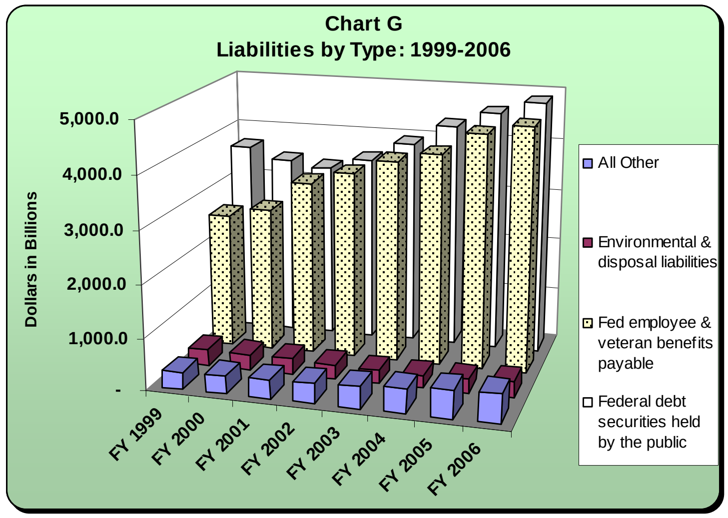
The Government's total assets increased $48.6 billion from $1,447.9 billion in fiscal year 2005 to $1,496.5 billion in 2006. During the year, all government asset balances increased except loans receivable and 'other' assets, which declined slightly. Representing almost 50 percent of total assets this fiscal year, net property, plant, and equipment has been the Government's largest asset over the past seven fiscal years. In fact, the reported value of these assets increased substantially in 2003 as a result of a change in Federal accounting standards. This change resulted in the recognition of a net book value of $325.1 billion in military equipment being presented on the balance sheet for the first time.

Liabilities – "What We Owe."

Chart G shows the major components of liabilities, or what the Government owes, as of September 30, for fiscal years 2002 through 2006. During 2006, total liabilities increased $498.1 billion from $9,914.8 billion in 2005 to $10,412.9 billion.

The largest liability in recent years has been Federal debt held by the public and accrued interest, the balance of which increased to $4,867.5 billion in 2006. The Government borrowed a smaller amount of cash from the public this year primarily because of the sharp increase in tax revenues. Over the past seven fiscal years, Federal debt securities held by the public and accrued interest have moved in tandem with the budget results. ***The Statements of Changes in Cash Balance from Unified Budget and Other Activities*** reports how the annual unified budget surplus or deficit relates to the Federal Government's borrowing and changes in operating cash, and explains how a budget surplus or deficit normally affects changes in debt balances.

The Government's net borrowings from the public increased by $237.2 billion in fiscal year 2006 and by a combined $529.5 billion since 2005 to help finance more than 90% of the budget deficits in those years. Typically, budget surpluses, have resulted in borrowing reductions and budget deficits, have yielded borrowing increases. However, the Government's debt operations are much more complex than this would imply. Each year, trillions of dollars of debt matures and new debt takes its place. For example, in 2006, new borrowings were $4.5 trillion and maturing debts were $4.2 trillion.



Federal employee and veteran benefits payable have been increasing dramatically, from $2,600.7 billion as of the end of fiscal year 1999, to $4,679.0 billion as of fiscal year-end, 2006, making up nearly half of the Government's total reported liabilities in both 2005 and 2006.

The Office of Personnel Management (OPM) administers the largest civilian pension plan, covering about 90 percent of all Federal civilian employees, including 2.6 million current employees and 2.5 million annuitants. By comparison, the military pension plan covers 2.9 million current employees and 1.9 million annuitants. At the end of fiscal year 2006, civilian Federal employee benefits payable of $1,694.3 billion accounted for 36 percent of total Federal employee and veteran benefits payable, and included $1,349.0 billion of pensions, $295.2 billion of health, and $50.1 billion of other benefits.

Environmental and disposal liabilities increased $45.4 billion from $259.8 billion in 2005 to $305.2 billion in 2006. This increase, mainly due to the increases in environmental management baseline estimates at Energy, accounted for 9.1% of the change in total liabilities during 2006.

Social Insurance and Other Responsibilities

Information reported on social insurance programs addresses fundamental questions about their current and future financial condition, including whether scheduled benefits are sustainable with current scheduled income. This information is intended to facilitate an assessment of the programs' long-term sustainability as well as their ability to raise resources from future program participants to pay for benefits to present participants.

For the programs listed as social insurance (e.g., Social Security, Medicare Parts A, B, and D),the Statement of Social Insurance (SOSI) presents the actuarial present value for the projection period of: all future contributions and tax income (excluding interest) received from or on behalf of current and future participants; the estimated future scheduled expenditures paid to or on behalf of current and future participants; and the estimated future excess of contributions and tax income (excluding interest) over future scheduled expenditures. Amounts reported in the SOSI and in the supplemental information in this report are based on the official actuarial trust fund reports for each program.

Social Insurance Trust Funds

The social insurance trust funds were created to account for all related program income and expenses. Social Security and Medicare taxes, premiums, and other income are credited to the funds. Benefit payments and program administrative costs are the only purposes for which disbursements from the funds can be made. Program revenues not needed in the current year to pay benefits and administrative costs are invested in special non-marketable U.S. Government securities on which a market rate of interest is credited. The trust funds represent the accumulated value, including interest, of all prior program annual surpluses and provide automatic funding authority to pay benefits.

Social Insurance Trust Funds

Social Security:

- Old-Age and Survivors Insurance (OASI) pays retirement and survivors benefits,
- Disability Insurance (DI) pays disability benefits.

Medicare:

- Part A: Hospital Insurance (HI), which pays for inpatient hospital and related care.
- Part B: Supplementary Medical Insurance (SMI), which pays for physician and outpatient services
- Part D, SMI prescription drug benefit program.

Trustees Short-Range Outlook (2005-2015)

The adequacy of the OASI, DI, and HI Trust Funds is measured by comparing their assets at the beginning of a year to projected costs for that year (the "trust fund ratio"). A ratio of 100 percent or more (i.e., assets at least equal to projected benefit payments for a year) is considered a good indicator of a fund's short-term adequacy and means that even if expenditures exceed income, the trust fund reserves combined with annual tax revenues would be sufficient to pay full benefits for several years, allowing time for legislative action to restore financial adequacy.

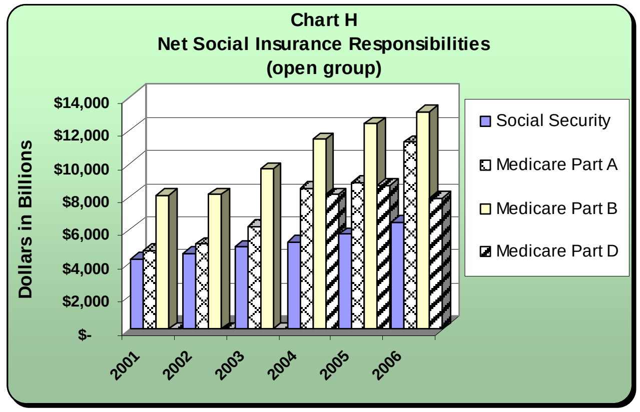
By this measure, the OASI and DI funds are considered financially adequate throughout the short range because the assets of each fund are projected to exceed the 100 percent level through the year 2015. The HI fund does not meet the short-range test of financial adequacy because its assets fall below the 100 percent level of one year's expenditures during 2014. For SMI, a less stringent annual "contingency reserve" asset test applies to both Part B and Part D because the financing of each of those accounts is provided by beneficiary premiums and Federal general fund revenue payments automatically adjusted each year to meet expected costs. Thus, under current law both SMI accounts are fully financed throughout the 75-year projection period no matter what the costs may be.

Trustees Long-Range Outlook (2005-2080)

Social Security and Medicare costs increase steeply between 2010 and 2030 because the number of people receiving benefits will increase rapidly as the large baby-boom generation retires. Thereafter, Social Security costs grow slowly primarily due to projected increasing life expectancy. Medicare costs continue to grow rapidly due to expected increases in the use and cost of health care. The continued development of new technology is expected to cause per capita health care expenditures to continue to grow faster in the long term, than the economy as a whole.

Comparison of projected Social Security and Medicare costs to gross domestic product (GDP) is a commonly-used metric for fund analysis. Medicare costs are projected to exceed Social Security's in 2024. Social Security expenditures amounted to 4.3 percent of GDP in 2006 and is projected to increase to 6.3 percent of GDP in 2080. Medicare's cost amounted to 3.2 percent of GDP in 2006 and is projected to grow more than threefold to 11.0 percent of GDP in 2080. Absent reform, Social Security and Medicare together will more than double as a percentage of the U.S. economy, from nearly 6 percent in 2006 to over 17 percent by 2080.

The Government's Net Liabilities and its Responsibilities



Information reported on social insurance programs addresses fundamental questions about their current and future financial sustainability, i.e., the extent to which the Government could meet future demands for resources under current laws and conditions. For the programs listed as social insurance (e.g., Old Age, Survivors' and Disability Insurance (OASDI) or Social Security, Medicare (Parts A, B, and D)), the Statement of Social Insurance (SOSI) shows the estimated future excess of scheduled benefit expenses over contributions and tax income (excluding interest), based on each program's actuarial trust fund report.

The social insurance figures in Tables 9 and 10 present estimated net social insurance and other responsibilities for the 'closed-group' population. which equals the present value of net payments (benefits less taxes) expected during the projection period (75 years) 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. For comparative purposes, Table 9 also presents actuarial social insurance estimates for the 'open group' population, which differs from the 'closed group' by including all future projected participants who will make contributions to postemployment benefit plans and/or receive and/or be eligible to receive benefits over the 75-year horizon. Open group trends are also shown in Chart H. The SOSI details the actuarial estimates attributable to each group.

Table 9: Social Insurance Responsibilities

billions of dollars (details may not add to totals due to rounding).	2002	2003	2004	2005	2006
This table shows the present value of 75-year actuarial projections of the benefit payments under current law for Social Security, Meidcare, and other social insurance programs in excess of their scheduled contributions and earmarked taxes for current participants ages 15 and over at the start of the period.					
Social Insurance Responsibilities, Net (closed group) [1]					
Social Security (OASDI)	**$ (11,216)**	**$ (11,742)**	**$ (12,552)**	**$ (13,583)**	**$ (14,976)**
Medicare:					
Medicare Part A	$ (6,409)	$ (7,287)	$ (9,254)	$ (9,621)	$ (12,153)
Medicare Part B	$ (6,487)	$ (7,720)	$ (9,055)	$ (9,900)	$ (10,630)
Medicare Part D	$ -	$ -	$ (6,306)	$ (6,818)	$ (6,257)
Subtotal: Medicare (Parts A, B, D)	**$ (12,896)**	**$ (15,007)**	**$ (24,615)**	**$ (26,339)**	**$ (29,040)**
Other Social Insurance Programs [2]	$ (107)	$ (109)	$ (112)	$ (116)	$ (131)
Total Social Insurance Responsibilities, Net (closed group)	**$ (24,219)**	**$ (26,858)**	**$ (37,279)**	**$ (40,038)**	**$ (44,147)**
Total Social Insurance Responsibilities, Net (open group) [2]	**$ (17,887)**	**$ (20,825)**	**$ (33,363)**	**$ (35,689)**	**$ (38,851)**

[1] The 'closed group' includes current participants (i.e., receiving and/or are eligible to receive benefits) ages 15 and over at the start of the period. The 'open' group' (shown below for comparative purposes), includes all current and future projected participants (i.e., individuals receiving and/or are eligible to receive benefits ages 15 and over at the start of the period, PLUS participants estimated to receive and/or be eligible to receive beneifts in the future over the 75-year horizon).

2 'Other Social Insurance Programs' for the 'closed' group includes the Railroad Retirement Program. The 'open' group includes both the Railroad Retirement and Black Lung Programs. The SOSI presents only 'open group' totals for Black Lung (i.e., does not identify 'closed' group amounts separately). Therefore, Black Lung is only reflected in the 'open' group amounts above.

Table 9 summarizes the Government's significant 'Other Responsibilities' for fiscal years 2002-2006. Social insurance and other responsibilities include amounts disclosed in the SOSI, as well as amounts disclosed in Notes 19 (Contingencies) and 20 (Commitments) that are not presented on the balance sheet.

Viewing this 'sustainability' information in concert with other financial statements and information provides both a short- and long-term view of significant financial issues facing the Government. It should be noted, however, that there are significant differences between liabilities presented on the balance sheet and the responsibilities from the SOSI, which limit their comparability. For the purposes of financial reporting, the ***Balance Sheet*** presents a 'snapshot' at a point in time of an entity's *current* financial condition, with an emphasis on how current and prior actions and events have impacted its assets and liabilities. By contrast, the ***SOSI*** presents the calculated net present value of future estimated revenues and expenditures over an extended period. They represent an assessment of the extent to which the social insurance programs are unfunded under current financing arrangements relative to scheduled benefit obligations. Since they are not liabilities, and therefore do not impact either an entity's current assets or liabilities, they are considered 'off-balance sheet' items; according to Federal accounting standards. While comparability of liabilities to 'other responsibilities' is limited, their significance can be analyzed in other contexts.

Table 10 shows how the Government's current net liabilities compare to its estimated future social insurance responsibilities. Fiscal year 2006 total assets of $1,496.5 billion and total liabilities of $10,412.9 billion combine to derive the Government's current net liability of $8,916.4 billion. By comparison, the net present value of estimated future net social insurance responsibilities is $44,147 billion[1]. The net social insurance responsibilities (scheduled benefits in excess of estimated revenues) indicate that those programs are on an unsustainable fiscal path and difficult choices will be necessary in order to address their large and growing long-term fiscal imbalance. Delay is costly and choices will be more difficult as the retirement of the 'baby boom' gets closer to becoming a reality with the first wave of boomers eligible for retirement under Social Security in 2008.

Table 10: Comparing Net Liabilities to Social Insurance Responsibilities

billions of dollars	2002	2003	2004	2005	2006
Total Assets	$ 997	$ 1,405	$ 1,397	$ 1,448	$ 1,497
Total Liabilities	$ (7,817)	$ (8,500)	$ (9,107)	$ (9,915)	$ (10,413)
Liabilites, net of Assets (balance sheet)	**$ (6,820)**	**$ (7,094)**	**$ (7,710)**	**$ (8,467)**	**$ (8,916)**
Social Insurance Responsibilities, Net (closed group - off-balance sheet)	**$ (24,219.0)**	**$ (26,858.0)**	**$ (37,279.0)**	**$ (40,038.0)**	**$ (44,147.0)**
Net Liabilities and Net Social Insurance Responsibilities - Closed Group (Combined)	**$ (31,039)**	**$ (33,952)**	**$ (44,989)**	**$ (48,505)**	**$ (53,062)**

The President's Management Agenda: Managing for Results

Fiscal responsibility requires the sound stewardship of taxpayer dollars. Once the Congress and the President decide on overall spending levels, taxpayer dollars should be managed to maximize results. The President's Management Agenda (PMA) is creating a results-oriented Government where each agency and program is managed professionally and efficiently and achieves the results expected by the Congress and the American people.

Launched in August 2001, the PMA articulates the goal of making the Government more results-oriented, focusing on achievement, efficiency, and accountability. It emphasizes improving Government operations by setting clear goals and implementing action plans, Agencies continue to manage for and achieve better results.

The PMA Executive Scorecard is used to measure agencies' progress and overall achievement in meeting the overall improvement goals, otherwise known as standards for success. The following pages contain an overview and discussion of agency performance on the PMA initiatives:

- Implementing Strategic Human Capital
- Gaining Efficiencies Through Strategic Sourcing
- Improving Financial Performance
- Expanding Electronic Government
- Eliminating Improper Payments
- Budget and Performance Integration.
- Asset Management

PMA Scores

	Status	Progress
Red	Any of a number of serious flaws.	Initiative in serious jeopardy. Unlikely to realize objectives without significant
Yellow	Satisfies intermediate levels of performance in all criteria.	Slippage in implementation schedule, quality of deliverables, or other issues requiring adjustments by agency in order to achieve initiative on a timely basis.
Green	Meets all of the standards for success.	Implementation proceeding according to plans.

The fourth quarter scorecard on the following page and the accompanying discussion of agency performance under the PMA initiative presents the agencies' status and progress ratings as of September 30, 2006. These ratings preceded the publication of the fiscal year 2006 audited financial statements. The status and progress ratings in the first quarter scorecard, as of December 31, 2006, will reflect auditors' findings from the fiscal year 2006 financial statement audit. For example, several agency audit opinions and internal controls declined during 2006. OMB will review these changes and update the status and progress ratings reflecting the fiscal year-end 2006 results during the fiscal year 2007 first quarter assessment cycle. Additional information on the PMA initiatives may be found at www.whitehouse.gov/results/agenda/standards.pdf.

[1] Tables 9 and 10 both focus on closed-group obligations, 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, making the closed-group numbers more forward-looking than a strict accrual-based calculation.

Executive Branch Management Scorecard										
	Current Status as of September 30, 2006.					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	G	G ↑	R	R ↓	Y	Y	G	G	Y	G
COMMERCE	Y	Y	G	Y	G ↑	G	G	G	G	G
DEFENSE	Y	Y ↑	R	R	Y	G	Y	G	R	G
EDUCATION	Y	G	G	G	G ↑	G	G	G	G	G
ENERGY	G	G ↑	R	Y	G	G	G	G	G	Y
EPA	Y	G	G	G ↑	Y	G	G	G	G	G
HHS	G	G	R	R ↓	Y	G	G	G	Y	G
DHS	Y	Y	R	R	Y	G	R	R	G	G
HUD	Y	Y	R	G	Y	G	Y	G	G	G
INTERIOR	G	G	R	Y ↑	Y	G	R	G	R	G
JUSTICE	G	Y	R	Y ↑	G	G	G	G	G	G
LABOR	G	G	G	G	G	G	G	G	G	G
STATE	G	G ↑	G	G ↑	G	G	G	G	G	Y
DOT	G	G	R	G ↑↑	G	G	Y	G	Y	G
TREASURY	G	G	R	Y	Y	G	Y	G	Y	Y
VA	G	R	R	R	R	G	R	G	Y	Y
AID	Y	R	Y	Y	G	G	G	G	G	Y
CORPS	G	Y	R	R	R	G	Y	G	Y	G
GSA	Y	G	R	Y	G ↑	G	Y	G	G	G
NASA	G	G	R	R ↓	G	G	G	Y	R	G
NSF	G	R	G	G	G	G	R	G	G	G
OMB	Y	R	R	Y	R	G	G	G	G	G
OPM	G	G	Y	R	Y	G	G	G	R	G
SBA	Y	G	R	G ↑↑	G	G	G	G	G	G
SMITHSONIAN	Y	R	G	Y	G ↑	G	Y	G	G	G
SSA	G	G ↑	G	Y ↓	G	G	G	G	R	G

Legend: R = Red Y = Yellow G = Green
↑↓ Arrows indicate change in status since evaluation on June 30, 2006.

Strategic Management of Human Capital

HUMAN CAPITAL	
GREEN STATUS as of 9/30/2006	
USDA	Transportation
Energy	Treasury
HHS	VA
Interior	Corps of Engineers
Justice	NASA
Labor	NSF
State	OPM
SSA	

The Strategic Management of Human Capital Initiative recognizes that the men and women serving in the Federal Government are its most important resource. Through this initiative, the Government seeks to maximize the workforce's ability to accomplish agencies' missions for the American people by supporting agency efforts to institute state-of-the-art human capital management systems, including strategic alignment, leadership and knowledge management, results-oriented performance culture, talent management, and accountability. An ultimate goal of the initiative is to "imbed" the strategic management of human capital into an agency's daily management operations. To accomplish this, agencies must transition to a system of strong self-accountability whereby agency leaders will use Human Capital results in strategic decision making.

Workforce planning must assure alignment of federal human capital resources with agency mission, objectives and goals. Agencies must design agile strategic human capital plans to ensure that their workforce has the competencies needed to meet new challenges and demands, perform new functions, and accomplish the agency's mission.

Federal workforce demographics are changing quickly, requiring agencies to identify effective succession management, and service and mission continuity strategies and systems. Agencies are working to pinpoint competency gaps in mission-critical occupations and develop and implement successful strategies to close them. Agencies have made significant progress in establishing and implementing personnel management practices to better achieve their missions. They are deploying and improving performance management systems that better link individual performance to agency mission and results, thus providing the foundation for establishing new compensation systems that reward performance instead of time on the job. Federal executives play a key role. Over the past year, agencies have improved their SES performance plans, particularly in the way performance measures are established. These programs aim not only to ensure that potential future managers are waiting in the wings, but that those individuals have the proper skills to work in today's changing work environment.

Competitive Sourcing

COMPETITIVE SOURCING	
GREEN STATUS as of 9/30/2006	
USDA	State
Education	Transportation
Energy	Treasury
EPA	GSA
HHS	NASA
Interior	OPM
Labor	SBA
SSA	

Managers of highly commercial activities – including those responsible for finance and accounting activities and information technology support – are using public-private competition to make common-sense determinations about whether our taxpayers are better served through performance by the most efficient government organization or, alternatively by the best qualified contractor. Competitions are helping agencies find new and better ways of delivering service to taxpayers by leveraging technology, lowering contract support costs, realigning their workforces, and establishing clearer performance standards. Competitions completed between fiscal years 2003-2005 are expected to generate more than $5 billion over the next 10 years, which equates to about $23,000 in annualized net savings for every job examined through competition. Savings will continue to grow as more competitions are completed and cost control and performance efficiencies are brought to bear on a larger number of daily tasks. Agencies could generate taxpayer savings of more than $4 billion annually by competing just half of the commercial FTEs identified as suitable for competition in their workforce inventories.

Improved Financial Performance

FINANCIAL PERFORMANCE	
GREEN STATUS as of 9/30/2006	
Comerce	State
Education	NSF
EPA	Smithsonian
Labor	SSA

The ultimate goal of the President's Management Agenda (PMA) Improved Financial Performance initiative is for managers to have access to reliable financial information for decision-making. Reliable and timely financial information is measured in many ways such as the rendering of an unqualified opinion from the independent auditor on the agency's financial statements, the absence of material internal control weaknesses, and reporting annual financial information by November 15 and meeting other relevant reporting deadlines. For fiscal year 2006, the Government strengthened its requirements for reliable and timely financial information by making agencies subject to updated guidance on management's responsibility for internal control. This guidance (OMB Circular A-123, Management's Responsibility for Internal Control) requires management to undertake a more rigorous assessment process over internal controls over financial reporting, including direct testing, and for agency heads to provide a separate management assurance on the internal control over financial reporting.

Federal agencies continue to show their resolve in meeting these requirements as demonstrated by their continuing efforts to implement rigorous corrective actions plans to reduce material process, systems, and control weaknesses. In conjunction with the implementation of new financial management controls and processes and accelerated reporting schedules, these accomplishments lay the foundation for the production and availability of more reliable information to support day-to-day management.

Improved financial business practices, management systems, and reporting tools enable agencies to enhance the timeliness, accuracy, and reliability of financial information. These improvements yield better management of Federal dollars, and consequently, greater taxpayer confidence that the proper safeguards are in place for effective financial stewardship.

Expanded Electronic Government

The Expanded Electronic Government initiative focuses on two key areas—strengthening agencies' management of their information technology (IT) resources and using the Internet to simplify and enhance service delivery to the citizen. The Government must capitalize on its approximate $65 billion annual investment in IT.

E-GOVERNMENT	
GREEN STATUS as of 9/30/2006	
Education	**State**
EPA	**Transportation**
HUD	**NSF**
Labor	**SBA**

Most agencies have improved their IT management since fiscal year 2003. Also, 88 percent of agency IT systems have been certified and accredited, up from 85 percent the previous year. In addition, currently about 83 percent of agencies have an effective enterprise architecture, an integral part of ensuring their IT investments support overall agency goals and do not duplicate Government-wide IT investments. Such improvements are central ingredients in developing a more focused and results-oriented approach to IT investment across agencies.

Specific improvements in service delivery are being achieved through the E-Gov Initiatives. For instance, GovBenefits.gov has expanded assistance information available through the site, now including links to some state-funded, state-administered programs. The addition of state links ensures GovBenefits.gov is truly a one-stop resource for government benefits. To date, GovBenefits.gov has provided benefits information to more than 22 million visitors and referred nearly 5 million citizens to benefit programs. Another E-Gov Initiative, Grants.gov, hosts information regarding all of the Federal grant programs on its site. In fiscal year 2006, 76 percent of all Federal discretionary grant opportunities (2,092 out of 2,757) were available for electronic application via Grants.gov and grantees submitted more than 86,000 applications through Grants.gov. This is a 32 percent increase over the number of opportunities that were available for electronic application submission in 2005 (44 percent) and Grants.gov has received more than 5 times the number of applications submitted in 2005 (16,000).

Through the E-Payroll initiative, the Federal Government has consolidated many payroll systems, reducing the cost of payroll processing. For example, the Department of Health and Human Services (HHS) has reduced its annual costs of payroll processing for its more than 65,000 employees by almost $11 million, from $259 to $90 per employee. The Environmental Protection Agency (EPA) has also reduced its average cost from $270 to $90 per employee; with its staff of 18,000 the agency has realized an annual savings of approximately $3.2 million.

Grants Management Line of Business (GMLOB) is working to create a common solution for grants management that will promote citizen access, customer service, and agency financial and technical stewardship. To date, three agencies (ED, HHS-ACF, and NSF) have been designated as Federal consortia leads. These agencies offer shared grants management technical solutions and services that will allow partner agencies to process grants in a decentralized way using common business processes. Consortium leads will spread operations and maintenance (O&M) costs, and development, modernization, and enhancement (DME) costs across agencies, decreasing the burden that any one agency must bear. Automated business processes available through consortium lead agencies will decrease agency reliance on manual and paper-based processing.

The Government is investing significant resources in IT to assist it in achieving its mission and better serving the American taxpayer. Agencies are making improvements towards ensuring these investments are well managed, more secure, and providing services to the American people more efficiently and effectively.

Budget and Performance Integration

BUDGET & PERFORMANCE INTEGRATION	
GREEN STATUS as of 9/30/2006	
Commerce	Transportation
Education	USAID
Energy	GSA
Interior	NASA
Justice	NSF
Labor	SBA
State	Smithsonian
SSA	

Executive departments and agencies are using meaningful program performance information to inform their budget and management decisions. They are asking whether their programs are working and, if not, they are taking steps to improve them. Assessments of programs using the Program Assessment Rating Tool (PART) have helped focus agency efforts to improve program results. OMB and agencies have now assessed the performance of more than 800 Federal programs, representing almost $1.5 trillion dollars in Federal spending. Summaries of PART findings for each program assessed, as well as the detailed PART analyses for those programs, can be found at the OMB website. The Administration will also launch a new website, ExpectMore.gov, to provide greater public access to information about what programs work, which ones don't, and efforts to improve.

The Administration is also using the PART to compare the performance and management of similar programs across Government so that lessons about how to improve program performance can be shared among those programs. These analyses will tell us what steps we need to take to improve program performance for similar programs across Government.

The PART is a vehicle for improving program performance. As more and more program assessments are conducted, the Administration will have better program performance information to use when making budget and management decision. Agencies will be better able to describe to the taxpayer what they are getting for their investment and what improvements in efficiency and results can be documented every year.

Eliminating Improper Payments

An improper payment occurs when the funds go to the wrong recipient, the recipient receives the incorrect amount of funds, the recipient uses the funds in an improper manner, or when a duplicate payment occurs.[2] In fiscal year 2006, the Government continued to make progress toward identifying all Government-wide improper payments and is well on its way to establishing a baseline measurement for all programs susceptible to improper payments. Currently, 85 percent of all high-risk programs are reporting an improper payment error measurement ($1.3 trillion of $1.5 trillion in high-risk programs) and the number of high-risk programs reporting is increasing annually. A key achievement in 2006 was establishing error measurement plans for a majority of the remaining high-risk programs.

OMB anticipates that 57 or more programs will likely report on their program integrity efforts through their fiscal year 2006 Performance and Accountability Reports (PAR) under the Improper Payments Information Act (IPIA) of 2002 (compared with 30 reporting programs in 2004, the initial year of implementation). Programs reporting for the first time in 2006 include the Special Supplemental Nutrition Program for Women, Infants, and Children, the Child and Adult Care Food Program, and the Individual and Household (temporary housing due to natural disasters) Program. Beginning in 2007, Medicaid, Temporary Assistance to Needy Families, and the State Children's Health Insurance Program will report component error rates. In 2008, OMB projects that these programs will be reporting comprehensive national error measurements. At that point, the OMB projects that virtually all of high-risk programs will be reporting a national improper payment estimate.

Much of this success can be attributed to agency commitment to identify and reduce improper payments, the Chief Financial Officers (CFO) Council's Improper Payments Transformation Team, and the PMA initiative. Another key success factor has been information sharing. To that end, the CFO Council's Improper Payments Transformation Team will co-sponsor an event in fiscal year 2007 to facilitate State-to-State and program-to-program best practices discussions on program integrity for means-tested programs.

OMB continues its commitment to identify all improper payments Government-wide and to help agencies establish corrective action plans to address their root causes. In some cases, this might lead to legislative and/or regulatory changes. Regardless, taxpayers will be more fully served by the assurance that their tax dollars are being used in proper amounts and for their intended purposes.

Asset Management

Pursuant to the PMA Real Property Management program initiative, agencies continue to make significant progress in implementing the tools necessary to manage the size, condition, and costs of their asset portfolios and comply with the requirements of Executive Order 13327, Federal Real Property Asset Management. In fiscal year

[2] From OMB website - - http://www.whitehouse.gov/omb/financial/fia_improper.html

2006, Executive agencies reported more than 1.2 million assets, including land, buildings, and structures, to the Government-wide real property inventory, which provides, for the first time, a more complete picture of the Government's asset inventory; where the assets are located; and how and whether the assets are being used effectively to help serve agency mission and objectives. The Federal Real Property Council has also established a Performance Assessment Tool that helps agencies evaluate the performance of their real property portfolio and identifies assets for potential improvement or disposition. Having the inventory and performance information means that agencies, and the Government as a whole, can make smarter asset management decisions.

The Administration continues to hold agencies accountable for their asset management goals through the PMA process. Since fiscal year 2004, agencies have shown significant improvement in their asset management processes and their ability to gather and use inventory and performance data to drive the decision-making process toward the rightsizing the Government's real property assets. Executive Agencies have disposed of more than $3.5 billion in real property assets and are well on the way to meeting the Administration's goal of disposing $9 billion in assets by the close of fiscal year 2009.

Systems, Controls, & Legal Compliance

Systems

As Federal agencies have continued to demonstrate success in obtaining and keeping unqualified opinions on their audited financial statements, the Federal Government continues to face challenges in implementing financial systems that meet Federal requirements. In January 2006, the latest version of the Core Financial Systems requirements were released, and most major agencies are in the process of having completed or implementing certified commercial-off-the-shelf financial management systems that meet these requirements. However, many agencies continue to struggle when implementing these complex systems and agency auditors' Federal Financial Management Improvement Act (FFMIA) reviews have indicated that a majority of CFO Act agencies experience challenges with their financial management systems.

The Financial Management Line of Business (FMLoB) initiative is intended to help agencies implement financial systems compliant with Federal requirements. It is intended to improve the cost, quality, and performance in the Government's financial management systems by leveraging shared service solutions and implementing Government-wide reforms that improve efficiency of financial operations. OMB expects this initiative to help agencies meet Federal standards and achieve efficiencies, while delivering cost savings to the taxpayers.

Multiple FMLoB initiatives are underway that will collectively make these improved results possible, including standardizing financial processes across the Government, creating opportunities for agencies to move financial systems to shared-service providers where a single provider supports multiple customers, and increasing transparency by establishing performance measures to evaluate the results of these efforts. Through the FMLoB and other information-sharing initiatives, the Federal financial community is working to ensure that mistakes of the past are not repeated and that agencies initiating complex modernization efforts have a clear understanding of significant risks and appropriate mitigation strategies.

Controls

Federal managers have a fundamental responsibility to develop and maintain effective internal control. Effective internal control helps to ensure that programs are managed with integrity and resources are used efficiently and effectively through three objectives: effective and efficient operations, reliable financial reporting, and compliance with applicable laws and regulations. The safeguarding of assets is a subcomponent of each objective.

The Federal Managers' Financial Integrity Act (FMFIA) requires the head of each executive agency to annually prepare a statement reporting the effectiveness of the agency's internal control and whether its systems comply with the federal financial system requirements. OMB Circular No. A-123, *Management's Responsibility for Internal Control* (A-123), provides instruction to agencies in implementing the FMFIA and the OMB Circular No. A-127, *Financial Management Systems*, provides instruction for complying with the federal financial system requirements (see the Systems section for more discussion on federal systems).

Recognizing the importance of effective internal control within Federal agencies, OMB revised A-123 in December 2004. The revisions to A-123 primarily focused on providing agencies with a framework for assessing and managing financial reporting risks more strategically and effectively. Appendix A of the revised A-123 required management to undertake a more rigorous assessment process and for agency heads to provide a separate management assurance on the internal control over financial reporting.

Fiscal year 2006 was the initial year that the 24 CFO Act agencies began to implement the new requirements in the Appendix A of the A-123. Some agencies elected to implement the new requirements over multiple years rather than in this initial year, which was permitted by OMB. Those agencies specified their multi-year implementation strategy in their respective assurance statements. Over this past fiscal year, each agency completed risk assessments, identified key processes and controls, and tested these controls to determine their effectiveness, in accordance with A-123. These efforts culminated in the agencies' first management assurance statement specific to the internal control over financial reporting as of June 30, 2006. The separate assurance on the internal control over financial reporting is included in each agency's Performance and Accountability Report as a subset of the overall FMFIA statement.

During fiscal year 2007, OMB will continue to work with the Chief Financial Officers' Council to identify potential areas for additional guidance and to share best practices and strategies that agencies found most helpful during the initial year of implementation. OMB will also continue to incorporate key milestones from agencies' plans for this year's assessment into the Improved Financial Performance initiative scorecard under the President's Management Agenda to ensure agencies are accountable for meeting their goals.

While many agencies are making progress on identifying and resolving deficiencies found in internal control, continued diligence and commitment is needed. However, effective internal control is not only a challenge at the agency level, but it is also a challenge at the Government-wide level. Consequently, GAO has issued an adverse opinion on the effectiveness of the internal control for the Government as a whole, in its report.

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 test for compliance with selected laws and regulations related to financial reporting. Certain individual agency audit reports contain instances of noncompliance. None of these instances were material to the Government-wide financial statements. However, GAO reported that its work on compliance with laws and regulations was limited by the material weaknesses and scope limitations discussed in its report.

Additional Information

The appendices to this *Report* contain the names and web sites of the significant Government entities included in the *Financial Report's* financial statements. Details about the information contained in this report can be found in these entities' Performance and Accountability Reports. Related Government publications, include, but are not limited to:

- 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.

GAO
Accountability * Integrity * Reliability

Comptroller General
of the United States

United States Government Accountability Office
Washington, DC 20548

December 15, 2006

The President
The President of the Senate
The Speaker of the House of Representatives

Our report on the U.S. government's consolidated financial statements for fiscal years 2006 and 2005 is enclosed. In summary, we found the following:

- Certain material weaknesses in financial reporting[1] and other limitations on the scope of our work resulted in conditions that, for the 10th consecutive year, prevented us from expressing an opinion on the federal government's consolidated financial statements. About $797 billion, or 53 percent, of the federal government's reported total assets as of September 30, 2006, and approximately $790 billion, or 27 percent, of the federal government's reported net cost for fiscal year 2006 relate to 5 of the 24 Chief Financial Officers (CFO) Act agencies' fiscal year 2006 financial statements that were disclaimed on or not audited.[2]

- The federal government did not maintain effective internal control over financial reporting (including safeguarding assets) and compliance with significant laws and regulations as of September 30, 2006.

- Our work to test compliance with selected provisions of significant laws and regulations in fiscal year 2006 was limited by the material weaknesses and scope limitations discussed in our report.

While over the past 10 years significant progress has been made in improving federal financial management since the U.S. government began preparing consolidated financial statements, three major impediments continue to prevent us from rendering an opinion on

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[1]A material weakness is a condition that precludes the entity's internal control from providing reasonable assurance that misstatements, losses, or noncompliance material in relation to the financial statements or to stewardship information would be prevented or detected on a timely basis.

[2]The CFO Act agencies that received disclaimers of opinions on all of their fiscal year 2006 financial statements were the Department of Defense, Department of State, and the National Aeronautics and Space Administration. For the Department of Homeland Security for fiscal year 2006, only the Consolidated Balance Sheet and Statement of Custodial Activity were subjected to audit; the auditor was unable to express an opinion on these two financial statements. For fiscal year 2006, only the Consolidated Balance Sheet of the Department of Energy was subjected to audit, and the auditor qualified its opinion on this statement.

the consolidated financial statements: (1) serious financial management problems at the Department of Defense**,** (2) the federal government's inability to adequately account for and reconcile intragovernmental activity and balances between federal agencies, and (3) the federal government's ineffective process for preparing the consolidated financial statements. Until the problems outlined in our audit report are adequately addressed, they will continue to have adverse implications for the federal government and American taxpayers.

Accounting and financial reporting standards have continued to evolve to provide greater transparency and accountability over the federal government's operations and fiscal condition. Beginning in fiscal year 2006, the Statement of Social Insurance, which shows long-range actuarial projections of scheduled social insurance benefits in excess of earmarked revenues, became a principal financial statement.[3] This new statement shows projected scheduled benefits exceeding earmarked revenues by approximately $39[4] trillion in present value terms for the next 75-year period.[5] Considering this long-range projected funding gap in social insurance, in addition to reported liabilities (e.g., debt held by the public and federal employee and veterans benefits payable) and other implicit commitments and contingencies that the federal government has pledged to support, the federal government's fiscal exposures totaled approximately $50 trillion as of September 30, 2006, an increase of about $4 trillion over September 30, 2005, and up from about $20 trillion as of September 30, 2000.[6] This translates into a current burden of about $170,000 per American or approximately $440,000 per American household. Also, beginning in fiscal year 2006, the consolidated financial statements reported earmarked funds activity separately from nonearmarked funds activity.[7] For fiscal year 2006, earmarked funds revenue and nonearmarked funds revenue totaled about $1,094 billion and $1,532 billion respectively. In addition, for fiscal year 2006, earmarked funds had reported net operating revenue of approximately $172 billion and nonearmarked funds reported net operating cost of approximately $622 billion.[8]

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[3]Social insurance programs included in the Statement of Social Insurance are Social Security, Medicare, Railroad Retirement, and Black Lung.

[4]On an open group basis (current and future participants). On a closed group basis, which excludes the benefit payments and contributions of individuals under the age of 15 (or not yet born), this amount is approximately $44 trillion.

[5]Black Lung's long-range actuarial projections are over a 34-year period.

[6]The federal government's fiscal exposures are derived from information reported throughout the financial statements and related footnotes.

[7]Earmarked funds (e.g., Social Security and Medicare trust funds) are financed by specifically identified revenues and other financing sources which remain available over time; are required by statute to be used for designated activities, benefits, or purposes; and must be accounted for separately from the federal government's general revenues. See the Federal Accounting Standards Advisory Board's (FASAB) Statement of Federal Financial Accounting Standards No. 27, *Identifying and Reporting Earmarked Funds* (Washington, D.C.: Dec. 28, 2004).

[8]The earmarked funds net operating revenue is the excess of revenues and of transfers from nonearmarked funds over net costs. The nonearmarked funds net operating cost is the excess of net costs and of transfers to earmarked funds over revenues.

Although improvements have been made, additional financial reporting enhancements are needed to effectively convey the long-term financial condition of the U.S. government and annual changes therein. Specifically, the federal government's financial reporting should be expanded to disclose the reasons for significant changes during the year in scheduled social insurance benefits and funding. It should also include a Statement of Fiscal Sustainability—providing a long-term look at the sustainability of social insurance in the context of all federal programs.[9] The reporting on fiscal sustainability should include additional information that will assist in understanding the sustainability of current social insurance and other federal programs, including key measures of fiscal sustainability and intergenerational equity,[10] projected annual cash flows, and changes in fiscal sustainability during the reporting period. Further, earmarked Social Security and Medicare taxes that have not yet been used to pay benefits should be recorded as deferred earmarked revenue, resulting in an additional liability for such social-insurance-related obligations.[11] As of September 30, 2006, such "unused" earmarked taxes related to social insurance totaled over $2 trillion.

Finally, to better inform both Congress and American citizens about the federal government's fiscal condition and operations, the federal government should produce an easily understandable summary annual report that includes, in a clear, concise, and transparent manner, key financial and performance information embodied in the *Financial Report of the United States Government*. This report would include, among other things, illustrative graphs and charts depicting such information as (1) the cost of the federal government as a whole and for each major component such as defense and homeland security, (2) the primary components of federal revenues, and (3) various other current financial and future fiscal information.

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We appreciate the cooperation and assistance of the Department of the Treasury and Office of Management and Budget officials, as well as the federal agencies' CFO's and inspectors general, in carrying out our statutory responsibility to report on the U.S. government's consolidated financial statements. We look forward to continuing to work with these officials and the Congress to achieve the goals and objectives of financial management reform.

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[9]The Statement of Fiscal Sustainability would show the relationship between the present value of projected revenues and outlays for social insurance and for all other federal programs.
[10]Intergenerational equity assesses the extent to which different age groups may be required to assume financial burdens to sustain federal responsibilities.
[11]The FASAB recently issued the preliminary views document, *Accounting for Social Insurance, Revised* (Washington, D.C.: Oct. 23, 2006), which discusses differing views on accounting for social insurance.

Our audit report begins on page 149. Our guide[12] to the *Financial Report of the United States Government* will help those who seek to obtain a better understanding of the Financial Report. In addition, our recently issued guide[13] on *Understanding Similarities and Differences between Accrual and Cash Deficits* provides a useful perspective on the different purposes cash and accrual measures serve in providing a comprehensive picture of the federal government's fiscal condition today and over time. These guides and other GAO reports noted above are available on GAO's Web site at www.gao.gov.

Our report was prepared under the direction of Jeffrey C. Steinhoff, Managing Director, and Gary T. Engel, Director, Financial Management and Assurance. If you have any questions, please contact me on (202) 512-5500 or them on (202) 512-2600.

David M. Walker
Comptroller General
of the United States

cc: The Majority Leader of the Senate
The Minority Leader of the Senate
The Majority Leader of the House
The Minority Leader of the House

(198411)

[12]GAO, *Understanding the Primary Components of the Annual Financial Report of the United States Government*, GAO-05-958SP (Washington, D.C.: September 2005).

[13]GAO, *Understanding Similarities and Differences between Accrual and Cash Deficits*, GAO-07-117SP (Washington, D.C.: December 2006).

Financial Statements of the United States Government for the Years Ended September 30, 2006, and September 30, 2005

Statements of Net Cost

These statements present the net cost of fiscal years 2006 and 2005 Government operations, which include the operations related to earmarked funds, funds financed by specifically identified revenues, often supplemented by other financing sources, which remain available over time. For the purposes of this document, "Government" refers to the United States Government. It categorizes costs by Chief Financial Officer Act entities and other significant entities. Costs and earned revenues are generally presented by department on an accrual basis, while the budget presents costs and revenues by obligations and outlays generally on a cash basis. In the Statements of Net Cost, the costs and earned revenues are divided between the corresponding departments and entities mentioned above, providing greater accountability by showing the relationship of the agencies' net cost to the Governmentwide net cost. The focus of the budget of the United States is by agency. Budgets are prepared, defended, and monitored by agency. In reporting by agency, we are assisting the external users in assessing the budget integrity, operating performance, stewardship, and systems and control of the Federal Government.

These statements contain the following three components:

- Gross cost—This is the full cost of all the departments and entities. These costs are assigned on a cause-and-effect basis, or reasonably allocated to the corresponding departments and entities.
- Earned revenue—This is revenue the Government earned by providing goods and services to the public at a price.
- Net cost—This is computed by subtracting earned revenue from gross cost.

Net cost for Governmentwide reporting purposes includes the General Services Administration (GSA) and the Office of Personnel Management (OPM) agency allocations, and is net of intragovernmental eliminations. For this reason, individual agency net cost amounts will not agree with the agency's financial statements. Because of their specific functions, most of the costs originally associated with GSA and OPM have been allocated to and reflected in the costs of their user agencies. The remaining costs for GSA and OPM on the Statements of Net Cost are the administrative operating costs, the expenses from prior and past costs from health and pension plan amendments, and the actuarial gains and losses for these agencies. Health and pension benefits that are not reported in the individual agency statements have been allocated out of OPM to the agencies. The interest on securities issued by the Department of the Treasury (Treasury) held by the public is part of Treasury's responsibilities, but because of its importance, and the dollar amounts, it is reported separately in these statements.

Statements of Operations and Changes in Net Position

These statements report the results of Government operations which include the results of earmarked fund operations. They include unearned revenues that are generated principally by the Government's sovereign power to tax, levy duties, and assess fines and penalties. These statements also cover the cost of Government operations, net of revenue earned from the sale of goods and services to the public (earned revenues). They further include any adjustments and unreconciled transactions that affect the net position.

Revenue

Individual income tax and tax withholdings include Federal Insurance Contributions Act (FICA)/Self-Employment Contributions Act (SECA) taxes and other taxes including payroll taxes collected from other agencies. These taxes are characterized as “unearned” revenue.

Excise taxes consist of taxes collected for various items, such as airline tickets, gasoline products, distilled spirits and imported liquor, tobacco, firearms, and others. These are also characterized as “unearned” revenue.

Miscellaneous earned revenues consist of earned revenues received from the public with virtually no associated cost. Therefore, unlike other earned revenues, miscellaneous earned revenues are not subtracted from gross cost to derive net cost. It also includes rents and royalties on the Outer Continental Shelf Lands resulting from the leasing and development of mineral resources on public lands.

Earmarked revenues are from specifically identified “earmarked” activities during the year. Earmarked revenues are required by statute to be used for designated activities, benefits or purposes and must be accounted for separately from the rest of the Government’s non-earmarked revenues. Refer to Note 20—Earmarked Funds for detailed information.

Intragovernmental interest represents interest earned from the investment of surplus earmarked revenues, which finance the deficit spending of non-earmarked operations. These investments are recorded as Intragovernmental debt holdings and included in Note 10, in the table titled Intragovernmental Debt Holdings: Federal Debt Securities Held as Investments by Government Accounts. These interest payments, and the associated investments, are eliminated in the consolidation process.

Net Cost of Government Operations

The net cost of Government operations (which is gross cost less earned revenue) flows through from the Statements of Net Cost. The net cost associated with earmarked activities is separately reported.

Intragovernmental Transfers

Intragovernmental transfers reflect amounts required by statute to be transferred from the General Fund of the Treasury to earmarked funds, as well as contributions to earmarked funds made by Federal agencies on behalf of their employees, beneficiaries, or others.

Other-Unmatched Transactions and Balances

Unmatched transactions and balances are adjustments needed to bring the change in net position into balance due to unreconciled differences, agency reporting errors, and timing differences in the consolidated financial statements. Refer to Note 1—Summary of Significant Accounting Policies and the Supplemental Information—Unmatched Transactions and Balances for detailed information.

Net Position, Beginning of Period

The net position, beginning of period, reflects the net position reported on the prior year’s balance sheet as of the end of that fiscal year. The net position for earmarked funds is shown separately.

Prior period adjustments are revisions to adjust the beginning net position and balances presented on the prior year financial statements. Refer to Note 1B—Basis of Accounting and Revenue Recognition, and Note 17—Prior Period Adjustments-Corrections of Errors for detailed information.

Net Position, End of Period

The net position, end-of-period, amount reflects the net position as of the end of the fiscal year. The net position for earmarked funds is shown separately.

Reconciliations of Net Operating Cost and Unified Budget Deficit

The purpose of the reconciliation is to report how the proprietary net operating cost and the unified budget deficit relate to each other. The premise of the reconciliation is that the accrual and budgetary accounting bases share transaction data.

These statements report the reconciliation of the results of operations (net operating cost) on the Statements of Operations and Changes in Net Position to the unified budget deficit in the President's budget.

Receipts and outlays in the President's budget are measured primarily on a cash basis and differ from the basis of accounting measures used in the *Financial Report*. These statements begin with the net results of operations (net operating cost), where operating revenues are reported on a modified cash basis of accounting and the net cost of Government operations on an accrual basis of accounting and reports activities where the bases of accounting for the components of net operating cost and the unified budget deficit differed.

Components of Net Operating Cost Not Part of the Budget Deficit

This information includes the operating components, such as the changes of benefits payable for veterans, military and civilian employees, and the environmental liabilities and depreciation expense not included in the budget results.

Components of the Budget Deficit Not Part of Net Operating Cost

This information includes the budget components, such as capitalized fixed assets, changes in accounts and taxes receivable, and increases in other assets not included in the operating results. These items are typically part of the balance sheets only, and are not part of the operating results. All Other Reconciling Items represent the net difference that is needed to balance this statement to the unified budget deficit.

Statements of Changes in Cash Balance from Unified Budget and Other Activities

The primary purpose of these statements is to report how the annual unified budget deficit relates to the change in the Government's operating cash balance and debt held by the public. It explains why the unified budget deficit normally would not result in an equivalent change in the Government's operating cash balance.

These statements reconcile the unified budget deficit to the change in operating cash during the fiscal year and explain how the budget deficits (fiscal years 2006 and 2005) were financed. A budget deficit is the result of outlays (expenditures) exceeding receipts (revenue) during a particular fiscal year.

In depicting how the unified budget deficits were financed, these statements show that in fiscal years 2006 and 2005, the greatest amounts were net new borrowings from the public. Other transactions also required cash disbursements and are not part of the repayments of the debt. These other transactions, such as the payment of interest on debt held by the public, required cash payments and contributed to the use of cash. These statements show the differences between accrual and cash budgetary basis, mainly because of timing differences in the financial statements.

Balance Sheets

The balance sheets show the Government's assets and liabilities. When combined with stewardship information, this information presents a more comprehensive understanding of the Government's financial position. All of the line items on the balance sheets are described in the Notes to the Financial Statements. The net position for earmarked funds is shown separately.

Assets

Assets included on the balance sheets are resources of the Government that remain available to meet future needs. The most significant assets that are reported on the balance sheets are property, plant, and equipment; inventories; and loans receivable. There are, however, other significant resources available to the Government that extend beyond the assets presented in these financial statements. Those resources include stewardship assets, including natural resources, and the Government's sovereign powers to tax, regulate commerce, and set monetary policy.

Liabilities and Net Position

Liabilities are obligations of the Government resulting from prior actions that will require financial resources. The most significant liabilities reported on the balance sheets are Federal debt securities held by the public and accrued interest and Federal employee and veteran benefits payable. Liabilities also include environmental and disposal liabilities and social insurance benefits due and payable as of the reporting date.

As with reported assets, the Government's responsibilities, policy commitments, and contingencies are much broader than these reported balance sheet liabilities. They include the social insurance programs in the Statements of Social Insurance and are disclosed in the Supplemental Information—Social Insurance section and a wide range of other programs under which the Government provides benefits and services to the people of this Nation, as well as certain future loss contingencies.

The magnitude and complexity of social insurance programs, coupled with the extreme sensitivity of projections relating to the many assumptions of the programs, produce a wide range of possible results. Note 23—Social Insurance describes the social insurance programs, reports long-range estimates that can be used to assess the financial condition of the programs, and explains some of the factors that impact the various programs. Using this information, readers can apply their own judgment as to the condition and sustainability of the individual programs.

Each of the social insurance programs has an associated trust fund to account for its activity. The collection of earmarked taxes and other earmarked revenue is credited to the corresponding trust fund that will use these funds to meet a particular Government purpose. If the collections from taxes and other sources exceed the payments to the beneficiaries, the excess revenue is invested in Treasury securities or "loaned" to the Treasury's General Fund; therefore, the trust fund balances do not represent cash. An explanation of the trust funds for social insurance and many of the other large trust funds is included in Note 20—Earmarked Funds and Note 21—Dedicated Collections. That note also contains information about trust fund receipts, disbursements, and assets.

The Government has entered into contractual commitments requiring the future use of financial resources and has unresolved contingencies where existing conditions, situations, or circumstances create uncertainty about future losses. Commitments as well as contingencies that do not meet the criteria for recognition as liabilities on the balance sheets, but for which there is at least a reasonable possibility that losses have been incurred, are disclosed in Note 18—Contingencies and Note 19—Commitments.

Because of its sovereign power to tax and borrow, and the country's wide economic base, the Government has unique access to financial resources through generating tax revenues and issuing Federal debt securities. This provides the Government with the ability to meet present obligations and those that are anticipated from future operations and are not reflected in net position.

Statements of Social Insurance

The Statements of Social Insurance provide estimates of the status of the most significant Social Insurance programs; Social Security, Medicare, Railroad Retirement, and Black Lung social insurance programs, which are administered by the Social Security Administration (SSA), the Department of Health and Human Services (HHS), the Railroad Retirement Board (RRB), and the Department of Labor (DOL), respectively. The estimates are actuarial present values[1] of the projections and are based on the economic and demographic assumptions representing the trustees' best estimates as set forth in the relevant Social Security and Medicare trustees' reports and in the relevant agency performance and accountability reports for the Railroad Retirement Board and the Department of Labor (Black Lung).

[1] Present values recognize that a dollar paid or collected next year is worth less than a dollar today, because a dollar today could be saved and earn a year's worth of interest. To calculate a present value, future amounts are thus reduced using an assumed interest rate, and those reduced amounts are summed.

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United States Government
Statements of Net Cost
for the Years Ended September 30, 2006, and September 30, 2005

(In billions of dollars)	Gross Cost 2006	Earned Revenue 2006	Net Cost 2006	Gross Cost 2005	Earned Revenue 2005	Net Cost 2005
Department of Defense	658.0	24.1	633.9	703.9	26.9	677.0
Department of Health & Human Services	678.8	51.4	627.4	623.4	39.6	583.8
Social Security Administration	593.1	0.3	592.8	572.1	(2.0)	574.1
Interest on Treasury Securities held by the public	221.5	-	221.5	181.2	-	181.2
Department of Veterans Affairs	117.3	3.5	113.8	276.6	3.4	273.2
Department of Agriculture	109.0	11.4	97.6	112.6	19.9	92.7
Department of Education	97.3	4.7	92.6	75.6	4.7	70.9
Department of the Treasury	85.5	4.1	81.4	82.3	3.1	79.2
Department of Transportation	66.6	0.6	66.0	62.4	0.6	61.8
Department of Energy	70.9	5.1	65.8	46.8	3.7	43.1
Department of Homeland Security	63.4	6.8	56.6	74.6	6.7	67.9
Department of Labor	48.2	-	48.2	50.0	-	50.0
Department of Housing and Urban Development	43.0	1.0	42.0	43.6	1.3	42.3
Department of Justice	28.6	1.0	27.6	27.3	0.8	26.5
Office of Personnel Management	34.8	15.1	19.7	33.1	14.4	18.7
National Aeronautics and Space Administration	19.2	-	19.2	16.5	0.1	16.4
Department of the Interior	20.0	2.9	17.1	19.5	3.2	16.3
Department of State	16.0	2.2	13.8	15.6	2.0	13.6
Agency for International Development	10.5	0.1	10.4	13.0	0.2	12.8
Environmental Protection Agency	9.9	0.3	9.6	9.3	0.4	8.9
Department of Commerce	9.9	1.7	8.2	9.2	1.5	7.7
Federal Communications Commission	7.9	0.3	7.6	7.2	0.6	6.6
Railroad Retirement Board	12.1	5.0	7.1	9.5	-	9.5
National Science Foundation	5.7	-	5.7	5.5	-	5.5
Federal Deposit Insurance Corporation	1.8	0.1	1.7	1.4	0.2	1.2
Small Business Administration	1.7	0.3	1.4	1.4	0.4	1.0
U.S. Nuclear Regulatory Commission	1.0	0.6	0.4	0.9	0.5	0.4
General Services Administration	0.9	0.5	0.4	0.2	0.4	(0.2)
National Credit Union Administration	0.2	0.1	0.1	0.1	0.2	(0.1)
Tennessee Valley Authority	9.5	10.0	(0.5)	8.6	8.7	(0.1)
Export-Import Bank of the United States	-	1.3	(1.3)	(0.2)	2.5	(2.7)
Pension Benefit Guaranty Corporation	(0.5)	3.8	(4.3)	5.1	4.3	0.8
U.S. Postal Service	58.9	71.6	(12.7)	56.0	68.9	(12.9)
All other entities	27.0	(3.5)	30.5	30.3	7.6	22.7
Total	3,127.7	226.4	2,901.3	3,174.6	224.8	2,949.8

The accompanying notes are an integral part of these financial statements.

United States Government
Statements of Operations and Changes in Net Position
for the Years Ended September 30, 2006, and September 30, 2005

(In billions of dollars)	Non-Earmarked Funds	Earmarked Funds	2006 Consolidated	2005 Consolidated (Restated)
Revenue:				
Individual income tax and tax withholdings	1,045.7	800.4	1,846.1	1,690.1
Corporation income taxes	350.0	-	350.0	271.8
Unemployment taxes	-	41.4	41.4	40.0
Excise taxes	24.5	49.6	74.1	71.0
Estate and gift taxes	27.4	-	27.4	24.7
Customs duties	24.7	-	24.7	22.0
Other taxes and receipts	42.8	17.2	60.0	46.7
Miscellaneous earned revenues	17.1	-	17.1	19.2
Intragovernmental interest	-	185.3	185.3	-
Total revenue	1,532.2	1,093.9	2,626.1	-
Eliminations			(185.3)	-
Consolidated revenue			2,440.8	2,185.5
Net Cost:				
Net cost	1,635.1	1,266.2	2,901.3	2,949.8
Intragovernmental interest	185.3	-	185.3	-
Total net cost	1,820.4	1,266.2	3,086.6	-
Eliminations			(185.3)	
Consolidated net cost			2,901.3	2,949.8
Intragovernmental transfers	(344.3)	344.3	-	-
Other--Unmatched transactions and balances (Note 1)	11.0	-	11.0	4.1
Net Operating (Cost)/Revenue	(621.5)	172.0	(449.5)	(760.2)
Net position, beginning of period	(8,714.1)	247.2	(8,466.9)	(7,709.8)
Prior period adjustments-corrections of errors (Note 17 and Note 26)	-	-	-	2.9
Other prior period adjustments (Note 17)	-	-	-	0.2
Net Operating (Cost)/Revenue	(621.5)	172.0	(449.5)	(760.2)
Net position, end of period	(9,335.6)	419.2	(8,916.4)	(8,466.9)

The accompanying notes are an integral part of these financial statements.

United States Government
Reconciliations of Net Operating Cost and Unified Budget Deficit for the Years Ended September 30, 2006, and September 30, 2005

(In billions of dollars)	2006	2005 (Restated)
Net operating cost	(449.5)	(760.2)
Components of Net Operating Cost Not Part of the Budget Deficit:		
Increase (decrease) in Liability for Military Employee Benefits (Note 11):		
Increase in military pension liabilities	71.7	57.7
Increase in military health liabilities	3.3	108.6
(Decrease) Increase in other military benefits	(0.3)	3.3
Increase in liability for military employee benefits	74.7	169.6
Increase (Decrease) in Liability for Veterans Compensation (Note 11):		
Increase in liabilities for veterans	45.4	150.1
(Decrease) Increase in liabilities for survivors	(14.3)	47.2
Increase in liabilities for burial benefits	0.1	0.5
Increase in liability for veteran's compensation	31.2	197.8
Increase in Liabilities for Civilian Employee Benefits (Note 11):		
Increase in civilian pension liabilities	75.2	43.6
Increase in civilian health liabilities	4.5	24.6
Increase (Decrease) in other civilian benefits	1.6	(5.9)
Increase in liabilities for civilian employee benefits	81.3	62.3
Increase in Environmental Liabilities (Note 12):		
Increase in Energy's environmental liabilities	40.5	8.1
Increase in all others' environmental liabilities	4.9	2.5
Increase in environmental liabilities	45.4	10.6
Depreciation expense	82.9	79.7
Property, plant, and equipment disposals and revaluations	2.4	(43.7)
Increase in benefits due and payable	12.3	14.1
(Decrease) Increase in insurance programs	(20.4)	31.0
Increase in other liabilities	21.1	15.1
Seigniorage and sale of gold	(0.7)	(0.8)
(Decrease) Increase in accounts payable	(9.5)	7.8
(Increase) in accounts and taxes receivable	(2.7)	(9.7)
Components of the Budget Deficit Not Part of Net Operating Cost:		
Capitalized Fixed Assets:		
Department of Defense	(76.4)	(28.3)
Civilian Agencies	(27.3)	(25.1)
Total Capitalized Fixed Assets	(103.7)	(53.4)
(Increase) in inventory	(9.3)	(10.5)
(Increase) in Securities and Investments	(6.4)	(16.2)
Decrease (Increase) in other assets	0.5	(5.0)
Principal repayments of precredit reform loans	3.5	(2.2)
All Other Reconciling Items	(0.8)	(4.8)
Unified budget deficit	(247.7)	(318.5)

The accompanying notes are an integral part of these financial statements.

United States Government
Statements of Changes in Cash Balance from Unified Budget and Other Activities for the Years Ended September 30, 2006, and September 30, 2005

(In billions of dollars)		**2006**			**2005**	
Unified budget deficit			(247.7)			(318.5)
Adjustments for Noncash Outlays Included in the Budget:						
Interest accrued by Treasury on debt held by the public		(177.6)			(154.4)	
Subsidy expense (Note 4)		34.3			14.4	
Items Affecting the Cash Balance Not Included in the Budget:						
Net Transactions from Financing Activity:						
Repayment of debt held by the public	4,248.5			4,317.4		
Borrowings from the public	(4,485.5)			(4,614.1)		
Total		(237.0)			(296.7)	
Net Transactions from Monetary Activity:						
Increase/(decrease) in special drawing rights	0.4			(4.5)		
Increase in other monetary assets	3.1			0.3		
(Decrease) in loans to the IMF	(6.6)			(6.2)		
Total		(3.1)			(10.4)	
Net Transactions from Other Activities:						
Net direct loan activity	(3.7)			-		
Interest paid by Treasury on debt held by the public	171.4			152.2		
Net guaranteed loan activity	(46.9)			(20.1)		
(Decrease)/Increase in miscellaneous assets	(0.5)			0.3		
(Increase)/Decrease in allocations of special drawing rights	(0.1)			0.1		
Decrease/(Increase) in deposit fund balances	1.0			(2.0)		
Decrease in miscellaneous liabilities	0.1			-		
Seigniorage and other equity	(0.7)			(0.9)		
Reclassification of aged unreconciled accounts	-			-		
NRRIT non-Federal securities[1]	2.1			2.1		
Prior period adjustment	(2.7)			-		
Total		120.0			131.7	
Disposition of deficit			(263.4)			(315.4)
Increase/(Decrease) in operating cash balance			15.7			(3.1)
Operating Cash: (Note 2)						
Operating cash balance beginning of period			27.9			31.0
Operating cash balance end of period			43.6			27.9

[1] For more information, see Railroad Retirement in the Supplemental Information-Social Insurance section. The amount for the change in the NRRIT non-Federal Securities reflected above is based on NRRIT amounts reported as of August 31. This differs from the amounts reflected in Note 7, Securities and Investments, for NRRIT which are as of September 30.

The accompanying notes are an integral part of these financial statements.

United States Government
Balance Sheets
as of September 30, 2006, and September 30, 2005

(In billions of dollars)	2006	2005 (Restated)
Assets:		
Cash and other monetary assets (Note 2)	97.9	85.8
Accounts and taxes receivable, net (Note 3)	68.8	66.1
Loans receivable, net (Note 4)	220.8	221.8
Inventories and related property, net (Note 5)	281.3	272.0
Property, plant, and equipment, net (Note 6 and Note 26)	688.5	670.2
Securities and investments (Note 7)	83.8	75.3
Other assets (Note 8)	55.4	56.7
Total assets	1,496.5	1,447.9
Stewardship property, plant, and equipment		
Stewardship Land (Note 24) and Heritage Assets (Note 25)		
Liabilities:		
Accounts payable (Note 9)	58.4	67.9
Federal debt securities held by the public and accrued interest (Note 10)	4,867.5	4,624.2
Federal employee and veteran benefits payable (Note 11)	4,679.0	4,491.8
Environmental and disposal liabilities (Note 12)	305.2	259.8
Benefits due and payable (Note 13)	129.3	117.0
Insurance program liabilities (Note 14)	72.8	93.2
Loan guarantee liabilities (Note 4)	66.4	47.7
Other liabilities (Note 15)	234.3	213.2
Total liabilities	10,412.9	9,914.8
Contingencies (Note 18) and Commitments (Note 19)		
Net position:		
Earmarked funds (Note 20)	419.2	
Non-earmarked funds	(9,335.6)	
Total net position	(8,916.4)	(8,466.9)
Total liabilities and net position	1,496.5	1,447.9

The accompanying notes are an integral part of these financial statements.

United States Government
Statements of Social Insurance
Present Value of Long-Range (75 Years, except Black Lung) Actuarial Projections

(In billions of dollars)	2006	2005	2004	2003	2002
	************UNAUDITED***********				
Federal Old-Age, Survivors and Disability Insurance (Social Security): (Note 23)					
Contributions and Earmarked Taxes from:					
Participants who have attained age 62	533	464	411	359	348
Participants ages 15-61	16,568	15,290	14,388	13,576	13,048
Future participants (under age 15 and births during period)	15,006	13,696	12,900	12,213	11,893
All current and future participants	32,107	29,450	27,699	26,147	25,289
Expenditures for Scheduled Future Benefits for:					
Participants who have attained age 62	5,866	5,395	4,933	4,662	4,402
Participants ages 15-61	26,211	23,942	22,418	21,015	20,210
Future participants (under age 15 and births during period)	6,480	5,816	5,578	5,398	5,240
All current and future participants	38,557	35,154	32,928	31,075	29,851
Present value of future expenditures less future revenue	6,449[1]	5,704[2]	5,229[3]	4,927[4]	4,562[5]
Federal Hospital Insurance (Medicare Part A): (Note 23)					
Contributions and Earmarked Taxes from:					
Participants who have attained eligibility age 65	192	162	148	128	125
Participants who have not attained eligibility age 15-64	5,685	5,064	4,820	4,510	4,408
Future participants (under age 15 and births during period))	4,767	4,209	4,009	3,773	3,753
All current and future participants	10,644	9,435	8,976	8,411	8,286
Expenditures for Scheduled Future Benefits for:					
Participants who have attained eligibility age 65	2,397	2,179	2,168	1,897	1,747
Participants who have not attained eligibility age 15-64	15,633	12,668	12,054	10,028	9,195
Future participants (under age 15 and births during period))	3,904	3,417	3,246	2,653	2,470
All current and future participants	21,934	18,264	17,468	14,577	13,412
Present value of future expenditures less future revenue	11,290[1]	8,829[2]	8,492[3]	6,166[4]	5,126[5]
Federal Supplementary Medical Insurance (Medicare Part B): (Note 23)					
Premiums from:					
Participants who have attained eligibility age 65	409	363	332	283	252
Participants who have not attained eligibility age 15-64	3,167	2,900	2,665	2,148	1,856
Future participants (under age 15 and births during period))	906	924	891	688	600
All current and future participants	4,481	4,187	3,889	3,119	2,708
Expenditures for Scheduled Future Benefits for:					
Participants who have attained eligibility age 65	1,773	1,622	1,475	1,306	1,132
Participants who have not attained eligibility age 15-64	12,433	11,541	10,577	8,845	7,463
Future participants (under age 15 and births during period))	3,407	3,408	3,277	2,622	2,238
All current and future participants	17,613	16,571	15,329	12,773	10,833
Present value of future expenditures less future revenue[6]	13,131[1]	12,384[2]	11,440[3]	9,653[4]	8,125[5]
Federal Supplementary Medical Insurance (Medicare Part D): (Note 23)					
Premiums and State Transfers from:					
Participants who have attained eligibility age 65	173	185	176		
Participants who have not attained eligibility age 15-64	1,700	1,790	1,857		
Future participants (under age 15 and births during period))	492	572	618		
All current and future participants	2,366	2,547	2,651		
Expenditures for Scheduled Future Benefits for:					
Participants who have attained eligibility age 65	792	880	773		
Participants who have not attained eligibility age 15-64	7,338	7,913	7,566		
Future participants (under age 15 and births during period))	2,121	2,440	2,431		
All current and future participants	10,250	11,233	10,770		
Present value of future expenditures less future revenue[6]	7,884[1]	8,686[2]	8,119[3]		

United States Government
Statements of Social Insurance
Present Value of Long-Range (75 Years, except Black Lung) Actuarial Projections

(In billions of dollars)	2006	2005	2004	2003	2002
		************UNAUDITED***********			
Railroad Retirement: (Note 23)					
Contributions and Earmarked Taxes from:					
Participants who have attained eligibility	5	4	4	4	3
Participants who have not attained eligibility	40	37	37	40	40
Future participants	56	41	39	41	41
All current and future participants	100	82	80	85	83
Expenditures for Scheduled Future Benefits for:					
Participants who have attained eligibility	92	84	81	80	74
Participants who have not attained eligibility	84	73	72	73	76
Future participants	25	16	14	14	13
All current and future participants	201	173	167	167	162
Present value of future expenditures less future revenues [7]	101 [1]	91 [2]	87 [3]	83 [4]	79 [5]
Black Lung (Part C): (Note 23)					
Present value of future expenditures less future revenues [8]	(4) [9]	(5) [10]	(4) [11]	(4) [12]	(5) [13]

[1] The projection period is 1/1/2006 - 12/31/2080 and the valuation date is 1/1/2006.
[2] The projection period is 1/1/2005 - 12/31/2079 and the valuation date is 1/1/2005.
[3] The projection period is 1/1/2004 - 12/31/2078 and the valuation date is 1/1/2004.
[4] The projection period is 1/1/2003 - 12/31/2077 and the valuation date is 1/1/2003.
[5] The projection period is 1/1/2002 - 12/31/2076 and the valuation date is 1/1/2002.
[6] These amounts represent the present value of the transfers from the General Fund of the Treasury to the Supplementary Medical Insurance Trust Fund. These future intragovernmental transfers are included as income in both HHS' and the Centers for Medicare & Medicaid Services' (CMS) Financial Report but are not income from the Governmentwide perspective of this report.
[7] These amounts approximate the present value of the financial interchange and transfers from the General Fund of the Treasury to the Social Security Equivalent Benefit (SSEB) Account (see discussion of Railroad Retirement Program in the required supplemental information section of this report). They are included as income in the Railroad Retirement Financial Report but are not income from the Governmentwide perspective of this report.
[8] Does not include interest expense accruing on the outstanding debt.
[9] The projection period is 9/30/2006 - 9/30/2040 and the valuation date is 9/30/2006.
[10] The projection period is 9/30/2005 - 9/30/2040 and the valuation date is 9/30/2005.
[11] The projection period is 9/30/2004 - 9/30/2040 and the valuation date is 9/30/2004.
[12] The projection period is 9/30/2003 - 9/30/2040 and the valuation date is 9/30/2003.
[13] The projection period is 9/30/2002 - 9/30/2040 and the valuation date is 9/30/2002.

Totals do not necessarily equal the sum of components due to rounding.

The accompanying notes are an integral part of these financial statements.

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United States Government Notes to the Financial Statements for the Years Ended September 30, 2006, and September 30, 2005

Note 1. Summary of Significant Accounting Policies

A. Reporting Entity

This *Financial Report* includes the financial status and activities of the executive branch, the legislative branch (the U.S. Senate and the U.S. House of the Representatives report on a cash basis), and the judicial branch (which also reports on a cash basis) of the Government. The judicial branch reports on a limited basis because it is not required by law to submit financial statement information to Treasury. The Appendix section of this report contains a list of significant Government entities included in the *Financial Report*, as well as examples of entities excluded. The excluded entities are not part of the *Financial Report* because they are Government sponsored enterprises, such as the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), etc.; or their activities are not included in the Federal budget's totals, such as the Thrift Savings Fund, and the Board of Governors of the Federal Reserve System.

Material intragovernmental transactions are eliminated in consolidation, except as described below in this note and in the Supplemental Information—Unmatched Transactions and Balances. The financial reporting period ends September 30 and is the same as used for the annual budget.

B. Basis of Accounting and Revenue Recognition

These financial statements were prepared using U.S. Generally Accepted Accounting Principles (GAAP), primarily based on Statements of Federal Financial Accounting Standards (SFFAS). Under these principles:

- Expenses are generally recognized when incurred except that the costs of social insurance programs including Social Security, Medicare, Railroad Retirement, Black Lung, and Unemployment Insurance are recognized only for amounts currently due and payable.
- Nonexchange (unearned) revenues, including taxes, duties, fines, and penalties, are recognized when collected and adjusted to the change in net measurable and legally collectable amounts receivable. Related refunds and other offsets, including those that are measurable and legally payable, are netted against nonexchange revenue.
- Exchange (earned) revenues are recognized when the Government provides goods and services to the public for a price. Exchange revenues include user charges such as admission to Federal parks and premiums for certain Federal insurance.

The basis of accounting used for budgetary purposes, which is primarily on a cash and obligation basis and follows budgetary concepts and policies, differs from the basis of accounting used for the financial statements which follow U.S. GAAP. See the Reconciliations of Net Operating Cost and Unified Budget Deficit in the Financial Statements section.

Beginning in fiscal year 2006, the Federal Government has implemented the requirements of new standards related to earmarked funds, social insurance, heritage assets and stewardship land, and required Governmentwide reporting.

- Earmarked funds:

As required by SFFAS No. 27,[1] the Federal Government now separately identifies: (1) earmarked fund activities in the statement of operations and changes in net position: and (2) the portion of net position attributable to earmarked fund activities on the balance sheet. As required by SFFAS No. 27, fiscal year 2005 balances and amounts have not been restated to show this separate identification of earmarked fund activities and net position. For further information on these funds, see Note 20—Earmarked Funds.

- Social Insurance:

As required by SFFAS Nos. 17, 25, 26, and 28,[2] the Statements of Social Insurance and related note on significant underlying assumptions were reclassified from required supplemental stewardship information to basic information. For further information on social insurance, see Note 23—Social Insurance.

- Heritage Assets and Stewardship Land:

As required by SFFAS No. 29,[3] information related to heritage assets and stewardship land was reclassified from required supplemental stewardship information to basic information. For further information on stewardship land and heritage assets, see Note 24—Stewardship Land, and Note 25—Heritage Assets, respectively.

- Governmentwide Reporting:

SFFAS No. 32[4] amends standards issued prior to January 2003 to specify disclosure requirements appropriate for the *Financial Report* based on the guidance contained in Statements of Federal Financial Accounting Concepts No. 4 (SFFAC 4). Some disclosure requirements contained in previously issued standards were modified to allow aggregation and reduce detail for Governmentwide reporting while other disclosure requirements were eliminated because of excessive detailed information required that is inappropriate for a Governmentwide report consistent with the guidance contained in SFFAC 4.

C. Direct Loans and Loan Guarantees

Direct loans obligated and loan guarantees committed after fiscal year 1991 are reported based on the present value of the net cashflows estimated over the life of the loan or guarantee. The difference between the outstanding principal of the direct loans and the present value of their net cash inflows is recognized as a subsidy cost allowance; the present value of estimated net cash outflows of the loan guarantees is recognized as a liability for loan guarantees.

The subsidy expense for direct or guaranteed loans disbursed during a year is the present value of estimated net cash outflows for those loans or guarantees. A subsidy expense also is recognized for modifications made during the year to loans and guarantees outstanding and for reestimates made as of the end of the year to the subsidy allowances or loan guarantee liability for loans and guarantees outstanding.

Direct loans obligated and loan guarantees committed before fiscal year 1992 are valued under two different methodologies within the Government: the allowance-for-loss method and the present-value method. Under the allowance-for-loss method, the outstanding principal of direct loans is reduced by an allowance for uncollectible amounts; the liability for loan guarantees is the amount the agency estimates would more likely than not require future cash outflow to pay default claims.

Under the present-value method, the outstanding principal of direct loans is reduced by an allowance equal to the difference between the outstanding principal and the present value of the expected net cashflows. The liability for loan guarantees is the present value of expected net cash outflows due to the loan guarantees.

D. Accounts and Taxes Receivable

Accounts receivable represents claims to cash or other assets from entities outside the Government that arise from the sale of goods or services, duties, fines, certain license fees, recoveries, or other provisions of the law.

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[1] SFFAS No. 27, Identifying and Reporting Earmarked Funds.

[2] SFFAS No. 17, Accounting for Social Insurance, No. 25, Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment; SFFAS No. 26, Presentation of Significant Assumptions for the Statement of Social Insurance: Amending SFFAS 25, and SFFAS No. 28, Deferral of the Effective Date of Reclassification of the Statement of Social Insurance: Amending SFFAS 25 and 26.

[3] SFFAS No. 29, Heritage Assets and Stewardship Land.

[4] SFFAS No. 32, Consolidated Financial Report of the United States Government Requirements: Implementing SFFAC 4 "Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government."

The category taxes receivable consists primarily of uncollected tax assessments, penalties, and interest when taxpayers have agreed the amounts are owed or a court has determined the assessments are owed. The balance sheets do not include unpaid assessments when neither taxpayers nor a court have agreed that the amounts are owed (compliance assessments) or the Government does not expect further collections due to factors such as the taxpayer's death, bankruptcy, or insolvency (writeoffs). Taxes receivable are reported net of an allowance for the estimated portion deemed to be uncollectible.

E. Inventories and Related Property

Inventories within the Government are valued using historical cost, net realizable value, and latest acquisition cost (see Note 5—Inventories and Related Property, Net). Historical cost methods include first-in-first-out, weighted average, and moving average. Estimated repair costs reduce the value of inventory held for repair. Excess, obsolete, and unserviceable inventories are valued at estimated net realizable value. When latest acquisition cost is used to value inventory held for sale, it is adjusted for holding gains and losses in order to approximate historical cost.

The related property portion of the inventory and related property line includes operating materials and supplies, stockpile materials, commodities, seized and monetary instruments, and forfeited property. Operating materials and supplies are valued at historical cost, latest acquisition cost, and standard price using the purchase and consumption method of accounting. Operating materials and supplies that are valued at latest acquisition cost and standard pricing are not adjusted for holding gains and losses.

F. Property, Plant, and Equipment

Property, plant, and equipment used in Government operations are carried at acquisition cost, with the exception of Department of Defense (DOD) military equipment (e.g., ships, aircraft, combat vehicles, and weapons). DOD comprises approximately 68 percent of the Government's reported property, plant, and equipment as of September 30, 2006. During fiscal year 2006, DOD changed its methodology to calculate "a more accurate" value for military equipment. DOD replaced the use of data from the Bureau of Economic Analysis (BEA) with an estimation methodology for military equipment based on internal DOD records to calculate a value for military equipment. DOD's prior use of the BEA data was determined to be incorrect and the new methodology reflects a correction of previously disclosed amounts for military equipment. DOD identified the universe of military equipment by accumulating information relating to program funding and associated military equipment, equipment useful life, and program acquisitions and disposals to create a baseline. The equipment baseline is updated using expenditure information and information related to acquisition and logistics to identify acquisitions and disposals. All property, plant, and equipment is capitalized if the acquisition costs (or estimated acquisition cost for DOD) are in excess of capitalization thresholds that vary considerably between the federal entities. Depreciation and amortization expense applies to property, plant, and equipment reported on the balance sheets except for land, unlimited duration land rights and construction in progress. Depreciation and amortization are recognized using the straight-line method over the estimated useful lives of the assets. All property, plant, and equipment are assigned useful lives depending on their category and vary considerably between the federal entities. The cost of acquisition, betterment, or reconstruction of all multi-use heritage assets is capitalized as general property, plant, and equipment and is depreciated. Construction in progress is used for the accumulation of the cost of construction or major renovation of fixed assets during the construction period. The assets are transferred out of construction in progress when the project is substantially completed. Automated data processing (internal use) software includes purchased commercial off-the-shelf software, contractor-developed software, and software that was internally developed by agency employees.

Please refer to the individual financial statements of DOD, National Aeronautics and Space Administration (NASA), the Department of Energy (DOE), the United States Postal Service (USPS), and the Tennessee Valley Authority (TVA) for significant detailed information on the useful lives and related capitalization thresholds for property, plant, and equipment. These agencies comprise 83 percent of the Government's total reported net property, plant, and equipment of $688.5 billion as of September 30, 2006.

G. Federal Employee and Veteran Benefits Payable

Generally, Federal employee and veteran benefits payable are recorded during the time employee services are rendered. The related liabilities for defined benefit pension plans, post-retirement health benefits, life insurance benefits, Federal Employee and Compensation Act benefits and veterans' compensation and burial benefits are recorded at estimated present value of future benefits, less any estimated present value of future normal cost contributions. The estimated present value for veteran's pension benefits is disclosed but is not included in the Federal employee and veteran benefits payable line. However, the estimated present value for veteran health benefits is not estimated; these benefits are expensed when services are provided.

Normal cost is the portion of the actuarial present value of projected benefits allocated as an expense for employee services rendered in the current year. Actuarial gains and losses (and prior service cost, if any) are recognized immediately in the year they occur, without amortization.

H. Environmental and Disposal Liabilities

Environmental and disposal liabilities are recorded at the estimated current cost of removing, containing and/or disposing of hazardous waste and environmental contamination, assuming the use of current technology. Hazardous waste is a solid, liquid, or gaseous waste that, because of its quantity or concentration, presents a potential hazard to human health or the environment. Remediation consists of removal, decontamination, decommissioning, site restoration, site monitoring, closure and post-closure cost, treatment, and/or safe containment. Where technology does not exist to clean up hazardous waste, only the estimable portion of the liability, typically safe containment, is recorded.

I. Deferred Maintenance

Deferred maintenance is maintenance that was not performed when it should have been or scheduled maintenance that was delayed or postponed. Maintenance is the act of keeping fixed assets in acceptable condition, including preventative maintenance, normal repairs, and other activities needed to preserve the assets, so they continue to provide acceptable services and achieve their expected life. Maintenance excludes activities aimed at expanding the capacity of assets or otherwise upgrading them to serve needs different from those originally intended. Deferred maintenance expenses are not accrued in the Statements of Net Cost or recognized as liabilities on the balance sheets. However, deferred maintenance information is disclosed in the Supplemental Information section of this report.

J. Contingent Liabilities

Liabilities for contingencies are recognized on the balance sheets when both:

- A past transaction or event has occurred.
- A future outflow or other sacrifice of resources is probable and measurable.

The estimated contingent liability may be a specific amount or a range of amounts. If some amount within the range is a better estimate than any other amount within the range, then that amount is recognized. If no amount within the range is a better estimate than any other amount, then the minimum amount in the range is recognized.

Contingent liabilities that do not meet the above criteria for recognition, but for which there is at least a reasonable possibility that a loss may have been incurred, are disclosed in Note 18—Contingencies.

K. Commitments

In the normal course of business, the Government has a number of unfulfilled commitments that may require the use of its financial resources. Note 19—Commitments describes the components of the Government's actual commitments that need to be disclosed because of their nature and/or their amount. They include long-term leases, undelivered orders, and other commitments.

Discussion of treaties and other international agreements entered into by the United States Government are included in the Commitments section.

L. Social Insurance

A liability for social insurance programs (Social Security, Medicare, Railroad Retirement, Black Lung, and Unemployment) is recognized for any unpaid amounts currently due as of the reporting date. No liability is recognized for future benefit payments not yet due. For further information, see the Supplemental Information—Social Insurance section, Note 20—Earmarked Funds, and Note 21—Dedicated Collections.

M. Related Party Transactions

Federal Reserve banks (FRBs) and private banks, which are not part of the reporting entity, serve as the Government's depositary and fiscal agent. They process Federal payments and deposits to Treasury's account and service Treasury securities. FRBs owned $764.6 billion and $732.7 billion of Treasury securities held by the public as of September 30, 2006, and 2005, respectively. FRB earnings that exceed statutory amounts of surplus established for FRBs are paid to the Government and are recognized as nonexchange revenue. Those earnings totaled $29.9 billion and $19.3 billion for the years ended September 30, 2006, and 2005, respectively. The primary source of these earnings is from interest earned on Treasury securities held by the FRBs. Also, as described in Note 15—Other Liabilities, the FRB holds certificates and special drawing rights certificates.

FRBs issue Federal Reserve notes, the circulating currency of the United States. Specific assets owned by FRBs, typically Treasury securities, collateralize these notes. Federal Reserve notes are backed by the full faith and credit of the Government.

The Government does not guarantee payment of the liabilities of Government-sponsored enterprises such as the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation, which are privately owned. These enterprises also are excluded from the reporting entity.

N. Unmatched Transactions and Balances

The reconciliation of the change in net position requires that the difference between ending and beginning net position equals the excess of revenues over net cost, plus or minus prior period adjustments.

The unmatched transactions and balances are needed to bring the change in net position into balance. The primary factors affecting this out of balance situation are:

- Unmatched intragovernmental transactions and balances between Federal agencies,
- General fund transactions,
- Timing differences and errors in Federal agencies' reporting.

Refer to the Supplemental Information—Unmatched Transactions and Balances for detailed information.

Note 2. Cash and Other Monetary Assets

Cash and Other Monetary Assets as of September 30

(In billions of dollars)	2006	2005
Operating cash	43.6	27.9
Other cash-not restricted	13.2	10.5
Other cash-restricted	2.9	4.5
Total cash	59.7	42.9
International monetary assets	27.2	32.0
Gold	11.0	10.9
Total cash and other monetary assets	97.9	85.8

Cash

Total cash consists of:

- Operating Cash of the Federal Government representing balances from tax collections, customs duties, other revenue, Federal debt receipts; and other various receipts net of cash outflows for budget outlays and other payments. Operating cash includes balances invested with commercial depositaries in Treasury Tax and Loan Accounts (including funds invested through the Term Investment Option program and the Repo Pilot program). Checks outstanding are netted against operating cash until they are cleared by the Federal Reserve System.
- Other cash not included in the operating cash balance includes balances representing cash equivalents and other funds held in agencies' books, such as demand deposits, amounts held in trust, deposits in transit, imprest funds, undeposited collections, and amounts representing the balances of petty cash. Restricted cash represents cash that is restricted due to the imposition on cash deposits by law, regulation, or agreement.

Operating Cash of the Federal Government held by depositary institutions is either insured (for balances up to $100,000) by the Federal Deposit Insurance Corporation or collateralized by securities pledged by the depositary institution or through securities held under reverse repurchase agreements.

International Monetary Assets

International monetary assets include the U.S. reserve position in the International Monetary Fund (IMF), U.S. holdings of Special Drawing Rights (SDRs), and official reserves of foreign currency and gold.

The U.S. reserve position in the IMF reflects the reserve asset portion of the financial subscription that the United States has paid in as part of its participation in the IMF. The IMF promotes international monetary cooperation and a stable payments system to facilitate growth in the world economy. Its primary activities are surveillance of member economies, financial assistance as appropriate, and technical assistance.

Only a portion of the U.S. financial subscriptions to the IMF is made in the form of reserve assets, the remainder is provided in the form of a letter of credit from the United States to the IMF.

The balance available under the letter of credit totaled $48.1 billion and $40.4 billion for the years ended September 30, 2006, and 2005, respectively. The U.S. reserve position in the IMF has a U.S. dollar equivalent of $6.6 billion and $13.2 billion for the years ended September 30, 2006, and 2005, respectively.

SDRs are international monetary reserves issued by the IMF. These interest-bearing assets can be obtained by IMF allocations, transactions with IMF member countries, interest earnings on SDR holdings, or U.S. reserve position in the IMF. SDR holdings are an asset of Treasury's Exchange Stabilization Fund (ESF), which held SDRs totaling $8.7 billion and $8.2 billion equivalent for the years ended September 30, 2006, and 2005, respectively.

The IMF allocates SDRs to its members in proportion to each member's quota in the IMF. The SDR Act of 1968 authorized the Secretary of the Treasury to issue SDR Certificates (SDRCs) to the Federal Reserve in exchange for dollars. The amount of SDRCs outstanding cannot exceed the dollar value of SDR holdings. The Secretary of the Treasury determines when Treasury will issue or redeem SDRCs. SDRCs outstanding totaled $2.2 billion for the years ended September 30, 2006, and 2005 and are included in Note 15—Other Liabilities.

As of September 30, 2006, and 2005, other liabilities included $7.2 billion and $7.1 billion, respectively, of interest-bearing liability to the IMF for SDR allocations. The SDR allocation item represents the cumulative total of SDRs distributed by the IMF to the United States in allocations that occurred in 1970, 1971, 1972, 1979, 1980, and 1981.

Gold

Gold is valued at the statutory price of $42.2222 per fine troy ounce. The number of fine troy ounces was 261,498,900 and 258,713,310 as of September 30, 2006, and 2005, respectively. The market value of gold on the London Fixing as of the reporting date was $599 and $473 per fine troy ounce for the years ended September 30, 2006, and 2005, respectively. Gold totaling $11.0 and $10.9 billion for the years ending September 30, 2006, and 2005, respectively, was pledged as collateral for gold certificates issued and authorized to the FRBs by the Secretary of the Treasury. Treasury may redeem the gold certificates at any time. See Note 15—Other Liabilities.

Note 3. Accounts and Taxes Receivable, Net

Accounts receivable includes related interest receivable of $5.4 billion and $4.8 billion for the years ended September 30, 2006, and 2005, respectively, and represents claims to cash or other assets from entities outside the Government. An allowance for estimated losses due to uncollectible amounts is established when it is more likely than not the receivables will not be totally collected. The allowance method varies among the agencies in the Government and is usually based on past collection experience. Methods include statistical sampling of receivables, specific identification and intensive analysis of each case, aging methodologies, and percentage of total receivables based on historical collection. Accounts receivable are net of an allowance for uncollectible accounts. The allowance amounts are $12.5 billion and $13.2 billion for the years ended September 30, 2006 and 2005, respectively.

Taxes receivable are the gross tax receivables net of allowance for doubtful accounts. Gross taxes receivable consists primarily of assessments, penalties, and related interest that were not paid or abated and which the taxpayers have agreed the amounts are owed or a court has determined the assessments are owed. The allowance for doubtful accounts is based on projections of collectibility from a statistical sample of unpaid tax assessments.

Accounts and Taxes Receivable as of September 30

(In billions of dollars)	2006	2005
Department of Agriculture	8.6	9.4
Department of Defense	7.9	7.6
Social Security Administration	7.6	7.0
Department of Energy	4.0	4.0
Department of Health and Human Services	3.2	2.1
Department of the Interior	2.5	2.7
Pension Benefit Guaranty Corporation	2.0	1.7
Tennessee Valley Authority	1.4	1.1
Department of Veterans Affairs	1.2	0.9
Department of Homeland Security	1.2	0.5
Department of Labor	1.1	1.0
All other departments	5.4	5.7
Accounts receivable, net	46.1	43.7
Gross taxes receivable	94.3	90.7
Allowance for doubtful accounts	(71.6)	(68.3)
Taxes receivable, net	22.7	22.4
Total accounts and taxes receivable, net	68.8	66.1

Note 4. Loans Receivable and Loan Guarantee Liabilities, Net

The Government uses two methods, direct loans and loan guarantee programs, to accomplish the same goals. These goals are to promote the Nation's welfare by making direct Federal loans and guaranteeing non-federal loans to segments of the population not served adequately by non-federal institutions. For those unable to afford credit at the market rate, Federal credit programs provide subsidies in the form of direct loans offered at an interest rate lower than the market rate. For those to whom non-federal financial institutions are reluctant to grant credit because of the high risk involved, Federal credit programs guarantee the payment of these non-federal loans and absorb the cost of defaults.

The amount of the long-term cost of post-1991 direct loans and loan guarantees outstanding equals the subsidy cost allowance for direct loans and the liability for loan guarantees as of the fiscal yearend. The amount of the long-term cost of pre-1992 direct loans and loan guarantees equals the allowance for uncollectible amounts (or present value allowance) for direct loans and the liability for loan guarantees. The long-term cost is based on all direct loans and guaranteed loans disbursed in this fiscal year and previous years that are outstanding as of the end of this fiscal year. It includes the subsidy cost of these loans and guarantees estimated as of the time of loan disbursement and subsequent adjustments such as modifications, reestimates, amortizations, and writeoffs.

Direct Loans and Loan Guarantees as of September 30

(In billions of dollars)	Face Value of Loans Outstanding 2006	Face Value of Loans Outstanding 2005 (Restated)	Long-term Cost of Loans and Guarantees Outstanding 2006	Long-term Cost of Loans and Guarantees Outstanding 2005	Net Loans Receivable 2006	Net Loans Receivable 2005	Amount Guaranteed by the Government 2006	Amount Guaranteed by the Government 2005 (Restated)	Subsidy Expense for the Fiscal Year Ended September 30 2006	Subsidy Expense for the Fiscal Year Ended September 30 2005
Direct Loan Programs:										
Federal Direct Student Loans - Education	101.0	97.7	8.3	2.0	92.7	95.7			6.6	5.2
Electric Loans - USDA	34.2	30.2	1.6	2.2	32.6	28.0			(0.3)	(0.1)
Rural Housing Services - USDA	26.8	26.8	7.0	6.0	19.8	20.8			1.0	(0.5)
Federal Family Education Loans - Education	21.2	20.2	7.6	8.5	13.6	11.7			-	-
Water and Environmental Loans - USDA	8.7	8.3	0.8	0.8	7.9	7.5			-	-
Farm Loans - USDA	6.7	6.9	0.5	0.6	6.2	6.3			0.1	0.1
Housing for the Elderly and Disabled - HUD	5.5	6.5	(0.1)	(0.1)	5.6	6.6			-	-
Export-Import Bank Loans	6.0	8.4	1.5	2.9	4.5	5.5			-	-
U.S. Agency for International Development	7.2	7.7	2.4	2.6	4.8	5.1			-	-
Housing and Urban Development	3.9	4.0	(0.4)	(0.1)	4.3	4.1			(0.2)	0.4
Telecommunications Loans - USDA	4.0	4.1	-	0.1	4.0	4.0			-	-
Foreign Military Financing Program	3.7	4.2	-	-	3.7	4.2			-	-
All Other Direct Loan Programs	32.3	32.8	11.2	10.5	21.1	22.3			1.2	(0.1)
Total	261.2	257.8	40.4	36.0	220.8	221.8			8.4	5.0
Guaranteed Loan Programs:										
Federal Housing Administration Loans - HUD	434.2	454.3	3.5	4.6			395.8	416.4	(1.4)	(1.2)
Federal Family Education Loans - Education	324.6	289.2	52.6	30.5			321.0	288.1	28.0	9.8
Veterans Housing Benefit Programs - VA	203.2	202.1	3.3	3.5			61.3	62.1	(0.8)	(1.5)
Small Business Loans - SBA	67.2	63.3	1.6	2.1			54.6	51.1	-	(0.3)
Export-Import Bank Guarantees	49.4	50.9	1.3	2.3			49.4	50.9	0.2	0.2
Rural Housing Services - USDA	15.9	14.8	0.6	0.6			14.3	13.3	0.1	0.1
Israeli Loan Guarantee Program - AID	12.9	13.0	1.2	1.1			12.9	13.0	-	0.2
Overseas Private Investment Corporation Credit Program	4.1	3.6	0.6	0.6			4.1	3.6	-	-
Export Credit Guaranteed Programs - USDA	3.0	4.2	0.2	0.3			2.9	4.1	(0.3)	(0.3)
Business and Industry Loans - USDA	3.9	4.2	0.3	0.4			2.9	3.1	-	0.1
Federal Ship Financing Fund (Title XI) - DOT	2.9	3.1	0.3	0.4			2.9	3.1	-	-
All Other Guaranteed Loan Programs	18.2	20.2	0.9	1.3			16.6	18.6	0.1	2.3
Total Guaranteed Loan Programs	1,139.5	1,122.9	66.4	47.7			938.7	927.4	25.9	9.4

Net loans receivable includes related interest and foreclosed property, and is included in the assets section of the balance sheets. Foreclosed property is property that is transferred from borrowers to a Federal credit program, through foreclosure or other means, in partial or full settlement of post-1991 direct loans or as a compensation for losses that the Government sustained under post-1991 loan guarantees. Please refer to the individual financial statements of the Department of Veterans Affairs (VA) and the Department of Housing and Urban Development (HUD) for significant detailed information regarding foreclosed property.

The total subsidy expense is the cost of direct loans and loan guarantees recognized during the fiscal year. It consists of the subsidy expense incurred for direct and guaranteed loans disbursed during the fiscal year, for modifications made during the fiscal year of loans and guarantees outstanding, and for reestimates as of the end of the fiscal year of the cost of loans and guarantees outstanding. This expense is included in the Statements of Net Cost.

Major Loan Programs

The Department of Education (Education) has two major education loan programs. The first major education loan program, the Federal Direct Student Loan Program, established in fiscal year 1994, offers four types of education loans: Stafford, Unsubsidized Stafford, PLUS for parents, and consolidation loans. Evidence of financial need is required for a student to receive a subsidized Stafford loan. The other three types of loans are available to borrowers at all income levels. These loans usually mature 9 to 13 years after the student is no longer enrolled. They are unsecured. The second major education loan program, the Federal Family Education Loan Program established in fiscal year 1965, is a guaranteed loan program. Like the Federal Direct Student Loan Program, it offers four types of loans: Stafford, Unsubsidized Stafford, PLUS for parents, and consolidation loans.

The USDA offers direct and guaranteed loans through credit programs in the Farm and Foreign Agricultural Services (FFAS) Mission Area through the Farm Service Agency (FSA) and the Commodity Credit Corporation (CCC), and in the Rural Development Mission Area (RD).

The FFAS delivers commodity, credit, conservation, disaster and emergency assistance programs that help strengthen and stabilize the agricultural economy.

The FSA offers direct and guaranteed loans to farmers who are unable to obtain private commercial credit and through this supervised credit to graduate its borrowers to commercial credit. The CCC offers both guarantee credit and direct credit programs for buyers of U.S. exports, suppliers, and sovereign countries in need of food assistance.

The RD provides affordable housing and essential community facilities to rural communities through its housing loan and grant programs. These programs include:

- Very low- and low-to-moderate-income home ownership loans and guarantees.
- Very low-income housing repair loans.
- Multifamily housing loans and guarantees.
- Domestic farm labor housing loans.
- Housing site loans.
- Credit sales of acquired property.

The Rural Utilities Program administers a variety of loan programs for electric energy, telecommunications, and water and environmental projects in rural America.

The Department of Housing and Urban Development, Federal Housing Administration (FHA) provides mortgage insurance to encourage lenders to make credit available to expand home ownership. FHA predominately serves borrowers that the conventional market does not serve adequately. This includes first-time homebuyers, minorities, low-income families, and residents of under-served areas.

The VA’s Veterans Housing Benefit Program provides partial guarantee of residential mortgage loans issued to eligible veterans, reservists, and service members by private lenders. This guarantee allows veterans, reservists, and service members to purchase a home without a substantial down payment.

The Export-Import Bank (EXIM) aids in financing and promoting U.S. exports. To accomplish its objectives, the bank’s authority and resources are used to:

- Assume commercial and political risk that exporters or private institutions are unwilling or are unable to undertake.
- Overcome maturity and other limitations in private sector financing.
- Assist U.S. exports to meet foreign officially sponsored export credit competition.
- Provide leadership and guidance in export financing to the U.S. exporting and banking communities and to foreign borrowers.

The average repayment terms for these loans are approximately 7 years.

The U.S. Agency for International Development (USAID) provides economic assistance to selected countries in support of U.S. efforts to promote stability and security interests in strategic regions of the world.

Other loan programs include the Small Business Administration general business loan guarantees and disaster loans; and the Farm Service Agency's farm ownership, emergency, and disaster loans.

Government-sponsored enterprises have the authority to request borrowings totaling $10 billion, subject to the approval of the Secretary of the Treasury. The face value and amounts guaranteed by the Federal government of guaranteed loans related to Small Business loans—SBA as of September 30, 2005 were restated to reduce both by $10 billion. Refer to Note 26—Restatements for further detail.

Please refer to the individual financial statements of the agencies specified above for significant detailed information regarding direct and guaranteed loans.

Note 5. Inventories and Related Property, Net

Inventories and Related Property as of September 30

(In billions of dollars)	Defense 2006	All Others 2006	Total 2006	Defense 2005	All Others 2005	Total 2005
Inventory purchased for resale	86.5	0.7	87.2	80.0	0.6	80.6
Inventory held in reserve for future sale	-	-	-	-	-	-
Inventory and operating material and supplies held for repair	48.1	0.5	48.6	45.3	0.4	45.7
Inventory—excess, obsolete, and unserviceable	9.8	0.1	9.9	6.8	-	6.8
Operating materials and supplies held for use	130.5	4.6	135.1	126.3	5.2	131.5
Operating materials and supplies held in reserve for future use	-	0.2	0.2	-	0.2	0.2
Operating materials and supplies—excess, obsolete, and unserviceable	2.1	(0.2)	1.9	3.7	(0.3)	3.4
Stockpile materials	0.1	42.9	43.0	0.1	42.2	42.3
Stockpile materials held for sale	1.0	0.3	1.3	1.2	0.3	1.5
Forfeited Property	-	0.2	0.2	-	0.1	0.1
Other related property	0.8	0.8	1.6	0.9	1.1	2.0
Total allowance for inventories and related property	(47.2)	(0.5)	(47.7)	(41.7)	(0.4)	(42.1)
Total inventories and related property, net	231.7	49.6	281.3	222.6	49.4	272.0

Inventory is tangible personal property that is (1) held for sale, principally to Federal agencies, (2) in the process of production for sale, or (3) to be consumed in the production of goods for sale or in the provision of services for a fee.

Inventory purchased for resale is the cost or value of tangible personal property purchased by an agency for resale. DOD, which accounts for nearly all of the inventory purchased for resale in the Government, generally uses the Latest Acquisition Cost (LAC) method, which is revalued for holding gains and losses. DOD is transitioning their inventory to the moving average cost (MAC) method to be compliant with SFFAS No. 3 and approximately 60 percent of their inventory is now reported using MAC.

Inventory held in reserve for future sale is inventory not readily available, or inventory that will be needed in the future.

Inventory and operating materials and supplies held for repair are damaged inventory that require repair to make them suitable for sale (inventory) or is more economic to repair than to dispose of (operating materials and supplies).

Inventory—excess, obsolete, and unserviceable:

- Excess inventory is that which exceeds the demand expected in the normal course of operations and which does not meet management's criteria to be held in reserve for future sale.
- Obsolete inventory is that which no longer is needed due to changes in technology, laws, customs, or operations.
- Unserviceable inventory is inventory damaged beyond economic repair.

Excess, obsolete, and unserviceable inventory is reported at net realizable value.

Please refer to the individual financial statements of DOD and GSA for significant detailed information regarding inventory held for future sale.

Operating materials and supplies held for use are tangible personal property to be consumed in normal operations.

Operating materials and supplies held in reserve for future use are materials retained because they are not readily available in the market or because they will not be used in the normal course of operations, but there is more than a remote chance that they will eventually be needed. DOD, which accounts for most of the reported operating materials and supplies held for use, uses LAC and Standard Price under the purchase and consumption methods of accounting and does not adjust for holding gains and losses, which does not approximate historical cost.

Operating materials and supplies—excess, obsolete, and unserviceable:

- Excess operating materials and supplies are materials that exceed the demand expected in the normal course of operations, and do not meet management's criteria to be held in reserve for future use.
- Obsolete operating materials and supplies are materials no longer needed due to changes in technology, laws, customs, or operations.
- Unserviceable operating materials and supplies are materials damaged beyond economic repair.

DOD, which accounts for most of the reported excess, obsolete, and unserviceable operating materials and supplies, revalues it to a net realizable value of zero through the allowance account.

Please refer to the individual financial statements of DOD and NASA for significant detailed information regarding operating materials and supplies.

Stockpile materials include strategic and critical materials held in reserve for use in national defense, conservation, or national emergencies due to statutory requirements; for example, nuclear materials and oil, and stockpile materials that are authorized to be sold. The majority of the amount reported by the DOD is stockpile materials held for sale, and the amount reported in all others is stockpile materials held in reserve, with the majority of it being reported by DOE. Please refer to their individual financial statements for more information on stockpile materials.

Other related property:

- Commodities include items of commerce or trade that have an exchange value used to stabilize or support market prices. Please refer to the financial statements of the USDA for detailed information regarding commodities.
- Seized monetary instruments are comprised of only monetary instruments that are awaiting judgment to determine ownership. The related liability is included in other liabilities. Other property seized by the Government, such as real property and tangible personal property, is not included as a Government asset. It is accounted for in agency property-management records until the property is forfeited, returned, or otherwise liquidated. Please refer to the individual financial statements of the Department of Justice (Justice), Treasury, and the Department of Homeland Security (DHS) for significant detailed information regarding seized property.
- Forfeited property is comprised of monetary instruments, intangible property, real property, and tangible personal property acquired through forfeiture proceedings; property acquired by the Government to satisfy a tax liability; and unclaimed and abandoned merchandise. Please refer to the individual financial statements of Justice, Treasury, and DHS for significant detailed information regarding forfeited property.
- Other property not classified above.

Note 6. Property, Plant, and Equipment, Net

The category of property, plant, and equipment consists of tangible assets including land, buildings, structures, automated data processing software, and other assets used to provide goods and services. Depreciation and amortization is recognized using the straight-line method over the estimated useful lives of the assets.

Property, Plant, and Equipment as of September 30, 2006

	Cost		Accumulated Depreciation/ Amortization		Net	
(In billions of dollars)	Defense	All Others	Defense	All Others	Defense	All Others
Buildings, structures, and facilities	167.9	180.2	98.4	91.9	69.5	88.3
Furniture, fixtures, and equipment	700.4	127.7	338.6	76.6	361.8	51.1
Construction in progress	20.0	47.2	N/A	N/A	20.0	47.2
Land	10.5	11.0	N/A	N/A	10.5	11.0
Automated data processing software	8.7	8.9	5.3	3.8	3.4	5.1
Assets under capital lease	0.6	1.6	0.5	0.6	0.1	1.0
Leasehold improvements	0.3	4.4	0.2	2.5	0.1	1.9
Other property, plant, and equipment	0.1	50.8	-	33.4	0.1	17.4
Subtotal	908.5	431.8	443.0	208.8	465.5	223.0
Total property, plant, and equipment, net		1,340.3		651.8		688.5

Property, Plant, and Equipment as of September 30, 2005 (Restated)

	Cost		Accumulated Depreciation/ Amortization		Net	
(In billions of dollars)	Defense	All Others	Defense	All Others	Defense	All Others
Buildings, structures, and facilities	163.9	172.7	95.4	87.3	68.5	85.4
Furniture, fixtures, and equipment (restated)	665.5	121.7	316.1	71.1	349.4	50.6
Construction in progress	20.3	44.0	N/A	N/A	20.3	44.0
Land	10.5	10.7	N/A	N/A	10.5	10.7
Automated data processing software	7.9	7.4	4.4	2.7	3.5	4.7
Assets under capital lease	0.6	1.6	0.4	0.5	0.2	1.1
Leasehold improvements	0.3	4.0	0.1	2.3	0.2	1.7
Other property, plant, and equipment	0.2	49.3	-	30.1	0.2	19.2
Subtotal	869.2	411.4	416.4	194.0	452.8	217.4
Total property, plant, and equipment, net		1,280.6		610.4		670.2

For physical quantity information related to the multiuse heritage assets, refer to Note 25—Heritage Assets.

Due to DOD's correction of errors, the fiscal year 2005 furniture, fixtures, and equipment acquisition costs, accumulated depreciation, and the net balances were restated downward by $600.9 billion, $592.7 billion, and $8.2 billion, respectively. Refer to Note 26—Restatements for further detail.

Please refer to the individual financial statements of DOD, NASA, DOE, USPS, and the TVA for significant detailed information for property, plant and equipment. These agencies comprise 83 percent of the Government's total reported net property, plant, and equipment of $688.5 billion as of September 30, 2006.

Note 7. Securities and Investments

Securities and Investments as of September 30

(In billions of dollars)	2006	2005
Securities and investments:		
Pension Benefit Guaranty Corporation[1]	35.5	30.8
NRRIT	28.6	26.1
Exchange Stabilization Fund	9.3	9.4
All other	10.4	9.0
Total Securities and Investments	83.8	75.3

[1] For more information, see the Social Insurance, Railroad Retirement, segment in the Supplemental Information section.

These securities and investments do not include nonmarketable Treasury securities, which have been eliminated in consolidation. They are presented at cost, net of unamortized premiums and discounts. The Pension Benefit Guaranty Corporation (PBGC) invests primarily in fixed maturity and equity securities. As discussed in the Railroad Retirement section of Supplemental Information—Social Insurance, the NRRIT manages and invests railroad retirement assets that are to be used to pay retirement benefits to the Nation's railroad workers under the Railroad Retirement Program, a social insurance program. Treasury's Exchange Stabilization Fund invests primarily in foreign currency, bonds, and bills.

Note 8. Other Assets

Other Assets as of September 30

(In billions of dollars)	2006	2005
Advances and prepayments	29.9	32.8
Other	25.5	23.9
Total other assets	55.4	56.7

Other assets include advances and prepayments which represent funds disbursed in contemplation of the future performance of services, receipt of goods, the incurrence of expenditures, or the receipt of other assets. These include advances to contractors and grantees, travel advances, and prepayments for items such as rents, taxes, insurance, royalties, commissions, and supplies.

Other items included in other assets are regulatory assets, purchased power generating capacity, deferred nuclear generating units, nonmarketable equity investments in international financial institutions, the balance of assets held by the experience-rated carriers participating in the Health Benefits and Life Insurance Program carriers (pending disposition on behalf of OPM), and receivables from bank and thrift resolutions.

Note 9. Accounts Payable

Accounts Payable as of September 30

(In billions of dollars)	2006	2005
Department of Defense	27.4	28.6
Department of Agriculture	4.2	4.3
Department of Homeland Security	2.8	3.3
Agency for International Development	2.3	3.2
Department of Justice	2.3	1.9
Pension Benefit Guaranty Corporation	2.2	9.3
U.S. Postal Service	2.0	2.3
General Services Administration	2.0	2.1
National Aeronautics and Space Administration	1.7	2.1
Department of Energy	1.3	1.4
Department of State	1.3	1.3
Department of the Interior	1.1	1.0
Tennessee Valley Authority	1.1	0.8
Department of Labor	0.9	1.1
Department of Education	0.9	0.7
All other departments	4.9	4.5
Total accounts payable	58.4	67.9

The accounts payable table includes accounts payable for goods and property ordered and received, services rendered by other than Federal employees, and accounts payable for cancelled appropriations.

Note 10. Federal Debt Securities Held by the Public and Accrued Interest

Definitions of Debt

Debt Held by the Public—Federal debt held outside the Government by individuals, corporations, State or local governments, Federal Reserve banks, and foreign governments and central banks.

Intragovernmental Debt Holdings—Federal debt held by Government trust funds, revolving funds, and special funds.

Federal Debt Securities Held by the Public and Accrued Interest

(In billions of dollars)	Balance September 30, 2005	Net Change During Fiscal Year 2006	Balance September 30, 2006	Average Interest Rate 2006	Average Interest Rate 2005
Treasury Securities (Public):					
Marketable securities:					
Treasury bills	910.3	(1.8)	908.5	5.0%	3.4%
Treasury notes	2,328.2	117.1	2,445.3	4.2%	3.7%
Treasury bonds	520.5	14.0	534.5	7.6%	7.9%
Treasury inflation-protected securities (TIPS)	307.0	88.5	395.5	2.3%	2.4%
Total marketable Treasury securities	4,066.0	217.8	4,283.8		
Nonmarketable securities	535.2	24.1	559.3	5.0%	4.9%
Net unamortized premium/ (discounts)	(35.5)	(4.7)	(40.2)		
Total Treasury securities, net (public)	4,565.7	237.2	4,802.9		
Agency Securities:					
Tennessee Valley Authority	22.9	-	22.9		
All other agencies	0.3	(0.1)	0.2		
Total agency securities, net of unamortized premiums and discounts	23.2	(0.1)	23.1		
Accrued interest payable	35.3	6.2	41.5		
Total Federal debt securities held by the public and accrued interest	4,624.2	243.3	4,867.5		

Types of marketable securities:
Bills – Short-term obligations issued with a term of 1 year or less.
Notes – Medium-term obligations issued with a term of at least 1 year, but not more than 10 years.
Bonds – Long-term obligations of more than 10 years.
TIPS – Term of more than 5 years.

This table details Government borrowing to finance operations and shows marketable and nonmarketable securities at face value less net unamortized discounts including accrued interest.

Securities that represent Federal debt held by the public are issued primarily by the Treasury and include:

- Interest-bearing marketable securities (bills, notes, bonds, and inflation-protected).
- Interest-bearing nonmarketable securities (foreign series, State and local government series, domestic series, and savings bonds).
- Non interest-bearing marketable and nonmarketable securities (matured and other).

Section 3111 of Title 31, United States Code (U.S.C.) authorizes the Secretary of the Treasury to use money received from the sale of an obligation and other money in the General Fund of the Treasury to buy, redeem, or refund, at or before maturity, outstanding bonds, notes, certificates of indebtedness, Treasury bills, or savings certificates of the Government. There were no buyback operations in fiscal years 2006 and 2005.

As of September 30, 2006, and 2005, respectively, $8,420.3 billion and $7,871.0 billion of debt were subject to a statutory limit (31 U.S.C. § 3101). That limit was $8,965.0 billion as of September 30, 2006, and $8,184.0 billion as of

September 30, 2005. The debt subject to the limit includes Treasury securities held by the public and Government guaranteed debt of Federal agencies (shown in the table above) and intragovernmental debt holdings (shown in the table below).

Intragovernmental debt holdings represent the portion of the gross Federal debt held as investments by Government entities. This includes trust funds that are earmarked funds. For fiscal year 2005, these trust funds were reported as dedicated collections. For more information on earmarked funds and dedicated collections, see Note 20─Earmarked Funds and Note 21─Dedicated Collections. These intragovernmental debt holdings are eliminated in the consolidation of these financial statements.

Intragovernmental Debt Holdings: Federal Debt Securities Held as Investments by Government Accounts as of September 30

(In billions of dollars)	Balance 2005	Net Change During Fiscal Year 2006	Balance 2006
Social Security Administration, Federal Old-Age and Survivors Insurance	1,616.1	177.0	1,793.1
Office of Personnel Management, Civil Service Retirement and Disability	660.8	29.1	689.9
Department of Health and Human Services, Federal Hospital Insurance	277.3	24.9	302.2
Social Security Administration, Federal Disability Insurance	193.3	8.9	202.2
Department of Defense, Military Retirement Fund	177.3	4.5	181.8
Department of Defense, Medicare-Eligible Retiree Health Care Fund	52.9	19.8	72.7
Department of Labor, Unemployment	54.8	11.4	66.2
Federal Deposit Insurance Corporation Funds	48.2	1.1	49.3
Pension Benefit Guaranty Corporation Fund	13.0	23.6	36.6
Department of Energy, Nuclear Waste Disposal	33.5	3.0	36.5
Department of Health and Human Services, Federal Supplementary Medical Insurance	17.2	15.1	32.3
Office of Personnel Management, Employees' Life Insurance	29.5	1.8	31.3
Housing and Urban Development, Federal Housing	22.6	(0.6)	22.0
Department of Treasury, Exchange Stabilization Fund	15.2	0.5	15.7
Office of Personnel Management, Employees Health Benefits	12.5	2.3	14.8
Department of State, Foreign Services Retirement and Disability Fund	13.4	0.5	13.9
Department of Transportation, Highway Trust Fund	8.3	2.7	11.0
Department of Veterans Affairs, National Service Life Insurance Fund	10.6	(0.4)	10.2
Department of Transportation, Airport and Airway Trust Fund	10.0	(2.0)	8.0
All other programs and funds	65.0	9.2	74.2
Subtotal	3,331.5	332.4	3,663.9
Unamortized net (discounts)/premiums	14.7	(15.9)	(1.2)
Total intragovernmental debt holdings, net	3,346.2	316.5	3,662.7

Note 11. Federal Employee and Veteran Benefits Payable

The Government offers its employees life and health insurance, as well as retirement and other benefits. These benefits, which include actuarial and amounts due and payable to beneficiaries and health care carriers, apply to civilian and military employees.

The Federal Government administers more than 40 pension plans. OPM administers the largest civilian plan. DOD, meanwhile, administers the largest military plan. Other significant pension plans with more than $10 billion in accrued benefits payable include those of the Coast Guard and the Foreign Service. The changes in the accrued post-retirement pension and health benefit liability and components of related expense for the years ended September 30, 2006, and 2005, respectively, are presented below.

Federal Employee and Veteran Benefits Payable as of September 30

	Civilian		Military		Total	
(In billions of dollars)	2006	2005	2006	2005	2006	2005
Pension and accrued benefits	1,349.0	1,273.8	967.1	895.4	2,316.1	2,169.2
Post-retirement health and accrued benefits	295.2	290.7	837.2	833.9	1,132.4	1,124.6
Veterans compensation and burial benefits	N/A	N/A	1,153.8	1,122.6	1,153.8	1,122.6
Life insurance and accrued benefits	34.2	32.9	-	-	34.2	32.9
FECA benefits	14.4	14.3	22.2	22.7	36.6	37.0
Liability for other benefits	1.5	1.3	4.4	4.2	5.9	5.5
Total Federal employee and veteran benefits payable	1,694.3	1,613.0	2,984.7	2,878.8	4,679.0	4,491.8

Change in Pension and Accrued Benefits

(In billions of dollars)	Civilian	Military	Total
Actuarial accrued pension liability as of September 30, 2005	1,273.8	895.4	2,169.2
Pension Expense:			
Normal costs	26.8	15.6	42.4
Plan amendment changes	-	0.1	0.1
Assumption changes	1.0	35.4	36.4
Interest on liability	78.0	55.0	133.0
Prior (and past) service cost	-	-	-
Actuarial (gains)/losses	29.7	6.1	35.8
Total pension expense	135.5	112.2	247.7
Less benefits paid	60.3	40.5	100.8
Actuarial accrued pension liability as of September 30, 2006	1,349.0	967.1	2,316.1

Significant Long-Term Economic Assumptions Used in Determining Pension Liability and the Related Expense

	Civilian		Military	
(In percentages)	2006	2005	2006	2005
Rate of interest	6.25%	6.25%	6.00%	6.25%
Rate of inflation	3.50%	3.25%	3.00%	3.00%
Projected salary increases	4.25%	4.00%	3.75%	3.75%

Change in Post-Retirement Health and Accrued Benefits

(In billions of dollars)	Civilian	Military	Total
Actuarial accrued post-retirement health benefits liability, as of September 30, 2005	290.7	833.9	1,124.6
Post-Retirement Health Benefits Expense:			
Normal costs	11.2	21.0	32.2
Interest on liability	17.1	52.9	70.0
Other actuarial (gains)/losses	(12.5)	(53.8)	(66.3)
Total post-retirement health benefits expense	15.8	20.1	35.9
Less claims paid	11.3	16.8	28.1
Actuarial accrued post-retirement health benefits liability, as of September 30, 2006	295.2	837.2	1,132.4

Significant Long-Term Economic Assumptions Used in Determining Post-Retirement Health Benefits and the Related Expense

	Civilian		Military	
(In percentages)	2006	2005	2006	2005
Rate of interest	6.25%	6.25%	6.25%	6.25%
Rate of health care cost inflation	7.00%	7.00%	6.25%	6.25%

Separate boards of actuaries for OPM and DOD determine the actuarial assumptions used in calculating the pension liability and the post-retirement health benefit liability for the civilian and military personnel. Both boards use generally accepted actuarial methodologies. The board for OPM uses a fixed rate of inflation and projected salary increases over all years for both the pension and post-retirement health benefit liabilities. These rates are shown in the tables above. The board for DOD uses a range of rates for the inflation and the projected salary increases, with an ultimate rate for the long term. The board for DOD also uses different health care cost inflation rates for inpatient, outpatient, and prescription drugs. The long-term ultimate rate is shown in the tables above.

The long-term ultimate rate for fiscal year 2006 of 6.25 percent is shown in the tables above. For disclosure and comparison purposes, DOD's estimate of a single equivalent fixed rate of health care cost inflation for fiscal year 2006 is 7.20 percent, which is an approximation of the single equivalent rate that would produce that same actuarial liability as the actual rates used.

Civilian Employees

Pensions

OPM administers the largest civilian pension plan, which covers approximately 90 percent of all Federal civilian employees. This plan includes two components of defined benefits. These are the Civil Service Retirement System (CSRS) and the Federal Employees' Retirement System (FERS). The basic benefit components of the CSRS and the FERS are financed and operated through the Civil Service Retirement and Disability Fund (CSRDF).

CSRDF monies are generated primarily from employees' contributions, agency contributions, payments from the General Fund, and interest on investments in Treasury securities. See Note 20—Earmarked Funds.

The Federal Retirement Thrift Investment Board, an independent Government agency, administers the Thrift Savings Plan (TSP) Fund. The TSP Fund includes the C-Fund, S-Fund, F-Fund, I-Fund, and G-Fund, and the newly established L-Funds. These financial statements exclude this fund because the CSRS and FERS employees own its assets.

Treasury securities held in the G-Fund are included and classified as Treasury securities held by the public. Beginning January 2006, there are no limits on the percentage of contribution to the plan for CSRS and FERS employees, as long as they do not exceed the Internal Revenue Service elective deferral limit, which is $15,000 for 2006. FERS participants received the following: Agency Automatic (1 percent) Contributions; Agency Matching Contributions; and vesting is immediate for agency automatic contributions and attributable earnings. Vesting is generally 3 years for agency matching contributions and attributable earnings. To receive the maximum agency Matching Contribution, FERS employees must contribute at least five percent of the basic pay each pay period during the year. (The first five percent of the basic pay each pay period is matched dollar-for-dollar on the first percent, and 50 cents on the dollar for the next two percent.) CSRS employees do not receive any agency contributions.

The G-Fund held $72.2 billion and $63.5 billion in nonmarketable Treasury securities as of September 30, 2006, and 2005, respectively. The Federal Government's related liability is included in total Federal debt securities held by the public and accrued interest in the balance sheets.

The L-Funds, established August 1, 2005, diversifies participant accounts among the G, F, C, S, and I Funds, using professionally determined investment mixes (allocations) that are tailored to different time horizons.

Health Benefits

The post-retirement civilian health benefit liability is an estimate of the Government's future cost of providing post-retirement health benefits to current employees and retirees. Although active and retired employees pay an insurance premium under the Federal Employees Health Benefits Program, these premiums cover only a portion of the costs. The OPM actuary applies economic assumptions to historical cost information to estimate the liability, which is then reduced by certain operating costs and premiums received during the year.

Other Benefits

One of the largest other employee benefits is the Federal Employee Group Life Insurance Program. Employee and annuitant contributions and interest on investments fund a portion of this liability. The actuarial life insurance liability is the expected present value of future benefits to pay to, or in behalf of, existing Life Insurance Program participants. The OPM actuary uses interest rate, inflation, and salary increase assumptions that are consistent with the pension liability.

Military Employees (Including Veterans)

Pensions

The DOD Military Retirement Fund (MRF) finances military retirement and survivor benefit programs. The increase in the actual liability for Military Pensions is largely the result of a decrease in the assumed interest rate on invested balances, and thus a decrease in the associated assumed earnings of $32.8 billion and an increase in the actuarial liability. The majority of the remaining change is due to expected liability increases.

Projected revenues into the MRF come from three sources: interest earnings on MRF assets, monthly DOD contributions, and annual contributions from the Treasury Department. Beginning with fiscal year 2005, the contributions made by Treasury were increased by an amount equal to the annual expense for the new concurrent receipt provision of the fiscal year 2004 National Defense Authorization Act.

The military retirement system consists of a funded, noncontributory, defined benefit plan. It applies to the Departments of the Army, Navy, Air Force, and Marine Corps. This system includes nondisability retirement pay, disability retirement pay, and retirement pay for reserve service and survivor annuity programs. Military personnel (Army, Navy, Marine Corps, and Air Force) who remain on active duty for 20 years or longer are eligible for retirement. There are three different retirement systems that are currently being used by the military: Final Pay, High-3 Year Average, and the Military Retirement Reform Act of 1986 (REDUX). The date each individual enters the military determines which retirement system they would fall under and if they have the option to pick their retirement system.

Final Pay Retirement System: Final Pay applies to individuals who entered the Service before September 8, 1980. Each year of service is worth 2.5 percent towards the retirement multiplier. The longer an individual stays on active duty, the higher the multiplier and the higher the retirement income, up to the maximum of 75 percent. This multiplier is applied against the final basic pay of the individual’s career. A cost of living adjustment (COLA) is given annually based on the increase in the CPI.

High–3 Year Average Retirement System: High–3 Year Average applies to members who first entered the Service after September 8, 1980, but before August 1, 1986. It also applies to individuals who entered on or after August 1, 1986, who do not elect the REDUX retirement system with the $30,000 career status bonus (CSB) at their 15^{th} year of service. The High–3 Year Average calculation is similar to the Final Pay except the High-3 Year Average uses the multiplier against basic pay for the highest 36 months of the individual’s career. A COLA is given annually based on the increase in the CPI.

CSB/REDUX Retirement System: The REDUX applies to those who entered the Service on or after August 1, 1986, and who elected to receive the $30,000 CSB at their 15^{th} year of service. Under the CSB/REDUX retirement system, each of the first 20 years of service is worth 2 percent towards the retirement multiplier and each year after 20 years of service is worth 3.5 percent. The retirement multiplier under this retirement system is applied against the average basic pay for the highest 36 months of the individual’s basic pay. A COLA is given annually based on the increase in the CPI minus 1 percent. Members retiring under CSB/REDUX receive a one-time catchup at age 62 that restores the retired pay to what it would have been at that point had the member retired under High-3 Year Average. Thereafter, CSB/REDUX members receive reduced (i.e., based on the increase in the CPI minus 1 percent) COLAs for life.

On October 30, 2000, the Floyd D. Spence National Defense Authorization Act for fiscal year 2001 (Public Law No. 106-398) was signed into law. This law extended participation in the TSP to members of the uniformed services. Members may contribute from their pay, and their contributions and earnings attributable to their TSP belongs to them even if they do not serve the 20 or more years ordinarily required to receive retirement pay.

Health Benefits

Military benefits entitle retirees and their dependents to health care in military medical facilities if a facility can provide the needed care. Until they reach age 65, military retirees and their dependents also are entitled to be reimbursed for the cost of health care from civilian providers. A premium is charged to enroll in DOD's civilian care program. In addition, there are deductible and copayment requirements for civilian care. Medicare, and since fiscal year 2002, Tricare as secondary payer, covers military retirees after they reach 65 years of age.

Military retiree health care figures include the cost of education and training, staffing, buildings and equipment, as well as the operation and maintenance of medical facilities. They also include claims paid to civilian providers and the cost of administering the program.

Chapter 56 of Title 10, U.S.C. created the DOD Medicare-Eligible Retiree Health Care Fund effective October 1, 2002. The purpose of this fund is to account for the health benefits of Medicare-eligible members and former members of the DOD Uniformed Services who are entitled to retirement or retainer pay, and their eligible dependents who are Medicare eligible.

In addition to the health care benefits for civilian and military retirees and their dependents, the VA also provides medical care to veterans on an "as available" basis, subject to the limits of the annual appropriations. In accordance with 38 CFR 17.36 (c), VA's Secretary makes an annual enrollment decision that defines the veterans, by priority, who will be treated for that fiscal year subject to change based on funds appropriated, estimated collections, usage, the severity index of enrolled veterans, and changes in cost. VA recognizes the medical care expenses in the period the medical care services are provided. For the time period 2002-2006, the average medical cost per year was $25.7 billion.

Veterans Compensation and Burial Benefits

The Government compensates disabled veterans and their survivors. Veterans compensation is payable as a disability benefit or a survivor's benefit. Entitlement to compensation depends on the veteran's disabilities having been incurred in, or aggravated during, active military service; death while on duty; or death resulting from service-connected disabilities, if not in active duty.

Burial benefits include a burial and plot or interment allowance payable for a veteran who, at the time of death, is qualified to receive compensation or a pension, or whose death occurred in a VA facility.

The liability for veteran's compensation and burial benefits payable increased by $31.2 billion in fiscal year 2006 and increased by $197.8 billion in fiscal year 2005. The primary factors contributing to these fluctuations were changes in interest rates and other actuarial assumptions; various assumptions in the actuarial model, such as the number of veterans and dependents receiving payments; and life expectancy.

Veterans Compensation and Burial Benefits as of September 30

(In billions of dollars)	2006	2005
Veterans	970.8	925.4
Survivors	179.1	193.4
Burial benefits	3.9	3.8
Total compensation and burial benefits payable	1,153.8	1,122.6

Significant Economic Assumptions Used in Determining Veterans Compensation and Burial Benefits as of September 30

(In percentages)	2006	2005
Rate of interest	4.76%	3.93%
Rate of inflation	4.10%	3.60%

Other Benefits

Veterans insurance includes the following programs:

- United States Government Life Insurance, established in 1919 to handle new issues and the conversion of World War I Risk Term Insurance.
- National Service Life Insurance, established in 1940 to meet the needs of World War II service personnel.
- Veterans Special Life Insurance, established in 1951 for Korean veterans who did not have service-connected disabilities.
- Service-Disabled Veterans Insurance, established in 1951 for veterans with service-connected disabilities.
- Veterans Reopened Insurance, which established a 1-year reopening in 1965 of National Service Life Insurance for certain disabled World War II and Korean veterans.

The VA supervises Service members' Group Life Insurance and Veterans' Group Life Insurance programs which provide life insurance coverage to members of the uniformed armed services, reservist, and post-Vietnam veterans. The VA also provides certain veterans and/or their dependents with pension benefits, based on annual eligibility reviews, if the veteran died or was disabled for nonservice-related causes. The actuarial present value of the future liability for pension benefits is a nonexchange transaction and is not required to be recorded on the balance sheet. The projected amounts of future payments for pension benefits as of September 30, 2006, and 2005 were $97.0 billion and $96.8 billion, respectively.

Note 12. Environmental and Disposal Liabilities

Environmental and Disposal Liabilities as of September 30

(In billions of dollars)	2006	2005
Department of Energy:		
Environmental Management Facilities	159.1	121.4
Active and Surplus Facilities	27.6	26.0
Legacy Environmental Liabilities	18.2	17.5
High-level Waste and Spent Nuclear Fuel	15.5	15.1
Surplus Plutonium and HEU Disposition	9.9	9.8
Total Department of Energy	230.3	189.8
Department of Defense:		
Environmental Restoration	33.5	36.0
Disposal of Weapon Systems Program	30.2	23.2
Base Realignment and Closure	4.1	4.1
Active Installations	2.2	1.7
Total Department of Defense	70.0	65.0
All other agencies	4.9	5.0
Total environmental and disposal liabilities	305.2	259.8

During World War II and the Cold War, DOE (or predecessor agencies) developed a massive industrial complex to research, produce, and test nuclear weapons. The nuclear weapons complex included nuclear reactors, chemical-processing buildings, metal machining plants, laboratories, and maintenance facilities.

At all the sites where these activities took place, some environmental contamination occurred. This contamination was caused by the production, storage, and use of radioactive materials and hazardous chemicals, which resulted in contamination of soil, surface water, and groundwater. The environmental legacy of nuclear weapons production also includes thousands of contaminated areas and buildings, and large volumes of waste and special nuclear materials requiring treatment, stabilization, and disposal.

Of those environmental liabilities, this report presents only cleanup costs from Federal operations known to result in hazardous and radioactive waste that the Government is required to clean up by Federal, State, or local statutes and/or regulations. Some of these statutes are the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA); the Resource Conservation and Recovery Act; and the Nuclear Waste Policy Act of 1982, which provides for permanent disposal of the Nation's high-level radioactive waste and spent nuclear fuel; and Public Law No. 105-204, which requires a plan for the conversion of depleted uranium hexaflouride.

DOE is responsible for managing the legacy of contamination from the nuclear weapons complex. The environmental management baseline estimate includes projections of the technical scope, schedule, and costs for environmental restoration; managing nuclear materials waste treatment, storage and disposal activities; and post-cleanup monitoring and stewardship at each installation. The baseline estimate includes costs for related activities such as landlord responsibilities, program management, and legally prescribed grants and cooperative agreements for participation and oversight by Native American tribes, regulatory agencies, and other stakeholders. Active and surplus facilities represent anticipated remediation costs for those facilities that are conducting ongoing operations but ultimately will require stabilization, deactivation, and decommissioning.

Estimated cleanup costs at sites for which there are no current feasible remediation approach are excluded from the baseline estimates, although applicable stewardship and monitoring costs for these sites are included. Significant projects not included are the Nuclear explosion test areas (e.g., Nevada test site).

Estimating DOE's environmental cleanup liability requires making assumptions about future activities and is inherently uncertain. The future course of DOE's environmental management program will depend on a number of fundamental technical and policy choices to be made in the future. The sites and facilities could be restored to a pristine condition suitable for any desirable use, or could be restored to a point where they pose no near-term health risks. Achieving pristine conditions would have a higher cost but may, or may not, warrant the costs and potential ecosystem disruption, or be legally required. The environmental estimates include contingency estimates intended to account for the uncertainties associated with the technical cleanup scope of the program.

DOE's environmental liability estimates are dependent on annual funding levels and achievement of work as scheduled. Recent increases in project cost estimates have created a significant gap between DOE's preliminary budgetary funding levels and the estimated costs of performing the work as recorded in the environmental liability estimates. If additional funding is not received, cleanup work scope will need to be extended and delayed resulting in higher costs.

DOE is also required to recognize closure and post-closure costs for its general property, plant, and equipment and environmental corrective action costs for current operations. The cleanup cost associated with general property, plant, and equipment that is allocated to operating periods beyond the balance sheet date is identified as the unrecognized portion. The DOE unrecognized portion of the cleanup cost associated with general property, plant, and equipment is $505.0 million and $440.0 million for fiscal years 2006 and 2005, respectively. The unrecognized portion of the cleanup cost is recognized over a predetermined period of time. Please refer to the financial statements of the Department of Energy for significant detailed information regarding DOE's environmental and disposal liabilities, including cleanup costs.

DOD is required to clean up contamination resulting from waste disposal practices, leaks, spills, and other activities that have created a public health or environmental risk. DOD must restore active installations, installations affected by base realignment and closure, and other areas formerly used as defense sites. DOD also bears responsibility for disposal of chemical weapons and environmental costs associated with the disposal of weapons systems (primarily nuclear powered aircraft carriers and submarines). DOD is responsible, as well, for training range and other nonrange unexploded ordnance cleanup.

DOD is required by law to adhere to CERCLA and the Superfund Amendment and Reauthorization Act to clean up contamination resulting from past waste disposal practices, leaks, spills, and other activities which have created a risk to public health or the environment. The Army is DOD's executive agent for cleaning up contamination at sites formerly used by DOD. CERCLA requires DOD to clean up contamination in coordination with regulatory agencies, other responsible parties, and current property owners.

DOD is currently using two independently validated estimating models, in addition to engineering estimates, to report its environmental liabilities. The models are the Remedial Action Cost Engineering Requirements (RACER) and the Department of Navy Normalization of Data System (NORM). These two methods of valuation are used in this note's table. Additionally, cost estimates are based on the following: (1) historic comparable project, (2) a specific bid or independent Government cost estimate for the project, (3) site level data, and (4) annual cost-to-complete estimate.

DOD is also required to recognize closure and post-closure costs for its general property, plant, and equipment and environmental corrective action costs for current operations. The cleanup cost associated with general property, plant, and equipment that is allocated to operating periods beyond the balance sheet date is identified as the unrecognized portion. The DOD unrecognized portion of the cleanup cost associated with general property, plant, and equipment is $1,527.4 million and $152.1million for fiscal years 2006 and 2005, respectively. The unrecognized portion of the cleanup costs is recognized over a predetermined period of time. Please refer to the financial statements of the Department of Defense for further detailed information regarding DOD's environmental and disposal liabilities, including cleanup costs.

Note 13. Benefits Due and Payable

These amounts are the benefits owed to program recipients or medical service providers as of the fiscal yearend that have not been paid. For a description of the programs, see the Supplemental Information—Social Insurance section.

Benefits Due and Payable as of September 30

(In billions of dollars)	2006	2005
Federal Old-Age and Survivors Insurance	41.6	39.3
Federal Supplementary Medical Insurance (Medicare Part B)	21.1	16.6
Federal Disability Insurance	20.9	19.2
Federal Hospital Insurance (Medicare Part A)	19.8	16.8
Grants to States for Medicaid	19.2	20.1
Supplemental Security Income	3.5	2.8
Unemployment Insurance	1.1	0.9
All Other Benefit Programs	2.1	1.3
Total benefits due and payable	129.3	117.0

Note 14. Insurance Program Liabilities

Insurance Program Liabilities as of September 30

(In billions of dollars)	2006	2005
Insurance Program Liabilities:		
Pension Benefit Guaranty Corporation's defined benefit pension plans	69.1	69.8
National Flood Insurance Program	3.6	23.4
All other insurance programs	0.1	-
Total Insurance Programs	72.8	93.2

Insurance programs are Federal programs that provide protection to individuals or entities against specified risks except for those Federal employees or veterans discussed in Note 11—Federal Employee and Veteran Benefits Payable. These funds are commonly held in revolving funds with the Federal Government, and losses sustained by participants are paid from these funds. Many of these programs receive appropriations to pay excess claims and/or have authority to borrow from the Treasury. Insurance programs do not include social insurance, loan guarantee programs, and programs designed to benefit only current, former, and dependents of Federal employees.

PBGC insures pension benefits of participants in covered defined benefit pension plans. As a wholly owned corporation of the U.S. Government, PBGC's financial activity and balances are included in the consolidated financial statements of the U.S. Government. However, under current law, PBGC's liabilities may be paid only from PBGC's assets and not from the General Fund of the Treasury or assets of the Government generally. As of September 30, 2006, PBGC had total liabilities of $80.0 billion, and its total liabilities exceeded its total assets by $18.9 billion. In addition, as discussed in Note 18—Contingencies, PBGC reported reasonably possible contingent losses of about $73.4 billion.

The Federal Emergency Management Agency of DHS administers the National Flood Insurance Program (NFIP). The NFIP is administered through sale or continuation-in-force of insurance in communities that enact and enforce appropriate flood plain management measures. This liability represents an estimate of NFIP losses that are unpaid at the balance sheet date and is based on the loss and loss adjustment expense factors, including interest payments, inherent in the NFIP insurance underwriting operations experience and expectations.

Note 15. Other Liabilities

Other Liabilities as of September 30

(In billions of dollars)	2006	2005 (Restated)
Nuclear Waste Fund	21.1	19.6
Other Accrued Liabilities	19.9	23.2
Contingent liabilities	17.6	6.6
Accrued wages and benefits	15.3	16.0
Accrued annual leave	14.2	9.5
Deferred revenue	13.8	8.5
Accrued grant liability	12.8	10.4
Actuarial liabilities	12.0	11.6
Gold certificates	11.0	10.9
Deposit funds and undeposited collections	9.8	11.2
Exchange Stabilization Fund	9.4	9.3
Custodial liabilities	9.2	7.3
District of Columbia pension liabilities	9.1	8.5
Other debt	8.8	8.8
Energy Employees Occupational Illness Compensation Act	6.9	7.4
Miscellaneous liabilities	43.4	44.4
Total Other Liabilities	234.3	213.2

The following are descriptions of some of the other categories (i.e., those over $8 billion) classified as other liabilities:

- Nuclear Waste Fund (NWF) refers to revenues that are accrued by DOE based on fees assessed against owners and generators of high-level radioactive waste and spent nuclear fuel and interest accrued on investments in Treasury securities. These revenues are recognized as revenues as costs are incurred for NWF activities.
- Other accrued liabilities include amounts accrued by the USDA for the Tobacco Transition Program, Direct and Counter-Cyclical Program, Conservation Reserve Program, and other accrued liabilities.
- Contingent liabilities include amounts accrued by DOE for Spent Nuclear Fuel Litigation, and amounts accrued by DOD for future contract financing payments and other contingent liabilities.
- Accrued wages and benefits consist of the estimated liability for civilian and military salaries and wages earned but unpaid.
- Accrued annual leave represents the dollar value of annual leave accrued to employees for annual leave hours earned but not used, and that is expected to be paid from future years' appropriations. Annual leave is an expense which accrues as it is earned by employees.
- Deferred revenue refers to revenue received but not yet earned, such as payments received in advance from outside sources for future delivery of products or services.
- Accrued grant liability represents the accruals related to grant program funds provided primarily to State and local governments, as well as universities and nonprofit organizations.
- Actuarial liabilities include the estimated liability for the future benefit payments of contracted employees at the DOE. These are not for employee related benefit payments and therefore are not reflected in the Federal Employee and Veteran Benefits Payable footnote.
- Gold certificates include monetized portions of gold and certificates deposited in FRBs.

- Deposit funds and undeposited collections are deposits held and maintained by the Government on behalf of a third party and include unclassified deposited funds that are amounts offsetting undeposited collections, as well as funds deposited in clearing accounts and suspense accounts that await disposition or reclassification.
- Exchange Stabilization Fund includes SDR certificates issued to the FRBs and allocations from the IMF.
- Custodial liabilities include funds collected into the Foreign Military Sales Trust Fund in advance of the performance of services or sale of articles.
- District of Columbia (D.C.) pension liability represents the amount payable to the Judicial Retirement Fund and the D.C. Federal Pension Fund by Treasury for the annual amortized payments that are required to be made from the General Fund of the U.S. Government to fund certain D.C. retirement plans.
- Other debt includes Government obligations, whether secured or unsecured, not included in public debt.
- Miscellaneous liabilities include amounts accrued for other liabilities by PBGC, DOD, TVA, DOE, VA, Treasury, and the DOI. Refer to the financial statements and footnotes of the respective agencies for additional details.

Note 16. Collections and Refunds of Federal Revenue

Collections of Federal Revenue for the Year Ended September 30, 2006

(In billions of dollars)	Federal Revenue Collections	Tax Year to Which Collections Relate			
		2006	2005	2004	Prior Years
Individual income and tax withholdings	2,034.2	1,309.4	690.8	17.3	16.7
Corporation income taxes	380.4	259.1	103.8	1.7	15.8
Unemployment taxes	41.6	22.8	10.1	8.6	0.1
Excise taxes	74.8	55.5	19.0	0.1	0.2
Estate and gift taxes	28.7	0.1	18.8	1.2	8.6
Railroad retirement taxes	4.7	3.6	1.1	-	-
Federal Reserve earnings	29.9	24.1	5.8	-	-
Fines, penalties, interest, and other revenue	2.4	2.0	0.4	-	-
Custom duties	25.9	25.9	-	-	-
Subtotal	2,622.6	1,702.5	849.8	28.9	41.4
Less: amounts collected for non-federal entities	(0.4)				
Total	2,622.2				

Treasury is the Government's principal revenue-collecting agency. Collections of individual income tax and tax withholdings consist of FICA/SECA and other taxes including payroll taxes collected from other agencies.

Federal Tax Refunds Disbursed for the Year Ended September 30, 2006

(In billions of dollars)	Refunds Disbursed	Tax Year to Which Refunds Relate 2006	2005	2004	Prior Years
Individual income and tax withholdings	245.2	0.6	225.5	13.5	5.6
Corporation income taxes	30.5	1.2	8.8	3.9	16.6
Unemployment taxes	0.1	-	0.1	-	-
Excise taxes	0.7	-	0.5	-	0.2
Estate and gift taxes	1.3	0.5	0.2	0.3	0.3
Custom duties	1.1	1.1	-	-	-
Total	278.9	3.4	235.1	17.7	22.7

Reconciliation of Collections to Revenue

(In billions of dollars)	2006	2005
Total revenue per the Statements of Operations and Changes in Net Position	2,440.8	2,185.5
Tax refunds	278.9	268.3
Earned Income Tax Credit and Child Tax Credit Imputed Revenue	(57.0)	(55.3)
Nontax related fines and penalties reported by agencies	(23.4)	(19.2)
Nontax related earned revenue	(17.1)	(19.2)
Collections of Federal revenue	2,622.2	2,360.1

Total revenue in the Statements of Operations and Changes in Net Position is presented on a modified cash basis, is net of tax refunds, and includes Earned Income Tax Credit (EITC) payments and other nontax related revenue. EITC and Child Tax Credit amounts (unaudited) are included in gross cost in the Statements of Net Cost as a component of Treasury.

On the other hand, collections of Federal revenue reported in the table in this Note are reported on a gross cash basis. The table above reconciles total revenue to collections.

Collections of Federal Revenue for the Year Ended September 30, 2005

(In billions of dollars)	Federal Revenue Collections	Tax Year to Which Collections Relate 2005	2004	2003	Prior Years
Individual income and tax withholdings	1,864.7	1,211.9	620.9	13.9	18.0
Corporation income taxes	306.9	209.4	83.1	1.2	13.2
Unemployment taxes	40.1	22.2	9.9	7.9	0.1
Excise taxes	72.4	52.8	18.9	0.1	0.6
Estate and gift taxes	25.6	0.1	16.6	1.3	7.6
Railroad retirement taxes	4.5	3.4	1.1	-	-
Federal Reserve earnings	19.3	14.2	5.1	-	-
Fines, penalties, interest, and other revenue	4.3	3.9	0.4	-	-
Custom duties	23.2	23.2	-	-	-
Subtotal	2,361.0	1,541.1	756.0	24.4	39.5
Less: Amounts collected for non-federal entities	(0.9)				
Total	2,360.1				

Federal Tax Refunds Disbursed for the Year Ended September 30, 2005

(In billions of dollars)	Refunds Disbursed	Tax Year to Which Refunds Relate 2005	2004	2003	Prior Years
Individual income and tax withholdings	230.0	0.6	211.1	12.8	5.5
Corporation income taxes	35.1	1.0	7.2	5.5	21.5
Unemployment taxes	0.1	-	0.1	-	-
Excise taxes	1.0	0.3	0.3	-	0.3
Estate and gift taxes	0.9	-	0.3	0.4	0.3
Custom duties	1.2	0.7	0.1	-	0.3
Total	268.3	2.6	219.1	18.7	27.9

Note 17. Prior Period Adjustments-Corrections of Errors

Prior Period Adjustments to Fiscal Years 2006 and 2005

(In billions of dollars)	Increases to Net Position 2006	Increases to Net Position 2005
Prior Period Adjustments-Corrections of Errors:		
Department of Defense	-	2.9
Other prior period adjustments	-	0.2
Total prior period adjustments	-	3.1

For fiscal year 2005, DOD recorded $10.9 billion (net) for correction of accounting errors. Of these corrections, $3.6 billion (net) were due to a change in accounting principle for the historical cost of inventory-SFFAS No. 3, *Accounting for Inventory and Related Property*, which became effective during fiscal year 1994 but DOD failed to implement the accounting principle until fiscal year 2005. The $7.3 (net) were due to prior period adjustments and were the result of the Air Force completing the conversion of its inventory valuation method from Latest Acquisition Cost to Moving Average Cost. This resulted in adjustments to eliminate allowance for gains and losses, establish an allowance for repair, and revalue the inventory. Other agencies recorded $0.2 (net) as prior period adjustments.

In fiscal year 2006, DOD recorded a prior period adjustment to property, plant, and equipment, net for ($8.2) billion and other adjustments $0.2 billion for correction of accounting errors. This adjustment was due to material errors resulting from a change in the methodology for the reporting of military equipment. Refer to Notes 6 and 26 for additional details.

Note 18. Contingencies

Financial Treatment of Loss Contingencies

Loss contingencies that are assessed to be at least reasonably possible are disclosed in this note. Loss contingencies involve situations where there is an uncertainty of a possible loss. The reporting of loss contingencies depends on the likelihood that a future event or events will confirm the loss or impairment of an asset or the incurrence of a liability. Terms used to assess the range for the likelihood of loss are probable, reasonably possible, and remote. Loss contingencies that are assessed as probable and measurable are accrued in the financial statements. Loss contingencies that are assessed as remote are not reported in the financial statements, nor disclosed in the notes. All other material loss contingencies are disclosed in this note. For an overview of the standards that provide criteria for how Federal agencies are to account for loss contingencies, based on the likelihood of the loss and measurability,[1] see the following table.

[1] In addition, a third condition must be met to be a loss contingency: a past event or an exchange transaction must occur.

Likelihood of future outflow or other sacrifice of resources.	Loss amount can be reasonably measured.	Loss range can be reasonably measured.	Loss amount or range cannot be reasonably measured.
Probable. Future confirming event(s) are more likely to occur than not.[2]	Accrue the liability. Reported on Balance Sheet & Statements of Net Cost.	Accrue liability of best estimate or minimum amount in loss range if there is no best estimate, and disclose nature of contingency and range of estimated liability.	Disclose nature of contingency and include a statement that an estimate cannot be made.
Reasonably possible. Possibility of future confirming event(s) occurring is more than remote and less than likely.	Disclose nature of contingency and estimated loss amount.	Disclose nature of contingency and estimated loss range.	Disclose nature of contingency and include a statement that an estimate cannot be made.
Remote. Possibility of future event(s) occurring is slight.	No disclosure.	No disclosure.	No disclosure.

The Government is subject to loss contingencies which include insurance and litigation cases. These loss contingencies arise in the normal course of operations and their ultimate disposition is unknown. Based on information currently available, however, it is management's opinion that the expected outcome of these matters, individually or in the aggregate, will not have a material adverse effect on the financial statements, except for the insurance and litigation described in the following sections:

Insurance Contingencies

At the time that an insurance policy is issued, a contingency arises. The contingency is the risk of loss assumed by the insurer, that is, the risk of loss from events that may occur during the term of the policy. For example, the estimated aggregate unfunded vested benefits exposure to PBGC for private-sector single-employer and multiemployer defined pension plans is $ 73.4 billion and $ 108.5 billion for 2006 and 2005, respectively.

Insurance in Force

Insurance in Force is the accumulation of policy limits for all policies issued and outstanding at a point in time. The Federal Government has Insurance in Force in the amount of $1,048.6 billion for 2006, and $864.3 billion for 2005. These amounts represent estimated maximum exposure to insurance claims and guarantee programs. The major types are identified below:

- DHS reported $994.1 billion and $811.6 billion for 2006 and 2005, respectively for the National Flood Insurance Program (NFIP).
- EXIM reported $36.4 billion and $35.9 billion for 2006 and 2005, respectively for Export Credit Insurance.

[2] For loss contingencies related to litigation, probable is defined as the future confirming event or events are more likely than not to occur , with the exception of pending or threatened litigation and unasserted claims. For the pending or threatened litigation and unasserted claims, the future confirming event or events are likely to occur.

Deposit Insurance

Deposit Insurance covers all types of deposits accounts such as checking, NOW and savings accounts, money market deposit accounts, and certificates of deposits (CDs) received at an insured bank, savings association, or credit union. The insurance covers the balance of each depositor's account, dollar-for-dollar, up to the insurance limit, including principal and any accrued interest through the date of the insured financial intuition's closing. As a result, the Federal Government has aggregated insured deposit exposure estimated at approximately $4,627.1 billion for 2006, and $4,344.4 billion for 2005. However, these amounts represent maximum possible losses assuming all the FDIC and NCUA member depository institutions were to fail and the acquired assets provided no recovery of funds. Actual losses have generally been a very small fraction of the aggregate estimated insured deposits. The breakdown by agency is identified below:

- Federal Deposit Insurance Corporation (FDIC) has estimated insured deposits of $4,094.7 billion for 2006, and $3,831.0 billion for 2005, respectively for the Deposit Insurance Fund (DIF).
- National Credit Union Administration (NCUA) has estimated insured deposits of $532.3 billion for 2006, and $513.4 billion for 2005, respectively for the National Credit Union Share Insurance Fund (NCUSIC).

Legal Contingencies

The Federal Government is party to various administrative claims and legal actions brought against it, some of which may ultimately result in settlements or decisions against the Federal Government.

Management and legal counsel have determined that it is "probable" that some of these actions will result in a loss to the Federal Government and the loss amounts are reasonably measurable. The estimated liabilities for these cases are $3.7 billion and $5.0 billion for 2006 and 2005, respectively, and are recorded in the balance sheet line items "Insurance Liabilities," or "Other Liabilities." A few of the major cases are summarized below:

- HHS has unasserted claims that resulted from processing errors where incorrect Medicare eligibility determinations were made. Estimated amounts payable to States to reimburse them for payments they paid on behalf of beneficiaries are $1.6 billion for 2005. No states have filed any claims since the HHS' Centers for Medicare and Medicaid Services (CMS) first disclosed this issue; no additional amounts have been recorded for 2006.
- DOI has estimated potential liability for a breach of contract case related to undeveloped Federal oil and gas leases in the amount of $0.5 billion.
- VA has recorded liabilities for pending legal claims related to medical malpractice and other tort claim exposure in the amounts of $0.6 billion and $0.5 billion for 2006 and 2005, respectively.

There are also administrative claims and legal actions pending where adverse decisions are considered by management and legal counsel as "reasonably possible" with an estimate of possible liability or a range of possible liability. The estimated potential losses for such claims and actions range from $7.6 billion to $9.5 billion for 2006, and from $1.2 billion to $7.9 billion for 2005. Two of the major cases are summarized below:

- USDA reported that, as of September 30, 2006, $2.9 billion could be owed to plaintiffs of a pending class action discrimination suit.
- DHS has pending legal claims in the range of $0.1 billion to $2.7 billion for refunds of user fees, harbor maintenance tax claims, and tariff claims as of September 30, 2006.

Numerous litigation cases are pending where the outcome is uncertain or there is at least a reasonable possibility that a loss has been incurred and where estimates cannot be made. There are other litigation cases where the plaintiffs have not made claims for specific dollar amounts, but the claimed amounts may be significant. The ultimate resolution of these legal actions for which the potential loss could not be determined may materially affect the U.S. Government's financial position or operating results. Examples of specific cases are summarized below:

- Native Americans allege that DOI and Treasury have breached trust obligations with respect to the management of the plaintiffs' individual Indian monies. The plaintiffs have not made claims for specific dollar amounts in the Federal district court proceedings, but in public statements have asserted that the class is owed tens of billions of dollars.
- Numerous complaints have arisen as a result of Hurricane Katrina. These New Orleans Federal Tort Claims Act (FTCA) cases allege personal injury, wrongful death, and property damages as a result of massive flooding caused by the hurricane. There are over 25,000 Administrative claims filed in relation to Hurricane Katrina with an aggregate claim amount of over $104 billion. In addition to administrative claims, there have been over 50 Katrina related litigations in Federal district courts with an aggregated claim amount of over $105 billion.

Additional suits are expected. The United States is currently awaiting a ruling on a motion to dismiss that will determine if an assertion of immunity would be successful. The range of potential loss is $10 billion to an amount perhaps several times larger. In addition to the tort claims, two purported class actions have been filed in the Court of Federal Claims alleging that property was taken in violation of the Fifth Amendment of the Constitution. The alleged just compensation owed exceeds $150 billion. Motions to dismiss have been filed in both actions.

- The North American Free Trade Agreement (NAFTA) allows Canadian and Mexican investors to bring arbitration proceedings against the United States for breaches of certain NAFTA provisions. These cases raise allegations of expropriation as well as other claims of treatment inconsistent with international law or specific treaty commitments that provide investment protections. The United States has successfully defended itself against two claims submitted to arbitration under Chapter 11 of the NAFTA. The United States is currently defending itself against eight claims submitted to arbitration and nine claims not yet submitted under Chapter 11 of NAFTA. These claims total approximately $1.4 billion.

Environmental and Disposal Contingencies

The Government is subject to loss contingencies for a variety of environmental cleanup costs for the storage and disposal of hazardous material and the operations and closures of facilities at which environmental contamination may be present and remediation costs.

Management and legal counsel have determined that it is "probable" that some of these actions will result in a loss to the Federal Government and the loss amounts are reasonably measurable. The estimated liabilities for these cases are $7.0 billion and $5.2 billion for 2006 and 2005, respectively, and are recorded in the balance sheet line item "Other Liabilities." DOE is subject to Spent Nuclear Fuel litigation for damages suffered by all utilities as a result of the delay in beginning disposal of spent nuclear fuel. Significant claims for partial breach of contract have been filed with estimated liability amounts of $6.8 billion and $5.0 billion for 2006 and 2005, respectively.

There are also administrative claims and legal actions pending where adverse decisions are considered by management and legal counsel as "reasonably possible" with an estimate of possible liability or a range of possible liability. The Department of Commerce (DOC) has estimated liabilities for a variety of cleanup costs, many of which are associated with the Second World War at various sites within the United States in the amounts of $0.5 billion and $0.8 billion for 2006 and 2005, respectively.

Other Contingencies

DOT has large contingency amounts. The major contingencies are summarized below:

- DOT's Federal Highway Administration (FHWA) reported $45 billion and $40 billion respectively, for 2006 and 2005 for Advance Construction Projects.
- DOT reported $1.8 billion and $0.2 billion for 2006 and 2005, respectively for Hurricanes Katrina and Rita.
- DOT's Federal Transit Administration (FTA) reported $1.4 billion and $2.2 billion for 2006 and 2005, respectively for Full Funding Agreements.

Note 19. Commitments

The Government has entered into contractual commitments that require future use of financial resources. It has significant amounts of long-term lease obligations and undelivered orders as shown in the following table. Undelivered orders represent the value of goods and services ordered that have not yet been received.

The Government has other contractual commitments that may require future use of financial resources. For example, the Government has callable subscriptions in the Multilateral Development Banks (MDB), which are autonomous international financial entities that finance economic and social development projects in developing countries. Callable capital resembles promissory notes to honor MDB debts if the MDB cannot otherwise meet its obligations through its other available resources. MDBs are able to use callable capital as backing to obtain very favorable financing terms when borrowing from world capital markets. Treasury officials do not anticipate any calls on MDB subscriptions. To date, there has never been a call on this capital for any of the major MDBs.

Commitments as of September 30

(In billions of dollars)	Capital Leases 2006	Operating Leases 2006	Capital Leases 2005	Operating Leases 2005
General Services Administration	0.3	22.9	0.3	22.9
U.S. Postal Service	0.7	8.4	-	9.6
Department of Homeland Security	0.1	1.8	0.1	1.4
Department of Health and Human Services	-	1.1	-	1.4
Department of Justice	0.1	0.9	0.1	-
Department of Defense	0.2	0.4	0.3	0.8
Tennessee Valley Authority	0.2	0.1	0.2	0.1
Other Capital Leases	0.4	4.2	0.5	3.8
Total long-term leases	2.0	39.8	1.5	40.0

	Undelivered Orders 2006	Undelivered Orders 2005
Department of Defense	173.6	174.5
Department of Housing & Urban Development	72.0	68.4
Department of Transportation	68.6	68.1
Department of Health and Human Services	67.6	67.9
Department of the Treasury	51.1	44.4
Department of Education	47.6	46.4
Department of Homeland Security	28.2	23.3
Department of Agriculture	16.0	16.0
Agency for International Development	11.6	13.0
Department of Energy	11.1	10.3
Environmental Protection Agency	9.2	9.7
Department of Justice	8.9	9.1
Department of State	8.6	7.3
National Science Foundation	7.3	7.1
Department of the Interior	6.6	6.4
Other undeliverable orders	37.2	25.4
Total undelivered orders	625.2	597.3

	Other Commitments 2006	Other Commitments 2005
Callable capital subscriptions for multilateral development banks	62.1	62.0
Sales of Surplus Power	23.4	10.9
Agriculture Direct Loans and Guarantees	22.3	21.0
Long-term satellite and systems	6.4	7.5
Power purchase obligations	4.3	4.3
Grant Programs - Airport Improvement Program	3.8	3.6
Fuel purchase obligations	3.0	2.3
Conservation Reserve Program	2.0	2.0
Other	2.7	2.6
Total other commitments	130.0	116.2

Other Commitments and Risks

The U.S. Government is a party to major treaties and other international agreements. These treaties and other international agreements address various issues including, but not limited to, trade, commerce, security, and arms that may involve financial obligations or give rise to possible exposure to losses. A comprehensive analysis to determine any such financial obligations or possible exposure to loss and their related effect on the consolidated financial statements of the U.S. Government has not yet been performed.

In addition, the United States Government has entered into other agreements that could potentially require claims on Government resources in the future. Examples include war risk and terrorism risk insurance.

Note 20. Earmarked Funds

Earmarked funds are financed by specifically identified revenues, often supplemented by other financing sources, which remain available over time. These specifically identified revenues and other financing sources are required by statute to be used for designated activities, benefits, or purposes and must be accounted for separately from the Government's general revenues. Earmarked funds generally include trust funds, public enterprise revolving funds (not including credit reform financing funds) and special funds.

In the Federal budget, the term "trust fund" means only that the law requires a particular fund be accounted for separately, used only for a specified purpose, and designated as a trust fund. A change in law may change the future receipts and the terms under which the fund's resources are spent. In the private sector, trust fund refers to funds of one party held and managed by a second party (the trustee) in a fiduciary capacity. The activity of earmarked funds differs from fiduciary activities primarily in that earmarked fund assets are Government-owned.

Public enterprise revolving funds include expenditure accounts authorized by law to be credited with offsetting collections, mostly from the public, that are generated by and earmarked to finance a continuing cycle of business-type operations. Some of the financing for these funds may be from appropriations.

Special funds are Federal funds earmarked by law for a specific purpose. Special funds include the special fund receipt account and the special fund expenditure account.

The following tables depict major earmarked funds separately chosen based on their significant financial activity and importance to taxpayers. All other Federal Government earmarked funds not separately shown are aggregated as "all other."

Total assets represent the unexpended balance from all sources of receipts and amounts due to the earmarked funds, regardless of source, including related Governmental transactions. These are transactions between two different entities within the Government (for example, monies received by one entity of the Government from another entity of the Government).

The intragovernmental assets are comprised of fund balances with Treasury, investments in Federal debt securities – including unamortized amounts, and other assets which includes the related accrued interest receivable on Federal investments. These amounts were eliminated in preparing the principal financial statements.

The non-federal assets represent only the activity with individuals and organizations outside of the Government.

Most of the earmarked fund assets are invested in intragovernmental debt holdings. The Federal Government does not set aside assets to pay future benefits or other expenditures associated with earmarked funds. The cash receipts collected from the public for an earmarked fund are deposited in the U.S. Treasury, which uses the cash for general Government purposes. Treasury securities are issued to Federal agencies as evidence of its receipts. Treasury securities are an asset to the Federal agencies and a liability to the U.S. Treasury and, therefore, they do not represent an asset or a liability in the *Financial Report of the U.S. Government*. These securities require redemption if a fund's disbursements exceed its receipts. Redeeming these securities will increase the Government's financing needs and require more borrowing from the public (or less repayment of debt), or will result in higher taxes than otherwise would have been needed, or less spending on other programs than otherwise would have occurred, or some combination thereof. See Note 10—Federal Debt Securities Held by the Public and Accrued Interest for further information related to the investments in Federal debt securities.

Earmarked Funds as of September 30, 2006*

(In millions of dollars)	Federal Old-Age & Survivors Insurance Trust Fund	Civil Service Retirement & Disability Fund	Federal Hospital Insurance Trust Fund (Medicare Part A)	Federal Disability Insurance Trust Fund	Military Retirement Fund	Medicare-Eligible Retiree Health Care Fund (MERHCF)
Assets:						
Cash and other monetary assets	-	-	13.0	-	-	-
Fund balance with Treasury	(795.0)	17.0	955.0	(348.0)	30.7	37.9
Investments in U.S. Treasury securities	1,793,129.0	689,936.0	302,186.0	202,178.0	208,392.1	85,395.0
Other Federal assets	23,006.0	9,861.0	24,693.0	2,628.0	-	-
Non-federal assets	2,112.0	277.0	882.0	2,886.0	23.3	8.8
Total assets	1,817,452.0	700,091.0	328,729.0	207,344.0	208,446.1	85,441.7
Liabilities:						
Liabilities due and payable to beneficiaries	41,677.0	4,545.0	19,751.0	23,611.0	-	-
Other Federal liabilities	3,867.0	3.0	20,531.0	720.0	1.3	49.1
Other Non-federal liabilities	-	1,287,185.0	595.0	6.0	967,106.1	538,860.6
Total liabilities	45,544.0	1,291,733.0	40,877.0	24,337.0	967,107.4	538,909.7
Total net position	1,771,908.0	(591,642.0)	287,852.0	183,007.0	(758,661.3)	(453,468.0)
Total liabilities and net position	1,817,452.0	700,091.0	328,729.0	207,344.0	208,446.1	85,441.7
Change in Net Position:						
Beginning net position	1,595,523.0	(549,022.0)	266,754.0	175,137.0	(697,577.3)	(477,660.1)
Investment revenue	89,385.0	36,618.0	15,541.0	10,495.0	12,317.8	4,052.8
Revenue from the public	530,006.0	-	180,392.2	90,001.0	-	-
Other changes in fund balance	9,138.0	46,416.0	10,954.8	(1,498.0)	39,419.9	27,749.9
Other expenses	-	-	2,929.0	-	-	-
Program expenses	452,144.0	125,654.0	182,861.0	91,128.0	112,821.7	7,610.6
Ending net position	1,771,908.0	(591,642.0)	287,852.0	183,007.0	(758,661.3)	(453,468.0)

* By law, certain expenses (costs), revenues, and other financing sources related to the administration of the above funds are not charged to the funds and are therefore financed and/or credited to other sources.

Earmarked Funds as of September 30, 2006

(In millions of dollars)	Unemployment Trust Fund	Federal Supplementary Medical Insurance Trust Fund (Medicare Parts B and D)	Railroad Retirement Trust Funds	Land and Water Conservation Fund	Foreign Service Retirement and Disability Fund	National Service Life Insurance Fund
Assets:						
Cash and other monetary assets	-	132.0	-	-	-	-
Fund balance with Treasury	60.3	27,771.0	(3.7)	14,836.2	2.1	5.0
Investments in U.S. Treasury securities	66,212.6	33,061.0	1,200.5	-	13,875.7	10,338.0
Other Federal assets	1,078.3	22,603.0	3,757.0	-	199.6	474.0
Non-federal assets	1,435.8	2,459.0	29,399.2	-	1.7	-
Total assets	68,787.0	86,026.0	34,353.0	14,836.2	14,079.1	10,817.0
Liabilities:						
Liabilities due and payable to beneficiaries	1,068.4	21,073.0	812.9	-	-	142.0
Other Federal liabilities	1,309.8	22,983.0	3,506.8	-	-	10,397.0
Other Non-federal liabilities	-	311.0	268.4	-	14,272.5	-
Total liabilities	2,378.2	44,367.0	4,588.1		14,272.5	10,539.0
Total net position	66,408.8	41,659.0	29,764.9	14,836.2	(193.4)	278.0
Total liabilities and net position	68,787.0	86,026.0	34,353.0	14,836.2	14,079.1	10,817.0
Change in Net Position:						
Beginning net position	54,496.5	9,266.0	28,067.8	14,303.5	72.5	284.0
Investment revenue	2,780.1	1,601.0	1,754.0	-	765.6	990.0
Revenue from the public	41,406.6	-	15.0	894.6	-	1.0
Other changes in fund balance	(1,768.7)	181,979.0	9,466.1	(361.9)	430.7	-
Other expenses	-	2,102.0	-	-	1,462.2	-
Program expenses	30,505.7	149,085.0	9,538.0	-	-	997.0
Ending net position	66,408.8	41,659.0	29,764.9	14,836.2	(193.4)	278.0

* By law, certain expenses (costs), revenues, and other financing sources related to the administration of the above funds are not charged to the funds and are therefore financed and/or credited to other sources.

Earmarked Funds as of September 30, 2006*

(In millions of dollars)	Airport and Airway Trust Fund	Highway Trust Fund	Hazardous Substance Superfund	Black Lung Disability Trust Fund	All Other Earmarked Funds	Total Earmarked Funds
Assets:						
Cash and other monetary assets	-	-	-	-	23,581.6	23,726.6
Fund balance with Treasury	645.5	4,431.6	35.1	39.3	39,275.5	86,995.5
Investments in U.S. Treasury Securities	7,967.5	10,997.6	2,619.5	-	127,269.4	3,554,757.9
Other Federal assets	-	-	24.2	-	14,425.6	102,749.7
Non-federal assets	-	331.0	269.0	8.8	56,388.9	96,482.5
Total assets	8,613.0	15,760.2	2,947.8	48.1	260,941.0	3,864,712.2
Liabilities:						
Liabilities due and payable to beneficiaries	-	-	-	21.2	7,500.8	120,202.3
Other Federal liabilities	2,214.2	-	129.0	9,631.6	20,310.3	95,653.1
Other Non-federal liabilities	-	3,888.6	434.7	-	416,687.9	3,229,615.8
Total liabilities	2,214.2	3,888.6	563.7	9,652.8	444,499.0	3,445,471.2
Total net position	6,398.8	11,871.6	2,384.1	(9,604.7)	(183,558.0)	419,241.0
Total liabilities and net position	8,613.0	15,760.2	2,947.8	48.1	260,941.0	3,864,712.2
Change in Net Position:						
Beginning net position	7,317.6	10,231.4	2,200.1	(9,160.0)	(183,006.7)	247,227.3
Investment revenue	483.4	1.1	108.8	0.3	8,454.2	185,348.1
Revenue from the public	10,202.1	38,753.4	298.5	607.4	16,030.9	908,608.7
Other changes in fund balance	-	27.2	1,214.7	(57.6)	21,121.7	344,231.8
Other expenses	-	-	-	-	26,528.6	33,021.8
Program expenses	11,604.3	37,141.5	1,438.0	994.8	19,629.5	1,233,153.1
Ending net position	6,398.8	11,871.6	2,384.1	(9,604.7)	(183,558.0)	419,241.0

* By law, certain expenses (costs), revenues, and other financing sources related to the administration of the above funds are not charged to the funds and are therefore financed and/or credited to other sources.

Depicted below is a description of the major earmarked funds shown in the above tables, which also includes the names of the Government agencies that administer each particular fund. For detailed information regarding these earmarked funds, please refer to the financial statements of the corresponding administering agencies. For information on the benefits due and payable liability associated with certain earmarked funds see Note 13—Benefits Due and Payable.

Federal Old-Age and Survivors Insurance Trust Fund

The Federal Old-Age and Survivors Insurance Trust Fund, administered by SSA, provide a basic annuity to workers to protect them from loss of income at retirement and provide a guaranteed income to survivors in the event of the death of a family's primary wage earner.

Payroll and self-employment taxes primarily fund the Federal Old-Age and Survivors Insurance Trust Fund. Interest earnings on Treasury securities, Federal agencies' payments for the Social Security benefits earned by military and Federal civilian employees, and Treasury payments for a portion of income taxes collected on Social Security benefits provide the fund with additional income. The law establishing the Federal Old-Age and Survivors Insurance Trust Fund and authorizing the depositing of amounts to the credit of the trust fund is set forth in 42 U.S.C. § 401.

Civil Service Retirement and Disability Fund

The CSRDF covers two Federal civilian retirement systems: CSRS—for employees hired before 1984, and FERS—for employees hired after 1983. OPM administers the CSRS and the FERS systems. The laws establishing the CSRDF and authorizing the depositing of amounts to the credit of the trust fund are set forth in 5 U.S.C. § 8334-8348. Funding sources include:

- Federal civilian employees' contributions.
- Agencies' contributions on behalf of employees.
- Appropriations.
- Interest earned on investments in Treasury securities.

Federal Hospital Insurance Trust Fund (Medicare Part A)

The Federal Hospital Insurance Trust Fund finances the Hospital Insurance Program (Medicare Part A). This program funds the cost of inpatient hospital and related care for individuals age 65 or older who meet certain insured status requirements, and eligible disabled people. HHS administers the program.

The Federal Hospital Insurance Trust Fund is financed primarily by payroll taxes, including those paid by Federal agencies. It also receives income from interest earnings on Treasury securities and a portion of income taxes collected on Social Security benefits. The law establishing the Federal Hospital Insurance Trust Fund and authorizing the depositing of amounts to the credit of the trust fund is set forth in 42 U.S.C. § 1395i.

Federal Disability Insurance Trust Fund

The Federal Disability Insurance Trust Fund provides assistance and protection against the loss of earnings due to a wage earner's disability in the form of money payments. SSA administers the Federal Disability Insurance Trust Fund.

Like the Federal Old-Age and Survivors Insurance Trust Fund, payroll taxes primarily fund the Federal Disability Insurance Trust Fund. The fund also receives income from interest earnings on Treasury securities, Federal agencies' payments for the Social Security benefits earned by military and Federal civilian employees, and a portion of income taxes collected on Social Security benefits. The law establishing the Federal Disability Insurance Trust Fund and authorizing the depositing of amounts to the credit of the trust fund is set forth in 42 U.S.C. § 401.

Military Retirement Fund

The Military Retirement Fund provides retirement benefits for Army, Navy, Marine Corps, and Air Force personnel and their survivors. The fund is financed by DOD contributions, appropriations, and interest earned on investments in Federal debt securities. DOD administers the Military Retirement Fund. The laws establishing the Military Retirement Fund and authorizing the depositing of amounts to the credit of the trust fund are set forth in 10 U.S.C. § 1461-1467.

Medicare-Eligible Retiree Health Care Fund

The Medicare-Eligible Retiree Health Care Fund, administered by DOD and established by 10 U.S.C. § 1111, finances and pays the liabilities under the DOD retiree health care programs for Medicare-eligible beneficiaries. Such beneficiaries include qualifying members, former members, and dependents of the Uniformed Services. The assets of the fund are comprised of any amounts appropriated to the fund, payments to the fund authorized by 10 U.S.C. § 1116, and interest on investments authorized by 10 U.S.C. § 1117.

Unemployment Trust Fund

The UTF provides temporary assistance to workers who lose their jobs. The program is administered through a unique system of Federal and State partnerships, established in Federal law, but executed through conforming State laws by State officials. DOL administers the Federal operations of the program.

Taxes on employers provide the primary funding source for the UTF. However, interest earned on investments in Treasury securities also provides income to the fund. Appropriations have supplemented the fund's income during periods of high and extended unemployment. The law establishing the UTF and authorizing the depositing of amounts to the credit of the trust fund is set forth in 42 U.S.C. § 1104.

Federal Supplementary Medical Insurance Trust Fund (Medicare Parts B and D)

The Federal Supplementary Medical Insurance Trust Fund finances the Supplementary Medical Insurance Program (Medicare Part B) and the Medicare Prescription Drug Benefit Program (Medicare Part D) that provides supplementary medical insurance for enrolled eligible participants to cover physician and outpatient services not covered by Medicare Part A and to obtain qualified prescription drug coverage, respectively. HHS administers the programs.

Medicare Part B financing is not based on payroll taxes; it is based on monthly premiums and income from the General Fund of the Treasury. The law establishing the Federal Supplementary Medical Insurance Trust Fund and authorizing the depositing of amounts to the credit of the trust fund is set forth in 42 U.S.C. § 1395t.

Medicare Part D was created by the *Medicare Prescription Drug, Improvement, and Modernization Act of 2003* (P.L. No. 108-173). Medicare Part D financing is similar to Part B; it is based on monthly premiums and income from the General Fund of the Treasury, not on payroll taxes. The law creating the Medicare prescription drug account within the Federal Supplementary Medical Insurance Trust Fund and authorizing the depositing of amounts to the credit of the trust fund is set forth in 42 U.S.C. § 1395w-116.

Railroad Retirement Trust Funds

The Railroad Retirement Trust Fund provides annuities and survivor benefits to eligible railroad employees and their survivors. The fund also pays disability annuities based on total or occupational disability. Payroll taxes paid by railroad employers and their employees provide the primary source of income for the Railroad Retirement

Survivor Benefit program. The law establishing the Railroad Retirement Trust Fund and authorizing the depositing of amounts to the credit of the trust fund is set forth in 45 U.S.C. § 231n and 45 U.S.C. § 231n-1.

The Railroad Retirement and Survivors' Improvement Act, enacted on December 21, 2001, created the National Railroad Retirement Investment Trust to administer the new fund, which is allowed to invest in Federal debt securities as well as other investments outside of the U.S. Government (see Railroad Retirement in the Supplemental Information-Social Insurance section).

Land and Water Conservation Fund

The Land and Water Conservation Fund (LWCF) is administered by DOI and was enacted in 1964, by Public Law 88-578, to create and maintain a nationwide legacy of high quality recreation areas and facilities. The LWCF Act established a funding source for both Federal acquisition of authorized national park, conservation, and recreation areas as well as grants to State and local governments to help them acquire, develop, and improve outdoor recreation areas. Annually, $903 million for the LWCF are transferred from the Minerals Management Service to the National Park Service, the majority of which are from royalties from Outer Continental Shelf oil deposits. Each year, amounts from the LWCF are warranted to some of the bureaus within the DOI and the rest to USDA's Forest Service. The law establishing the Land and Water Conservation Fund and authorizing the depositing of amounts to the credit of the trust fund is set forth in 16 U.S.C. § 4601-11.

Foreign Service Retirement and Disability Fund

The Foreign Service Retirement and Disability Fund (FSRD) is administered by the Department of State and provides pensions to retired and disabled members of the Foreign Service. The FSRD's revenues consist of contributions from active participants and their U.S. Government agency employers, appropriations, and interest on investments in Treasury securities. Monthly annuity payments are made to eligible retired employees or their survivors. Separated employees without title to an annuity may take a refund of their contributions. P.L. 96-465 limits the amount of administrative expense that can be charged to the fund to $5,000 per year. Cash is invested in U.S. Treasury securities until it is needed. The laws establishing the Foreign Service Retirement and Disability Fund and authorizing the deposit of amounts to the credit of the trust fund are set forth in 22 U.S.C. § 4042 and 22 U.S.C. § 4045.

National Service Life Insurance Fund

The National Service Life Insurance Program (NSLI) covers policyholders who served during World War II. The program opened October 8, 1940, when it became clear that large-scale military inductions were imminent. Over 22 million policies were issued under the NSLI Program. The majority of policies administered directly by the Department of Veteran's Affairs are NSLI policies. This program remained opened until April 25, 1951, when two new programs were established for Korean War service members and veterans. The financing sources for the NSLI come from the public and veterans. The law establishing the NSLI Program and authorizing the depositing of amounts to the credit of the trust fund is set forth in 38 U.S.C. § 1920.

Airport and Airway Trust Fund

The Airport and Airway Trust Fund provides for airport improvement and airport facilities maintenance. It also funds airport equipment, research, and a portion of the Federal Aviation Administration's administrative operational support. DOT administers the Airport and Airway Trust Fund. The law establishing the Airport and Airway Trust Fund and authorizing the depositing of amounts to the credit of the trust fund is set forth in 26 U.S.C. § 9502. Funding sources include:

- Taxes received from transportation of persons and property in the air and fuel used in commercial and general aviation.
- International departure taxes.

- Interest earned on investments in Treasury securities.

The above tables do not reflect any transfers from the Highway Trust Fund to the Airport and Airway Trust Fund for fuel which was used in aviation, but which was taxed at highway rates under P.L. 109-59 (SAFETEA-LU).

Highway Trust Fund

The Highway Trust Fund was established to promote domestic interstate transportation and to move people and goods. The fund provides Federal grants to States for highway construction, certain transit programs, and related transportation purposes. DOT administers programs financed by the Highway Trust Fund. The law establishing the Highway Trust Fund and authorizing the depositing of amounts to the credit of the trust fund is set forth in 26 U.S.C. § 9503. Funding sources include earmarked taxes on gasoline and other fuels, certain tires, the initial sale of heavy trucks, and highway use by commercial motor vehicles. As funds are needed for payments, the Highway Trust Fund Corpus investments are liquidated and funds are transferred to the Federal Highway Administration, the Federal Transit Administration, or other DOT entity, for payment of obligations.

Hazardous Substance Superfund

The Hazardous Substance Superfund was authorized to address public health and environmental threats from spills of hazardous materials and from sites contaminated with hazardous substances. The Environmental Protection Agency administers the fund. The law establishing the Hazardous Substance Superfund and authorizing the depositing of amounts to the credit of the trust fund is set forth in 26 U.S.C. § 9507. Funding sources include:

- Fines, penalties, and cost recoveries from responsible parties.
- Appropriations.
- Interest earned on investments in Treasury securities.

Black Lung Disability Trust Fund

The BLDTF provides disability benefits to coal miners who are totally disabled due to pneumoconiosis (black lung disease) and death benefits for the eligible survivors of those miners who die from the disease. Excise taxes on coal mine operators, based on the sale of coal, partially fund black lung disability payments as well as related administrative and interest costs. Intragovernmental advances to the BLDTF, which must be repaid with interest, fund the shortfall. DOL administers the BLDTF. The law establishing the BLDTF and authorizing the depositing of amounts to the credit of the trust fund is set forth in 26 U.S.C. § 9501.

All Other Earmarked Funds

The above sixteen earmarked funds represent the Government’s most significant earmarked activity. All other earmarked activity is aggregated as “all other” in accordance with SFFAS No. 27. This “all other” aggregate includes 210 earmarked funds that are designated as significant funds by the agencies in their collective financial statements. These funds address a variety of issues and are managed by a widespread number of agencies. Some of the funds that comprise the “all other” earmarked funds include the following:

- Department of the Treasury-Exchange Stabilization Fund
- Federal Communications Commission-Universal Service Fund
- United States Department of Agriculture-Federal Crop Insurance Corporation Fund and Funds for Strengthening Markets, Income, and Supply
- Environmental Protection Agency-Leaking Underground Storage Tanks
- Department of Commerce-U.S. Patent and Trademark Office
- Department of Veterans Affairs-Medical Care
- Department of Homeland Security-Customs User Fees, Immigration Examination Fees and the National Flood Insurance Program.

Note 21. Dedicated Collections

The implementation of SFFAS No. 27 in fiscal year 2006 supersedes the dedicated collections provisions in SFFAS No. 7 for earmarked funds. Earmarked funds were reported as dedicated collections in fiscal year 2005. For fiscal year 2006, the dedicated collection amounts related to non-earmarked funds are immaterial. Refer to Note 20—Earmarked Funds.

Dedicated Collections as of September 30, 2005*

(In millions of dollars)	Federal Old-Age & Survivors Insurance Trust Fund	Civil Service Retirement & Disability Fund	Federal Hospital Insurance Trust Fund (Medicare Part A)	Federal Disability Insurance Trust Fund	Military Retirement Fund	Medicare-Eligible Retiree Health Care Fund (MERHCF)
Assets:						
Fund balance	(384.0)	23.0	366.0	(73.0)	22.9	5.0
Investments	1,616,159.0	660,750.0	280,996.0	193,263.0	197,807.1	60,691.7
Other Federal assets	20,936.0	9,684.0	17,978.0	2,539.0	-	32.9
Non-federal assets	1,965.0	276.0	3,126.0	2,480.0	26.7	11.3
Total assets	1,638,676.0	670,733.0	302,466.0	198,209.0	197,856.7	60,740.9
Liabilities:						
Liabilities due and payable to beneficiaries	39,213.0	4,323.0	16,806.0	22,375.0	-	-
Other liabilities	3,940.0	1,215,432.0	18,906.0	697.0	895,434.0	538,401.0
Total liabilities	43,153.0	1,219,755.0	35,712.0	23,072.0	895,434.0	538,401.0
Total net position	1,595,523.0	(549,022.0)	266,754.0	175,137.0	(697,577.3)	(477,660.1)
Total liabilities and net position	1,638,676.0	670,733.0	302,466.0	198,209.0	197,856.7	60,740.9
Change in Net Position:						
Beginning net position	1,433,278.0	(537,448.0)	253,259.0	170,598.0	(649,695.1)	(466,096.2)
Nonexchange revenue	585,819.0	-	184,457.0	95,591.0	-	-
Other financing sources	16.0	25,652.0	9,431.0	47.0	-	-
Other changes in fund balance	9,416.0	-	-	(1,221.0)	-	-
Exchange revenue	-	57,864.0	2,314.0	-	48,812.2	28,412.4
Program expenses	433,006.0	95,090.0	180,380.0	89,878.0	96,694.4	39,976.3
Other expenses	-	-	2,327.0	-	-	-
Ending net position	1,595,523.0	(549,022.0)	266,754.0	175,137.0	(697,577.3)	(477,660.1)

* By law, certain expenses (costs), revenues, and other financing sources related to the administration of the above funds are not charged to the funds and are therefore financed and/or credited to other sources.

Dedicated Collections as of September 30, 2005*

(In millions of dollars)	Unemployment Trust Fund	Federal Supplementary Medical Insurance Trust Fund (Medicare Part B)	Railroad Retirement Trust Funds	Land and Water Conservation Fund	Foreign Service Retirement and Disability Fund
Assets:					
Fund balance	(273.0)	1,303.0	43.3	-	0.1
Investments	54,805.9	17,448.0	2,156.3	14,303.5	13,359.4
Other Federal assets	979.0	29,345.0	3,644.3	-	196.8
Non-federal assets	1,418.1	3,424.0	26,438.8	-	1.9
Total assets	56,930.0	51,520.0	32,282.7	14,303.5	13,558.2
Liabilities:					
Liabilities due and payable to beneficiaries	931.7	16,593.0	787.4	-	45.9
Other liabilities	1,501.8	25,661.0	3,784.2	-	13,439.8
Total liabilities	2,433.5	42,254.0	4,571.6	-	13,485.7
Total net position	54,496.5	9,266.0	27,711.1	14,303.5	72.5
Total liabilities and net position	56,930.0	51,520.0	32,282.7	14,303.5	13,558.2
Change in Net Position:					
Beginning net position	45,395.9	10,043.0	25,319.5	13,859.2	(345.8)
Nonexchange revenue	44,404.4	1,336.0	5,010.7	-	-
Other financing sources	0.1	115,784.0	3,176.0	444.3	-
Other changes in fund balance	(3,815.0)	(2,577.0)	-	-	-
Exchange revenue	-	35,945.0	4,868.5	-	1,206.8
Program expenses	31,488.9	149,463.0	10,664.2	-	-
Other expenses	-	1,802.0	(0.6)	-	788.5
Ending net position	54,496.5	9,266.0	27,711.1	14,303.5	72.5

* By law, certain expenses (costs), revenues, and other financing sources related to the administration of the above funds are not charged to the funds and are therefore financed and/or credited to other sources.

Dedicated Collections as of September 30, 2005*

(In millions of dollars)	National Service Life Insurance Fund	Airport and Airway Trust Fund	Corpus Highway Trust Fund	Hazardous Substance Superfund	Black Lung Disability Trust Fund
Assets:					
Fund balance	9.0	692.3	2,549.0	7.2	41.9
Investments	10,758.0	10,047.4	8,270.6	2,293.0	-
Other Federal assets	505.0	85.6	-	4.2	-
Non-federal assets	-	-	-	-	9.1
Total assets	11,272.0	10,825.3	10,819.6	2,304.4	51.0
Liabilities:					
Liabilities due and payable to beneficiaries	142.0	-	-	-	24.4
Other liabilities	10,846.0	3,507.7	11,708.0	-	9,186.6
Total liabilities	10,988.0	3,507.7	11,708.0	-	9,211.0
Total net position	284.0	7,317.6	(888.4)	2,304.4	(9,160.0)
Total liabilities and net position	11,272.0	10,825.3	10,819.6	2,304.4	51.0
Change in Net Position:					
Beginning net position	283.0	6,959.1	5,562.3	2,394.5	(8,711.4)
Nonexchange revenue	-	10,699.9	37,892.6	69.0	611.1
Other financing sources	1.0	-	34.8	1,247.5	-
Other changes in fund balance	-	-	-	-	(56.7)
Exchange revenue	1,081.0	-		52.5	-
Program expenses	1,081.0	10,341.4	44,378.1	1,459.1	1,003.0
Other expenses	-	-	-	-	-
Ending net position	284.0	7,317.6	(888.4)	2,304.4	(9,160.0)

* By law, certain expenses (costs), revenues, and other financing sources related to the administration of the above funds are not charged to the funds and are therefore financed and/or credited to other sources.

The tables above depict selected trust funds that have been chosen based on their financial activity. Additionally, the Federal Government has many other dedicated collections and trust funds. The tables above exclude all trust funds that are identified as earmarked funds as defined by SFFAS No. 27. See Note 20—Earmarked Funds for a listing of major earmarked funds. Dedicated collections include the Indian Trust Funds. Refer to Note 22—Indian Trust Funds for more details.

In the Federal budget, the term "trust fund" means only that the law requires a particular fund be accounted for separately, used only for a specified purpose, and designated as a trust fund. A change in law may change the future receipts and the terms under which the fund's resources are spent. In the private sector, trust fund refers to funds of one party held and managed by a second party (the trustee) in a fiduciary capacity.

The line item "investments," listed under assets in the tables above, refers to investments in Federal debt securities, net of unamortized discounts and premiums. Total assets represent the unexpended balance from all sources of receipts and amounts due the trust funds, regardless of source, including related Governmental transactions. These are transactions between two different entities within the Government (for example, monies received by one entity of the Government from another entity of the Government).

The intragovernmental assets are comprised of fund balance with Treasury, investments in Federal debt securities—including unamortized amounts, and other assets which include the related accrued interest receivable. These amounts were eliminated in preparing these financial statements. The non-federal assets represent only the activity with individuals and organizations outside the Government. All related Governmental balances are removed to present the Government's position as a whole.

Most of the trust fund assets are invested in intragovernmental debt holdings. These securities require redemption if a fund's disbursements exceed its receipts. Redeeming these securities to pay benefits as they become due and payable will require the Government to finance these benefit payments in the same way that it finances all Government spending, which is by using cash on hand or by issuing debt to the public, if there is insufficient cash on hand.

Note 22. Indian Trust Funds

DOI has responsibility for the assets held in trust on behalf of American Indian tribes and individuals.

DOI, through the Office of the Special Trustee (OST), holds trust funds in accounts for Indian tribes. It maintains approximately 1,450 accounts for Tribal and Other Special Trust Funds (including the Alaska Native Escrow Fund) and approximately 300,000 accounts for individuals. The OST was established by the American Indian Trust Fund Management Reform Act of 1994 (Public Law 103-412) and was created to improve the accountability and management of Indian funds held in trust by the Federal Government.

The balances that have accumulated in the Tribal and Other Special Trust Funds have resulted from judgment awards, settlements of claims, land use agreements, royalties on natural resource depletion, and other proceeds derived directly from trust resources and investment income.

The trust fund balances included in the Trust Funds Held for Indian Tribes and Other Special Trust Funds contain two categories: trust funds held for Indian tribes (considered non-federal funds) and trust funds held by DOI for future transfer to a tribe upon satisfaction of certain conditions or where the corpus of the fund is non-expendable (considered Federal funds).

The tables below depict the U.S. Government as trustee for Indian Trust Funds Held for Indian Tribes and Other Special Trust Funds. The Other Special Trust Funds included in the tables below ($284.2 million and $277.3 million for fiscal years 2006 and 2005, respectively, identified in DOI's financial statements) and trust funds considered Federal funds are included in DOI's financial statements.

U.S. Government as Trustee for Indian Trust Funds Held for Indian Tribes and Other Special Trust Funds
Statement of Assets and Trust Fund Balances as of September 30

(In millions of dollars)	2006	2005
Assets		
Current Assets:		
Cash and cash equivalents	503.4	501.6
Investments	2,417.8	2,380.2
Total assets	2,921.2	2,881.8
Trust fund balances, held for Indian Tribes and by DOI	2,921.2	2,881.8

U.S. Government as Trustee for Indian Trust Funds Held for Indian Tribes and Other Special Trust Funds
Statement of Changes in Trust Fund Balances as of September 30

(In millions of dollars)	2006	2005
Receipts	460.50	517.7
Disbursements	(421.1)	(611.2)
Increase (decrease) in trust fund balances, net	39.4	(93.5)
Trust fund balances, beginning of year	2,881.8	2,975.3
Trust fund balances, end of year	2,921.2	2,881.8

OST also maintains about 323,000 open Individual Indian Monies (IIM) accounts. The IIM fund is primarily a deposit fund for individuals who have a beneficial interest in the trust funds. The IIM account-holders realize receipts primarily from royalties on natural resource depletion, land use agreements, and enterprises that have a direct relationship to trust fund resources and investment income. Funds related to the IIM Trust Fund are included in the following tables.

U.S. Government as Trustee for Indian Trust Funds Held for Individual Indian Monies Trust Funds
Statement of Assets and Trust Fund Balances as of September 30

(In millions of dollars)	2006	2005
Assets:		
Cash and cash equivalents	61.9	28.3
Investments	353.9	388.6
Accrued interest receivable	2.5	3.0
Total assets	418.3	419.9
Trust fund balances, held for individual Indians	418.3	419.9

U.S. Government as Trustee for Indian Trust Funds Held for Individual Indian Monies Trust Funds
Statement of Changes in Trust Fund Balances as of September 30

(In millions of dollars)	2006	2005
Receipts	372.9	301.6
Disbursements	(374.5)	(278.4)
Increase (decrease) in trust fund balances, net	(1.6)	23.2
Trust fund balances, beginning of year	419.9	396.7
Trust fund balances, end of year	418.3	419.9

The amounts presented in the four tables of this note were prepared using a cash basis of accounting, which is a comprehensive basis of accounting other than GAAP. Receivables and payables are not recorded, and investment premiums and discounts are not amortized in the Trust Funds Held for Indian Tribes and Other Special Trust Funds. Receipts are recorded when received and disbursements when paid, and investments are stated at historical cost. The only basis of accounting difference between the Trust Funds Held for Indian Tribes and Other Special Trust Funds and the IIM Trust Fund is that the latter records the receivables and payables related to accrued interest and dividends when earned, including amortization of investment discounts and premiums, and investments are stated at amortized cost.

Note 23. Social Insurance

The statements of social insurance provide estimates of the status of the Social Security, Medicare, Railroad Retirement and Black Lung social insurance programs which are administered by the SSA, HHS, RRB, and DOL, respectively. The estimates are actuarial present values of the projections and are based on the economic and demographic assumptions presented later in this note as set forth in the relevant Social Security and Medicare trustees' reports and in the relevant agency performance and accountability reports for SSA, HHS, RRB and DOL (Black Lung). The projections are based on the continuation of program provisions contained in current law. The estimates in the consolidated financial statements are for persons who are participants or eventually will participate in the programs as contributors (workers) or beneficiaries (retired workers, survivors, and disabled) during a 75-year time period (Black Lung is projected only through 2040).

Contributions and earmarked taxes consist of payroll taxes from employers, employees, and self-employed persons; revenue from Federal income taxation of OASDI and railroad retirement benefits; excise tax on coal (Black Lung); and premiums from, and State transfers on behalf of, participants in Medicare. Income for all programs is presented from a consolidated perspective. Future interest payments and other future intragovernmental transfers have been excluded upon consolidation. Expenditures include scheduled benefit payments and administrative expenses. Scheduled benefits are projected based on the benefit formulas under current law. However, current Social Security and Medicare law does not provide for full benefit payments after the trust funds are exhausted.

Future participants for Social Security and Medicare include births during the projection period and individuals below age 15 as of January 1 of the valuation year. Railroad's future participants are the projected new entrants as of January 1 of the valuation year.

The present values of future expenditures less future revenues is the current amount of funds needed to cover projected shortfalls, excluding the starting trust fund balances, over the projection period. They are calculated by subtracting the actuarial present values of future scheduled contributions and dedicated tax income by and on behalf of current and future participants from the actuarial present value of the future scheduled benefit payments to them or on their behalf. For these calculations, the trust fund balances at the beginning of the valuation period are not included. The trust fund balances in billions of dollars, as of the valuation date, for the respective programs, including interest earned, are shown in the following table.

Social Insurance Program	********************UNAUDITED********************				
	2006	**2005**	**2004**	**2003**	**2002**
Social Security.......................	1,859	1,687	1,531	1,378	1,213
Medicare					
HI	285	268	256	235	209
SMI	23	19	24	34	41
Railroad Retirement	30	28	26	22	21
Black Lung.............................	(10)	(9)	(8)	(8)	(8)

The projection period for future participants covers the next 75 years for the Social Security, Medicare, and Railroad Retirement programs. The projection period for current participants in the Social Security and Medicare programs (i.e., those age 15 and over on January 1 of the valuation year, referred to as the "closed group") would theoretically cover all of their working and retirement years, a period that could be greater than 75 years in a relatively small number of instances.

Social Security – Program Description

The OASDI program, collectively referred to as "Social Security," provides cash benefits for eligible U.S. citizens and residents. Eligibility and benefit amounts are determined under the laws applicable for the period. Current law provides that the amount of the monthly benefit payments for workers, or their eligible dependents or survivors, is based on the workers' lifetime earnings histories.

The primary financing of these two funds are taxes paid by workers, their employers, and individuals with self-employment income, based on work covered by the OASDI Program. Refer to the *Social Insurance* segment in the Supplemental Information section for additional information on social security program financing.

That portion of each trust fund not required to pay benefits and administrative costs is invested, on a daily basis, in interest-bearing obligations of the U.S. Government. The Social Security Act authorizes the issuance by the Treasury of special nonmarketable, intragovernmental debt obligations for purchase exclusively by the trust funds. Although the special issues cannot be bought or sold in the open market, they are redeemable at any time at face value and thus bear no risk of fluctuations in principal value due to changes in market yield rates. Interest on the bonds is credited to the trust funds and becomes an asset to the funds and a liability to the General Fund of the Treasury. These Treasury securities and related interest are eliminated in consolidation at the Governmentwide level.

Medicare – Program Description

The Medicare Program, created in 1965, has two separate trust funds: the Hospital Insurance (HI, Medicare Part A) and Supplementary Medical Insurance (SMI, Medicare Parts B and D) Trust Funds.[1] HI pays for inpatient acute hospital services and major alternatives to hospitals (skilled nursing services, for example) and SMI pays for hospital outpatient services, physician services, and assorted other services and products through the Part B account and pays for prescription drugs through the Part D account. Though the events that trigger benefit payments are similar, HI and SMI have different earmarked financing structures. Similarly to OASDI, HI is financed primarily by payroll contributions. Other income to the HI fund includes a small amount of premium income from voluntary enrollees, a portion of the Federal income taxes that beneficiaries pay on Social Security benefits and interest credited on Treasury securities held in the HI Trust Fund. These Treasury securities and related interest are excluded in the consolidation at the Governmentwide level.

For SMI, transfers from the General Fund of the Treasury represent the largest source of income for both Parts B and D. Beneficiaries finance the remainder of Parts B and D costs via monthly premiums to these programs. With Part D drug coverage, Medicaid will no longer be the primary payer for beneficiaries dually eligible for Medicare and Medicaid. For those beneficiaries, States must pay the Part D account a portion of their estimated foregone drug costs for this population (referred to as State transfers). As with HI, interest received on Treasury securities held in the SMI Trust Fund is credited to the fund and these Treasury securities and related interest are eliminated in consolidation at the Governmentwide level. Refer to the *Social Insurance* segment in the Supplemental Information section for additional information on Medicare program financing.

Social Security and Medicare – Demographic and Economic Assumptions

The Boards of Trustees[2] of the OASDI and Medicare Trust Funds provide in their annual reports to Congress short-range (10-year) and long-range (75-year) actuarial estimates of each trust fund. Because of the inherent uncertainty in estimates for 75 years into the future, the Boards use three alternative sets of economic and demographic assumptions to show a range of possibilities. Assumptions are made about many economic and demographic factors, including gross domestic product (GDP), earnings, the consumer price index (CPI), the unemployment rate, the fertility rate, immigration, mortality, disability incidence and terminations, and for the Medicare projections, health care cost growth. The assumptions used for the most recent set of projections shown in Tables 1A (Social Security) and Table 1B (Medicare) are generally referred to as the “intermediate assumptions,” and reflect the trustees’ best estimate of expected future experience. For further information on Social Security and Medicare demographic and economic assumptions, refer to SSA’s and HHS’s performance and accountability reports.

[1] Medicare legislation in 2003 created the new Part D account in the SMI Trust Fund to account for the new prescription drug benefit that began in 2006. Similar to Medicare Part B, approximately three-quarters of revenues to the Part D account is expected to come from future transfers from the General Fund of the Treasury.

[2] There are six trustees: the Secretaries of Treasury (managing trustee), Health and Human Services, and Labor; the Commissioner of the Social Security Administration; and two public trustees who are generally appointed by the President and confirmed by the Senate for a 4-year term. By law, the public trustees are members of two different political parties.

Table 1A
Social Security – Demographic and Economic Assumptions

Demographic Assumptions

Year	Total Fertility Rate[1]	Age-Sex Adjusted Death Rate[2]	Net Immigration[3] (persons)	Period Life Expectancy at Birth[4] Male	Female
2006	2.03	848.9	1,075,000	75.0	79.7
2010	2.03	829.2	1,000,000	75.5	79.9
2020	2.01	767.1	950,000	76.6	80.7
2030	2.00	707.4	900,000	77.6	81.6
2040	2.00	654.5	900,000	78.5	82.4
2050	2.00	608.0	900,000	79.4	83.1
2060	2.00	566.9	900,000	80.3	83.9
2070	2.00	530.3	900,000	81.0	84.5
2080	2.00	497.6	900,000	81.8	85.1

Economic Assumptions

Year	Real Wage Differential[5] (percent)	Average Annual Wage in Covered Employment[6] (percent change)	CPI[7] (percent change)	Real GDP[8] (percent change)	Total Employment[9] (percent change)	Average Annual Interest Rate[10] (percent)
2006	1.2	4.1	2.9	3.4	1.7	4.9
2010	1.5	4.3	2.8	2.6	0.7	5.9
2020	0.9	3.7	2.8	2.1	0.4	5.7
2030	1.1	3.9	2.8	1.9	0.3	5.7
2040	1.1	3.9	2.8	2.0	0.3	5.7
2050	1.1	3.9	2.8	2.0	0.3	5.7
2060	1.1	3.9	2.8	1.9	0.3	5.7
2070	1.1	3.9	2.8	2.0	0.3	5.7
2080	1.1	3.9	2.8	1.9	0.3	5.7

[1] The total fertility rate for any year is the average number of children who would be born to a woman in her lifetime if she were to experience the birth rates by age observed in, or assumed for, the selected year, and if she were to survive the entire childbearing period. The ultimate total fertility rate of 2.0 is assumed to be reached in 2030.
[2] The age-sex-adjusted death rate is a weighted average of age-sex-specific death rates (deaths per 100,000) in a year where the weights are the number of people in the corresponding age-sex group as of April 1, 2000. The death rate is a summary measure and not a basic assumption; it summarizes the effects of the basic assumptions from which it is derived.
[3] Net immigration is the number of persons who enter during the year (both legally and otherwise) minus the number of persons who leave during the year.
[4] The period life expectancy for a group of persons born in a given year is the average that would be attained by such persons if the group were to experience in succeeding years the death rates by age observed in, or assumed for, the given year. It is a summary measure and not a basic assumption; it summarizes the effects of the basic assumptions from which it is derived.
[5] The real-wage differential is the difference between the percentage increases, before rounding, in the average annual wage in covered employment, and the average annual CPI.
[6] The average annual wage in covered employment is the total amount of wages and salaries for all employment covered by the OASDI program in a year divided by the number of employees with any such earnings during the year.
[7] The calendar price index (CPI) is the annual average value for the calendar year of the CPI for urban wage earners and clerical workers.
[8] The real Gross Domestic Product (GDP) is the value of total output of goods and services, expressed in 2000 dollars. It is a summary measure and not a basic assumption; it summarizes the effects of the basic assumptions from which it is derived.
[9] Total employment represents total of civilian and military employment in the U.S. economy.
[10] The average annual interest rate is the average of the nominal interest rates, which, in practice, are compounded semiannually for special-issue Treasury obligations sold only to the trust funds in each of the 12 months of the year.

Table 1B
Medicare – Demographic and Economic Assumptions

Demographic Assumptions

Year	Total Fertility Rate[1]	Age-Sex Adjusted Death Rate[2]	Net Immigration[3] (persons)
2006	2.03	848.9	1,075,000
2010	2.03	829.2	1,000,000
2020	2.01	767.1	950,000
2030	2.00	707.4	900,000
2040	2.00	654.5	900,000
2050	2.00	608.0	900,000
2060	2.00	566.9	900,000
2070	2.00	530.3	900,000
2080	2.00	497.6	900,000

Economic Assumptions

					Per Beneficiary Cost (percent change)[7]			
						SMI		
Year	Real Wage Differential[4] (percent)	Average Annual Wage in Covered Employment (percent change)	CPI[5] (percent change)	Real GDP[6] (percent)	HI	Part B	Part D	Real Interest Rate[8] (percent)
2006	1.2	4.1	2.9	3.4	4.7	8.6	0.0	1.4
2010	1.5	4.3	2.8	2.6	4.7	4.1	7.9	3.1
2020	0.9	3.7	2.8	2.1	4.4	4.5	6.6	2.9
2030	1.1	3.9	2.8	1.9	5.8	5.6	5.3	2.9
2040	1.1	3.9	2.8	2.0	5.8	5.3	5.2	2.9
2050	1.1	3.9	2.8	2.0	4.9	4.8	4.9	2.9
2060	1.1	3.9	2.8	1.9	4.6	4.7	4.6	2.9
2070	1.1	3.9	2.8	2.0	4.5	4.4	4.4	2.9
2080	1.1	3.9	2.8	1.9	4.3	4.3	4.3	2.9

[1] The total fertility rate for any year is the average number of children who would be born to a woman in her lifetime if she were to experience the birth rates by age observed in, or assumed for, the selected year, and if she were to survive the entire childbearing period. The ultimate total fertility rate of 2.0 is assumed to be reached in 2030.
[2] The age-sex-adjusted death rate is a weighted average of age-sex-specific death rates (deaths per 100,000) in a year where the weights are the number of people in the corresponding age-sex group as of April 1, 2000. The death rate is a summary measure and not a basic assumption; it summarizes the effects of the basic assumptions from which it is derived.
[3] Net immigration is the number of persons who enter during the year (both legally and otherwise) minus the number of persons who leave during the year.
[4] The real-wage differential is the difference between the percentage increases, before rounding, in the average annual wage in covered employment, and the average annual CPI.
[5] The calendar price index (CPI) is the annual average value for the calendar year of the CPI for urban wage earners and clerical workers.
[6] The real Gross Domestic Product (GDP) is the value of total output of goods and services, expressed in 2000 dollars. It is a summary measure and not a basic assumption; it summarizes the effects of the basic assumptions from which it is derived.
[7] These increases reflect the overall impact of more detailed assumptions that are made for each of the different types of service provided by the Medicare program (for example, hospital care, physician services, and pharmaceutical costs). These assumptions include changes in the payment rates, utilization, and intensity of each type of service.
[8] The average annual interest rate earned on new trust fund securities, above and beyond the rate of inflation.

Railroad Retirement – Program Description

The Railroad Retirement and Survivor Benefit program pays full retirement annuities at age 60 to railroad workers with 30 years of service. The program pays disability annuities based on total or occupational disability. It also pays annuities to spouses, divorced spouses, widow(er)s, remarried widow(er)s, surviving divorced spouses, children, and parents of deceased railroad workers. Medicare covers qualified railroad retirement beneficiaries in the same way as it does Social Security beneficiaries. The Railroad Retirement and Survivors' Improvement Act of 2001 (RRSIA), liberalized benefits for 30-year service employees and their spouses, eliminated a cap on monthly benefits for retirement and disability benefits, lowered minimum service requirements from 10 to 5 years, and provided for increased benefits for widow(er)s.

The RRB and the SSA share jurisdiction over the payment of retirement and survivor benefits. RRB has jurisdiction if the employee had at least 5 years (if performed after 1995) of railroad service. For survivor benefits, RRB requires that the employee's last regular employment before retirement or death be in the railroad industry. If a railroad employee or his or her survivors do not qualify for railroad retirement benefits, the RRB transfers the employee's railroad retirement credits to SSA.

Payroll taxes paid by railroad employers and their employees are a primary source of income for the Railroad Retirement and Survivor Benefit Program. By law, railroad retirement taxes are coordinated with Social Security taxes. Employees and employers pay tier I taxes at the same rate as Social Security taxes. Tier II taxes finance railroad retirement benefit payments that are higher than Social Security levels.

Other sources of program income include: financial transactions with the Social Security and Medicare Trust Funds, earnings on investments, Federal income taxes on railroad retirement benefits, and appropriations (provided after 1974 as part of a phase out of certain vested dual benefits). The financial interchanges and transactions between RRB's Social Security Equivalent Benefit (SSEB) Account, the Federal Old-Age and Survivors Insurance Trust Fund, the Disability Insurance Trust Fund, and the Federal Hospital Insurance Trust Fund are intended to put the latter three trust funds in the same position they would have been had railroad employment been covered under the Social Security Act. From a Governmentwide perspective, these future financial transactions are intragovernmental transfers and are excluded in the consolidation.

Railroad Retirement – Employment, Demographic and Economic Assumptions

The most recent set of projections are prepared using employment, demographic and economic assumptions and reflect the Board Members' best estimate of expected future experience.

Three employment assumptions were used in preparing the projections and reflect optimistic, moderate and pessimistic future passenger rail and freight employment. The average railroad employment is assumed to be 228,000 in 2006. This employment assumption, based on a model developed by the Association of American Railroads, assumes that (1) passenger service employment will remain at the level of 43,000 and (2) the employment base, excluding passenger service employment, will decline at a constant 2.5 percent annual rate for 25 years, at a falling rate over the next 25 years, and remain level thereafter. All the projections are based on an open group (i.e., future entrants) population.

The moderate (middle) economic assumptions include a cost of living increase of 3.0 percent, an interest rate of 7.5 percent, and a wage increase of 4 percent. The cost of living assumption reflects the expected level of price inflation. The interest rate assumption reflects the expected return on National Railroad Retirement Investment Trust (NRRIT) investments. The wage increase reflects the expected increase in railroad employee earnings.

The demographic assumptions include rates for mortality and total termination rates, remarriage rates for widows, retirement rates and withdrawal rates are listed in Table 2. For further details on the employment, demographic, economic and all other assumptions, refer to the *Railroad Retirement System Annual Report*, June 2006 and the 23rd *Actuarial Valuation of the Assets and Liabilities under the Railroad Retirement Acts* (Valuation Report) as of December 31, 2004, with Technical Supplement.

Table 2
Railroad Retirement Demographic Actuarial Assumptions

Mortality Rates[1]	Mortality after age retirement	2004 RRB Annuitants Mortality Table
	Mortality after disability retirement	2004 RRB Disabled Mortality Table for Annuitants with Disability Freeze
		2004 RRB Disabled Mortality Table for Annuitants without Disability Freeze
	Mortality during active service	1994 RRB Active Service Mortality Table
	Mortality of widow annuitants	1995 RRB Mortality Table for Widows
Total Termination Rates[2]	Termination for spouses	2004 RRB Spouse Total Termination Table
	Termination for disabled children	2004 RRB Total Termination Table for Disabled Children
Widow Remarriage Rate[3]	1997 RRB Remarriage Table	
Retirement Rates[4]	Age retirement	See the Valuation Report
	Disability retirement	See the Valuation Report
Withdrawal Rates[5]	See the Valuation Report	

[1] These mortality tables are used to project the termination of eligible employee benefit payments within the population.
[2] Total termination rates are used to project the termination of dependent benefits which are limited to spouses and disabled children.
[3] This rate is to project the termination of spousal survivor benefits.
[4] The retirement rates are used to determine the expected annuity to be paid based on age and years of service for both age and disability retirees.
[5] The withdrawal rates are used to project all withdrawals from the railroad industry and resultant effect on the population and accumulated benefits to be paid.

Black Lung – Program Description

The Black Lung Disability Benefit Program provides compensation for medical and survivor benefits for eligible coal miners who are disabled due to pneumoconiosis (black lung disease) arising out of their coal mine employment. The DOL operates the Black Lung Disability Benefit Program. The Black Lung Disability Trust Fund (BLDTF) provides benefit payments to eligible coal miners disabled by pneumoconiosis when no responsible mine operator can be assigned the liability.

Excise taxes on coal mine operators, based on the sale of coal, are the primary source of financing black lung disability payments and related administrative costs. Though excise tax revenues currently exceed costs (and are expected to in the future), that was not always the case. The Black Lung Benefits Revenue Act provides for repayable advances to the BLDTF from the General Fund of the Treasury, in the event that BLDTF resources are not adequate to meet program obligations. During earlier years of the program, general revenues were needed to pay for cash shortfalls in the program.

Black Lung – Demographic and Economic Assumptions

The demographic assumptions used for the most recent set of projections are the number of beneficiaries and their life expectancy. The beneficiary population data is updated from information supplied by the program. The beneficiary population is a nearly closed universe in which attrition by death exceeds new entrants by a ratio of more than ten to one. Life tables are used to project the life expectancies of the beneficiary population.

The economic assumptions used for the most recent set of projections are coal excise tax revenue estimates, the tax rate structure, Federal civilian pay raises, medical cost inflation, and the interest rate on new repayable advances from the Treasury.

Estimates of future receipts of the black lung excise tax are based on projections of future coal production and sale prices prepared by the Energy Information Agency of DOE. Treasury's Office of Tax Analysis provides the first 11 years of tax receipt estimates. The remaining years are estimated using a growth rate based on both historical tax receipts and Treasury's estimated tax receipts. The coal excise tax rate structure is $1.10 per ton of underground-mined coal and $0.55 per ton of surface-mined coal sold, with a cap of 4.40 percent of sales price, through December 31, 2013. Starting in 2014, the tax rates revert to $0.50 per ton of underground-mined coal and $0.25 per ton surface-mine coal sold, and a limit of 2 percent of sales price.

OMB supplies assumptions for future monthly benefit rate increases based on increases in the Federal pay scale and future medical cost inflation based on increases in the consumer price index-medical, which are used to calculate future benefit costs. During the current projection period, future benefit rate increases range from 4.00 percent to 4.30 percent, and medical cost increases range from 4.00 percent to 4.10 percent. Estimates for administrative costs for the first 11 years of the projection are supplied by DOL's Budget Office, while later years are based on the number of projected beneficiaries. Estimates for future interest on advances are based on the interest rates on outstanding advances ranging from 4.5 percent to 13.9 percent and new borrowings ranging from 4.9 percent to 5.8 percent.

SMI Part B Physician Update Factor

The projected Part B expenditure growth reflected in the accompanying SOSI is significantly reduced as a result of the structure of physician payment updates under current law. In the absence of legislation, this structure would result in multiple years of significant reductions in physician payments, totaling an estimated 37 percent over the next 9 years. Reductions of this magnitude are not feasible and such reductions are very unlikely to occur fully in practice. For example, Congress has overridden scheduled negative updates for each of the last 4 years. [3] However, since these reductions are required in the future under the current-law payment system, they are reflected in the accompanying SOSI as required under GAAP. Consequently, the projected actuarial present values of Part B expenditure shown in the accompanying SOSI is likely understated.

The potential magnitude of the understatement of Part B expenditures due to the physician payment mechanism can be illustrated using two hypothetical examples of changes to current law. These examples were developed by management for illustrative purposes only; the calculations have not been audited, and the examples do not attempt to portray likely or recommended future outcomes. Thus, the illustrations are useful only as general indicators of the substantial impacts that could result from future legislation on physician payments under Medicare and of the broad range of uncertainty associated with such impacts. Under current law, the projected 75-year present value of future Part B expenditures is $17.6 trillion. If Congress were to set future physician payment updates at zero percent per year, then absent other provisions to offset these costs, the projected present value would increase to $22.3 trillion. Alternatively, if Congress were to set future physician payment updates equal to the Medicare Economic Index (projected to be 2 to 2.5 percent per year), the present value would be $24.4 trillion.

The extent to which actual future Part B costs could exceed the projected current-law amounts due to physician payments depends on both the level of physician payment updates that might be legislated and on whether Congress would pass further provisions to help offset such costs (as it did, for example, in the Deficit Reduction Act). As noted, these examples only reflect hypothetical changes to physician payments. It is likely that in the coming years Congress will consider and pass numerous other legislative proposals affecting Medicare. Many of these would likely be designed to reduce costs in an effort to make the program more affordable. In practice, it is not possible to anticipate what actions Congress might take, either in the near term or over longer periods.

[3] Recently, Congress passed legislation to override scheduled reductions for 2007. The Tax Relief and Health Care Act of 2006, H.R. 6111, 109th Cong. As of December 11, 2006, the President had not signed the legislation.

Note 24. Stewardship Land

Stewardship land refers to federally-owned land that is set aside for the use and enjoyment of present and future generations and land on which military bases are located. Except for military bases, this land is not used or held for use in general Government operations. Stewardship land is land that the Government does not expect to use to meet its obligations, unlike the assets listed in the balance sheets. Stewardship land is measured in non-financial units such as acres of land and lakes, number of National Parks and square miles of National Marine Sanctuaries. Examples of stewardship land include national parks, national forests, wilderness areas, and land used to enhance ecosystems to encourage animal and plant species and to conserve nature. This category excludes lands administered by the Bureau of Indian Affairs and held in trust.

Most stewardship land managed by the Government was once part of the 1.8 billion acres of public domain land acquired between 1781 and 1867. Stewardship land accounts for 28 percent of the current U.S. landmass.

DOI modified its units of measure to more accurately reflect the major categories of uses of stewardship land. As of fiscal year 2006 they have 547 national wildlife refuges, 390 national parks, 126 geographic management areas, 86 fish hatcheries, and many other categories. At the end of fiscal year 2006 the Department of Agriculture's Forest Services managed an estimated 192.8 million acres of public land, while DOC had 13 National Marine Sanctuaries, which included near–shore coral reefs and open ocean, covering a total of 19 thousand square miles.

Stewardship lands are used and managed in accordance with the statutes authorizing their acquisition or directing their use and management. Additional detailed information concerning stewardship land can be obtained in the financial statements of DOI, DOC, DOD, and USDA.

Note 25. Heritage Assets

Heritage assets are Government-owned assets that have one or more of the following characteristics:

- Historical or natural significance.
- Cultural, educational, or artistic importance.
- Significant architectural characteristics.

The cost of heritage assets often is not determinable or relevant to their significance. Like stewardship land, the Government does not expect to use these assets to meet its obligations. The most relevant information about heritage assets is nonfinancial. The public entrusts the Government with these assets and holds it accountable for their preservation. Examples of heritage assets include Mount Rushmore National Memorial and Yosemite National Park. Other examples of heritage assets include the Declaration of Independence, the U.S. Constitution, and the Bill of Rights preserved by the National Archives. Also included are national monuments/structures such as the Vietnam Veterans Memorial, the Jefferson Memorial, and the Washington Monument, as well as the Library of Congress. Many other sites such as battlefields, historic structures, and national historic landmarks are placed in this category, as well.

Many laws and regulations have been put in place that govern the preservation and management of heritage assets. Established policies, by individual Federal agencies, for heritage assets ensure the proper care and handling of the assets under their controls and preserve these assets for the benefit of the American public.

Some heritage assets are used both to remind us of our heritage and for day-to-day operations. These assets are referred to as multi-use heritage assets. One typical example is the White House. The cost of acquisition, betterment or reconstruction of all multi-use heritage assets is capitalized as general property, plant, and equipment and is depreciated.

The discussion of the Government's heritage assets is not all-inclusive. Rather, it highlights significant heritage assets reported by Federal agencies.

The Government classifies heritage assets into two broad categories:

- Collection type
- Non-collection type

Collection type heritage assets include objects gathered and maintained for museum and library collections. Non-collection type heritage assets include national wilderness areas, wild and scenic rivers, natural landmarks, forests, grasslands, historic places and structures, memorials and monuments, buildings, national cemeteries and archeological sites.

Please refer to the individual financial statements of the Smithsonian Institution, the Department of the Interior, the Department of Agriculture-Forest Service, the National Archives and Records Administration, and the website for the Library of Congress at http://www.loc.gov/index.html, for additional information on multi-use heritage assets, including agency stewardship policies, physical units by major categories and the condition.

Note 26. Restatements

In billions of dollars)	September 30, 2005 Reported	Restated
Reconciliation of Net Operating Cost and Unified Budget Deficit:		
Net Operating Cost	760.0	760.2
Components of Net Operating Cost not Part of the Budget Deficit:		
Property, plant, and equipment disposals and revaluations	47.8	(43.7)
Components of the Budget Deficit not Part of Net Operating Cost:		
Capitalized Fixed assets:		
Department of Defense	(110.2)	(28.3)
Civilian Agencies	(36.4)	(25.1)
Total Capitalized Fixed Assets	(146.6)	(53.4)
(Increase) in Securities and Investments	(18.2)	(16.2)
Principal repayments of precredit reform loans	9.7	(2.2)
All other Reconciling Items	(13.2)	(4.8)
Guaranteed Loan Programs (Note 4):		
Small Business Loans-SBA:		
Face Value of Loans Outstanding	73.3	63.3
Amount Guaranteed By the Government	61.1	51.1
Property, Plant, and Equipment, Net (Note 6):		
Defense: Furniture, Fixtures and Equipment:		
Cost	1,266.4	665.5
Accumulated Depreciation	908.8	316.1
Net Balance	357.6	349.4

The fiscal year 2005 Reconciliation of Net Operating Cost and Unified Budget Deficit has been restated to correct for material errors made during the consolidation process. These errors caused an understatement of the property, plant, and equipment disposals and revaluations line item and an overstatement of the capitalized fixed assets line item by \$91.5 billion and by \$93.2 billion, respectively. The components of total capitalized fixed assets, Department of Defense and Civilian Agencies, were overstated by \$81.9 billion and \$11.3 billion, respectively. In addition, the increase in securities and investments and the principal repayments of precredit reform loans were also overstated by \$2.0 billion and \$11.9 billion, respectively. Lastly, all other reconciling items (formerly called the “net amount of all other differences”) was overstated by \$8.4 billion.

The Department of Defense reported a prior period adjustment due to material errors resulting from a change in the methodology for the reporting of military equipment. The methodology previously used by DOD was not compliant with Statement of Federal Financial Accounting Standards (SFFAS) Number 23, *Eliminating the Category National Defense Property, Plant, and Equipment.* This adjustment decreased the value of furniture, fixtures, and equipment (FFE) and associated accumulated depreciation by \$600.9 billion and 592.7 billion, respectively, resulting in an \$8.2 billion downward restatement in net FFE balance. The net effect of this adjustment impacted the fiscal year 2005 Balance Sheet and the Statements of Operations and Changes in Net Position. In fiscal year 2006, DOD recorded other adjustments of \$0.2 billion for correction of accounting errors.

During fiscal year 2006, the SBA discovered an error in their presentation of Guaranteed Loans Outstanding in its fiscal year 2005 financial statements. The amounts disclosed in the fiscal year 2005 consolidated financial statements’ Note 4—Loans Receivable and Loan Guarantee Liabilities, Net for Small Business Loans-SBA guaranteed loans outstanding as of September 30, 2005, were overstated by \$10 billion due to a data error in SBA's loan accounting system. The correction of this error by SBA has lowered both the face value and the amount guaranteed by the Federal Government of guaranteed loans outstanding as of September 30, 2005, by \$10 billion. Since these amounts are for informative purposes only and are not contained in any other financial statement line items, there is no further impact of this correction in the consolidated financial statements or notes.

United States Government Supplemental Information (Unaudited) for the Years Ended September 30, 2006, and September 30, 2005

Social Insurance

The social insurance programs were developed to provide income security and health care coverage to citizens under specific circumstances as a responsibility of the Government. Because taxpayers rely on these programs in their long-term planning, social insurance program information should indicate whether they are sustainable under current law, as well as what their effect will be on the Government's financial condition. The resources needed to run these programs are raised through taxes and fees. Eligibility for benefits rests in part on earnings and time worked by the individuals. Social Security benefits are generally redistributed intentionally toward lower-wage workers (i.e., benefits are progressive). In addition, each social insurance program has a uniform set of entitling events and schedules that apply to all participants.

Social Security and Medicare

Social Security

The Federal Old-Age and Survivors Insurance (OASI) Trust Fund was established on January 1, 1940, as a separate account in the Treasury. The Federal Disability Insurance (DI) Trust Fund, another separate account in the Treasury, was established on August 1, 1956. OASI pays cash retirement benefits to eligible retirees and their eligible dependents and survivors, and the much smaller DI fund pays cash benefits to eligible individuals who are unable to work due to medical conditions. At the end of calendar year 2005, OASDI benefits were paid to approximately 48 million beneficiaries. Though the events that trigger benefit payments are quite different, both trust funds have the same earmarked financing structure: primarily payroll taxes and income taxes on benefits. All financial operations of the OASI and DI Programs are handled through these respective funds. The two funds are often referred to as simply the combined OASDI Trust Funds.

The primary financing of these two funds are taxes paid by workers, their employers, and individuals with self-employment income, based on work covered by the OASDI Program. Since 1990, employers and employees have each paid 6.2 percent of covered earnings. The self-employed pay 12.4 percent of covered earnings. Payroll taxes are computed on wages and net earnings from self-employment up to a specified maximum annual amount ($94,200 in 2006) that increases each year with economy-wide wages.

Since 1984, up to one-half of OASDI benefits have been subject to Federal income taxation. Effective for taxable years beginning after 1993, the maximum percentage of benefits subject to taxation was increased from 50 percent to 85 percent. The revenue from income taxes on up to 50 percent of benefits is allocated to the OASDI Trust Funds and the rest is allocated to the Hospital Insurance (HI) Trust Fund.

Medicare

The Medicare Program, created in 1965, also has two separate trust funds: the Hospital Insurance (HI, Medicare Part A) and Supplementary Medical Insurance (SMI, Medicare Parts B and D) Trust Funds.[1] HI pays for inpatient acute hospital services and major alternatives to hospitals (skilled nursing services, for example) and SMI

[1] Medicare legislation in 2003 created the new Part D account in the SMI Trust Fund to track the finances of a new prescription drug benefit that began in 2006. As in the case of Medicare Part B, approximately three-quarters of revenues to the Part D account will come from future transfers from the General Fund of the Treasury. Consequently, the nature of the relationship between the SMI Trust Fund and the Federal budget described below is largely unaffected by the presence of the Part D account though the magnitude will be greater.

pays for hospital outpatient services, physician services, and assorted other services and products through the Part B account and pays for prescription drugs through the Part D account. Though the events that trigger benefit payments are similar, HI and SMI have different earmarked financing structures. Similarly to OASDI, HI is financed primarily by payroll contributions. Employers and employees each pay 1.45 percent of earnings, while self-employed workers pay 2.9 percent of their net earnings. Other income to the HI fund includes a small amount of premium income from voluntary enrollees, a portion of the Federal income taxes that beneficiaries pay on Social Security benefits (as explained above), and interest credited on Treasury securities held in the HI Trust Fund. These Treasury securities and related interest are excluded upon consolidation at the Governmentwide level.

For SMI, transfers from the General Fund of the Treasury represent the largest source of income covering about 75 percent of program costs for both Parts B and D. Beneficiaries pay monthly premiums that finance approximately 25 percent of costs. With Part D drug coverage, Medicaid will no longer be the primary payer for beneficiaries dually eligible for Medicare and Medicaid. For those beneficiaries, States must pay the Part D account a portion of their estimated foregone drug costs for this population (referred to as State transfers). As with HI, interest received on Treasury securities held in the SMI Trust Fund is credited to the fund. These Treasury securities and related interest are excluded upon consolidation at the Governmentwide level. Refer to Note 23—Social Insurance, for additional information on Medicare program financing.

Social Security, Medicare, and Governmentwide Finances

The current and future financial status of the separate Social Security and Medicare Trust Funds is the focus of the trustees' reports, a focus that may appropriately be referred to as the "trust fund perspective." In contrast, the Federal Government primarily uses the *unified budget* concept as the framework for budgetary analysis and presentation. It represents a comprehensive display of all Federal activities, regardless of fund type or on- and off-budget status, a broader focus than the trust fund perspective that may appropriately be referred to as the "budget perspective" or the "Governmentwide perspective." Social Security and Medicare are among the largest expenditure categories of the U.S. Federal budget. Together, they now account for more than a third of all Federal spending and the percentage is projected to rise dramatically for the reasons discussed below. This section describes in detail the important relationship between the trust fund perspective and the Governmentwide perspective.

Figure 1 is a simplified graphical depiction of the interaction of the Social Security and Medicare Trust Funds with the rest of the Federal budget.[2] The boxes on the left show sources of funding, those in the middle represent the trust funds and other Government accounts (of which the General Fund is a part) into which that funding flows, and the boxes on the right show simplified expenditure categories. The figure is intended to illustrate how the various sources of program revenue flow through the budget to beneficiaries. The general approach is to group revenues and expenditures that are linked specifically to Social Security and/or Medicare separately from those for other Federal programs. (For ease of understanding, these other Federal programs are referred to here as *other Government* programs.)

Each of the trust funds has its own sources and types of revenue. With the exception of General Fund transfers to SMI, each of these revenue sources is earmarked specifically for the respective trust fund, and cannot be used for other purposes. In contrast, personal and corporate income taxes and other revenue go into the General Fund of the Treasury and are drawn down for any Government program for which Congress has approved spending.[3] The arrows from the boxes on the left represent the flow of these revenues into the trust funds and other Government accounts.

The heavy line between the top two boxes in the middle of Figure 1 represents intragovernmental transfers between the SMI Trust Fund and other Government accounts. The Medicare SMI Trust Fund is shown separately from the two Social Security trust funds (OASI and DI) and the Medicare HI Trust Fund to highlight the unique financing of SMI. SMI is currently the only one of the four programs that receives large transfers from the General Fund of the Treasury, which is part of the other Government accounts (the Part D account will receive transfers from the States). The transfers finance roughly three-fourths of SMI Program expenses. While the transfers currently support the Part B account, in 2006 additional transfers were made to the Part D account and are expected to finance about three-fourths of expenses in that account. The transfers are automatic; their size depends on how much the program spends, not on how much revenue comes into the Treasury. If General Fund revenues become insufficient

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[2] The Federal unified budget encompasses all Federal Government financing and is synonymous with a Governmentwide perspective.

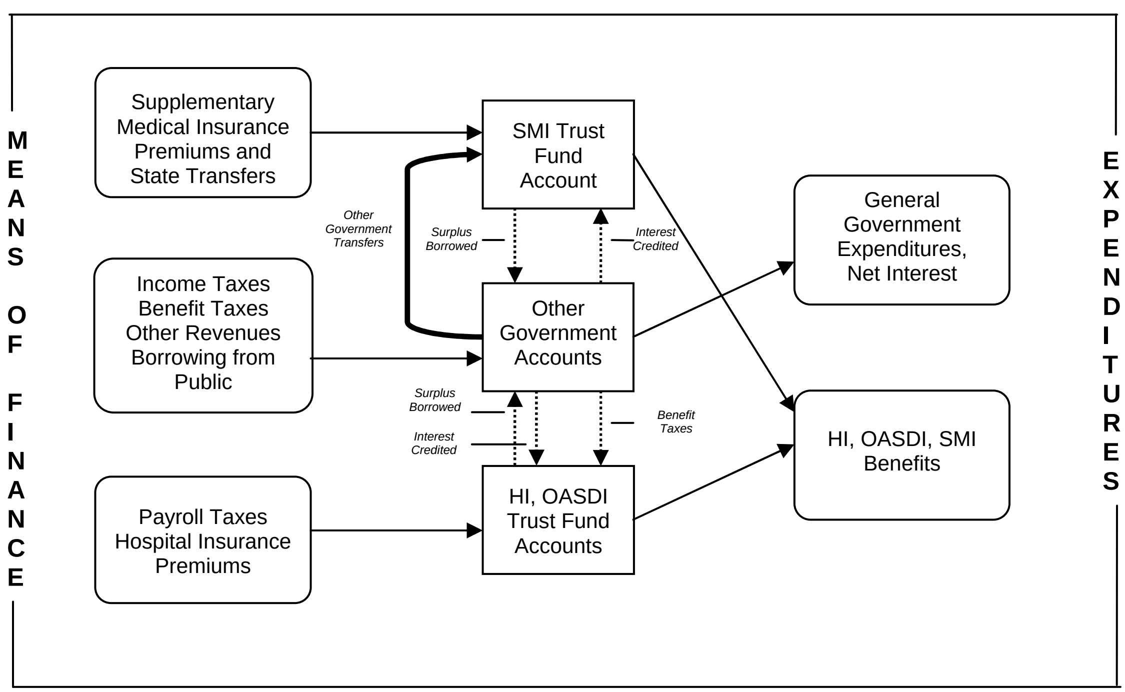
[3] Other programs also have dedicated revenues in the form of taxes and fees (and other forms of receipt) and there are a large number of earmarked trust funds in the Federal budget. Total trust fund receipts account for about 40 percent of total Government receipts with the Social Security and Medicare Trust Funds accounting for about two-thirds of trust fund receipts. For further discussion see *Federal Trust and Other Earmarked Funds*, GAO-01-199SP, January 2001. In the figure and the discussion that follows, we group all other programs, including these other earmarked trust fund programs, under "Other Government Accounts" to simplify the description and maintain the focus on Social Security and Medicare.

to cover both the mandated transfer to SMI and expenditures on other general Government programs, Treasury would have to borrow to make up the difference. In the longer run, if transfers to SMI are increasing—as shown below, they are projected to increase significantly in coming years—then Congress must either raise taxes, cut other Government spending, or reduce SMI benefits.

The dotted lines between the middle boxes of Figure 1 also represent intragovernmental transfers but those transfers arise in the form of "borrowing/lending" between the Government accounts. Interest credited to the trust funds arises when the excess of program income over expenses is loaned to the General Fund. The vertical lines labeled *Surplus Borrowed* represent these flows from the trust funds to the other Government accounts. These loans reduce the amount the General Fund has to borrow from the public to finance a deficit (or likewise increase the amount of debt paid off if there is a surplus). But the General Fund has to credit interest on the loans from the trust fund programs, just as if it borrowed the money from the public. The credits lead to future obligations for the General Fund (which is part of the other Government accounts). These transactions are indicated in Figure 1 by the vertical arrows labeled *Interest Credited*. The credits increase trust fund income exactly as much as they increase credits (future obligations) in the General Fund. So from the standpoint of the Government as a whole, at least in an accounting sense, these interest credits are a wash.

It is important to understand the additional implications of these loans from the trust funds to the other Government accounts. When the trust funds get the receipts that they loan to the General Fund, these receipts provide additional authority to spend on benefits and other program expenses. The General Fund, in turn, has taken on the obligation of paying interest on these loans every year and repaying the principal when trust fund income from other sources falls below expenditures—the loans will be called in and the General Fund will have to reduce other spending, raise taxes, or borrow more from the public to finance the benefits paid by the trust funds.

Figure 1
Social Security, Medicare, and Governmentwide Finances



Actual dollar amounts roughly corresponding to the flows presented in Figure 1 are shown in Table 1 for fiscal year 2006. The first three columns show revenues and expenditures for HI, SMI, and OASDI, respectively, and the fourth column is the sum of these three columns. The fifth column has total revenues and expenditures for all other Government programs, which includes the General Fund account, and the last column is the sum of the “combined” and “other Government” columns. In Table 1, revenues from the public (left side of Figure 1) and expenditures to the public (right side of Figure 1) are shown separately from transfers between Government accounts (middle of Figure 1). Note that the transfers ($162.8 billion) and interest credits ($114.5 billion) received by the trust funds appear as negative entries under other Government and are thus offsetting when summed for the total budget column. These two intragovernmental transfers are key to the differences between the trust fund and budget perspectives.

From the Governmentwide perspective, only revenues received from the public (and States in the case of Medicare, Part D) and expenditures made to the public are important for the final balance. Trust fund revenue from the public consists of payroll taxes, benefit taxes, and premiums. For HI, the difference between total expenditures made to the public ($184.9 billion) and revenues ($194.4 billion) was $9.5 billion in 2006, indicating that HI had a relatively small positive effect on the overall budget outcome *in that year*. For the SMI account, revenues from the public (premiums) were relatively small, representing about a quarter of total expenditures made to the public in 2006. The difference, $147.7 billion, resulted in a net draw on the overall budget balance in that year. For OASDI, the difference between total expenditures made to the public ($548.5 billion) and revenues from the public ($636.4 billion) was -$87.9 billion in 2006, indicating that OASDI had a positive effect on the overall budget outcome *in that year*.

The trust fund perspective is captured in the bottom section of each of the three trust fund columns. For HI, total revenues exceeded total expenditures by $25.4 billion in 2006, as shown at the bottom of the first column. This surplus would be added to the beginning trust fund (not shown) that leads to budget obligations in future years. For SMI, total revenues of $210.2 billion ($46.1 + $164.1), including $162.6 billion transferred from other Government accounts (the General Fund), exceeded total expenditures by $16.4 billion. Transfers to the SMI Program from other Government accounts (the General Fund), amounting to about 75 percent of program costs, are obligated under current law and therefore appropriately viewed as revenue from the trust fund perspective. For OASDI, total revenues of $733.8 billion ($636.4 + $97.4), including interest and a small amount of other Government transfers, exceeded total expenditures of $548.5 billion by $185.2 billion.

Table 1
Annual Revenues and Expenditures for Medicare and Social Security Trust Funds and the Total Federal Budget, Fiscal Year 2006

(In billions of dollars)

Revenue and Expenditure Categories	Trust Funds: HI	Trust Funds: SMI	Trust Funds: OASDI	Trust Funds: Combined	Other Government	Total[1]
Revenues from the Public:						
Payroll and benefit taxes	190.7	-	636.4	827.1	-	827.1
Premiums	3.7	46.1	-	49.8	-	49.8
Other taxes and fees	-	-	-	-	1,529.8	1,529.8
Total	194.4	46.1	636.4	876.9	1,529.8	2,406.7
Total expenditures to the public[2]	184.9	193.8	548.5	927.1	1,727.2	2,654.4
Net results for budget perspective[3]	9.5	(147.7)	87.9	(50.3)	(197.4)	(247.7)
Revenues from Other Government Accounts:						
Transfers	0.5	162.6	(0.3)	162.8	(162.8)	-
Interest credits	15.4	1.5	97.7	114.5	(114.5)	-
Total	15.9	164.1	97.4	277.3	(277.3)	-
Net results for trust fund perspective [3, 4]	25.4	16.4	185.2	227.0	N/A	N/A

[1] This column is the sum of the preceding two columns and shows data for the total Federal budget. The figure $247.7 was the total Federal deficit in fiscal year 2006.
[2] The OASDI figure includes $3.8 billion transferred to the Railroad Retirement Board for benefit payments and is therefore an expenditure to the public.
[3] Net results are computed as revenues less expenditures.
[4] Details may not add to totals due to rounding.
Note: "N/A" indicates not applicable.

Cashflow Projections

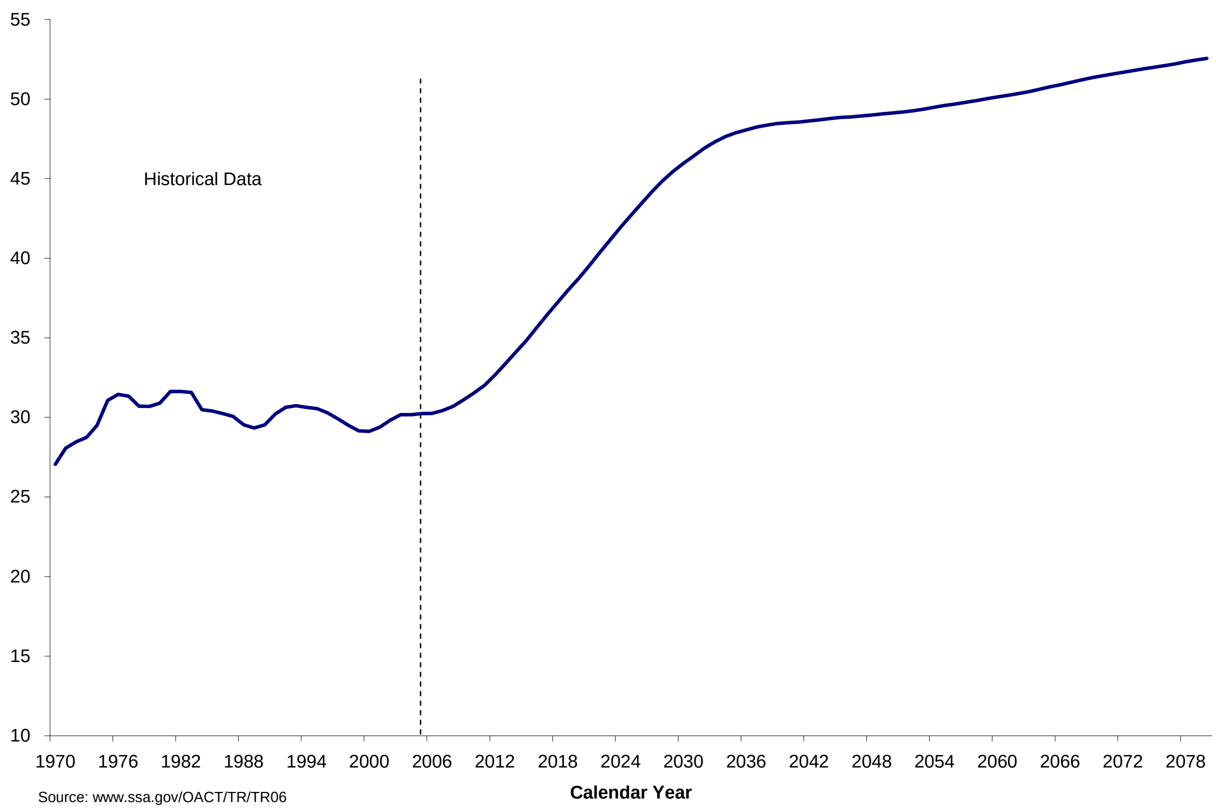
Background

Economic and Demographic Assumptions. The Boards of Trustees[4] of the OASDI and Medicare Trust Funds provide in their annual reports to Congress short-range (10-year) and long-range (75-year) actuarial estimates of each trust fund. Because of the inherent uncertainty in estimates for 75 years into the future, the Boards use three alternative sets of economic and demographic assumptions to show a range of possibilities. The economic and demographic assumptions used for the most recent set of intermediate projections for Social Security and Medicare are shown in the "Social Security" and "Medicare" sections of Note 23—Social Insurance.

[4] There are six trustees: the Secretaries of Treasury (managing trustee), Health and Human Services, and Labor; the Commissioner of the Social Security Administration; and two public trustees who are appointed by the President and confirmed by the Senate for a 4-year term. By law, the public trustees are members of two different political parties.

Beneficiary-to-Worker Ratio. Underlying the pattern of expenditure projections for both the OASDI and Medicare Programs is the impending demographic change that will occur as the large baby-boom generation, born in the years 1946 to 1964, retires or reaches eligibility age. The consequence is that the number of beneficiaries will increase much faster than the number of workers who pay taxes that are used to pay benefits. The pattern is illustrated in Chart 1 which shows the ratio of OASDI beneficiaries to workers for the historical period and estimated for the next 75 years. In 2006, there were about 30 beneficiaries for every 100 workers. By 2030, there will be about 46 beneficiaries for every 100 workers. A similar demographic pattern confronts the Medicare Program. For example, for the HI Program, there were about 26 beneficiaries for every 100 workers in 2006; by 2030 there are expected to be about 42 beneficiaries for every 100 workers. This ratio for both programs will continue to increase to about 50 beneficiaries for every 100 workers by the end of the projection period, after the baby-boom generation has moved through the Social Security system due to declining birth rates and increasing longevity.

Chart 1—OASDI Beneficiaries per 100 Covered Workers 1970-2080

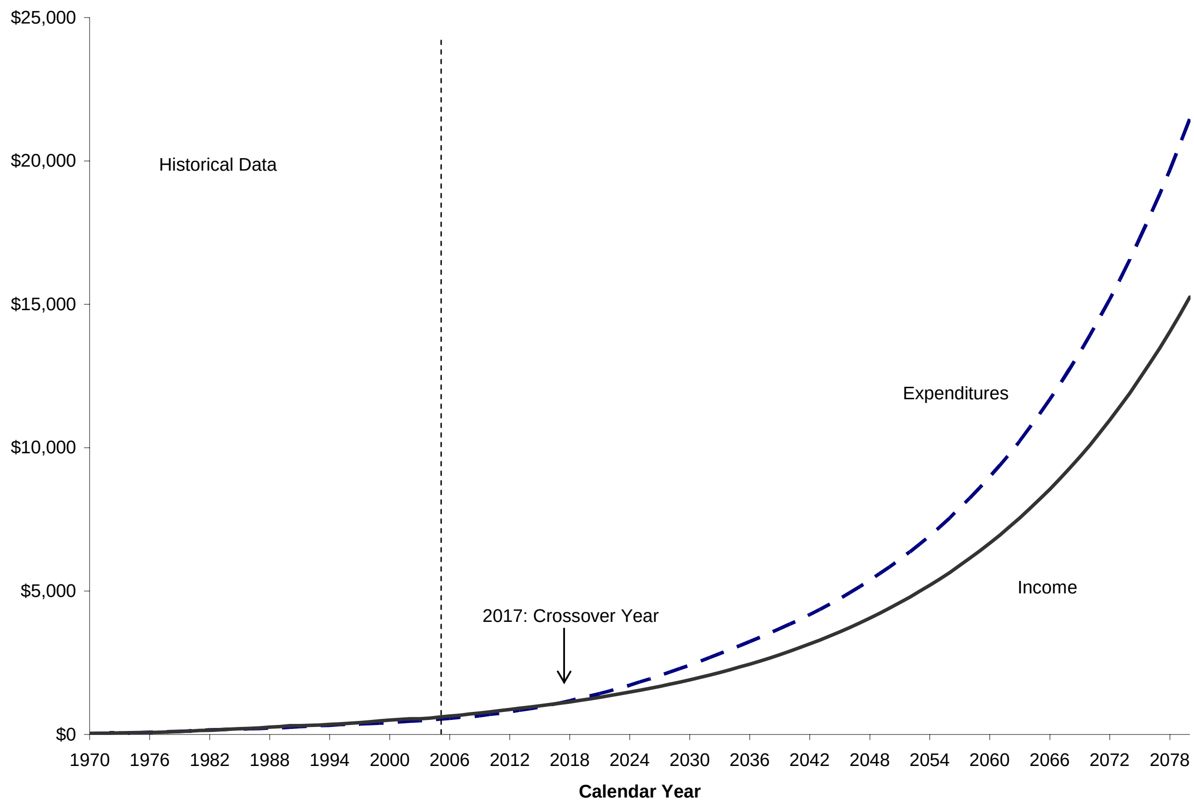


Social Security Projections

Nominal Income and Expenditures. Chart 2 shows historical values and actuarial estimates of combined OASDI annual income (excluding interest) and expenditures for 1970-2080 in nominal dollars. The estimates are for the open-group population. That is, the estimates include taxes paid from, and on behalf of, workers who will enter covered employment during the period, as well as those already in covered employment at the beginning of that period. These estimates also include scheduled benefit payments made to, and on behalf of, such workers during that period. Note that expenditure projections in Chart 2 and subsequent charts are based on current-law benefit formulas regardless of whether the income and assets are available to finance them.

Chart 2—OASDI Income (Excluding Interest) and Expenditures 1970-2080

(In billions of nominal dollars)



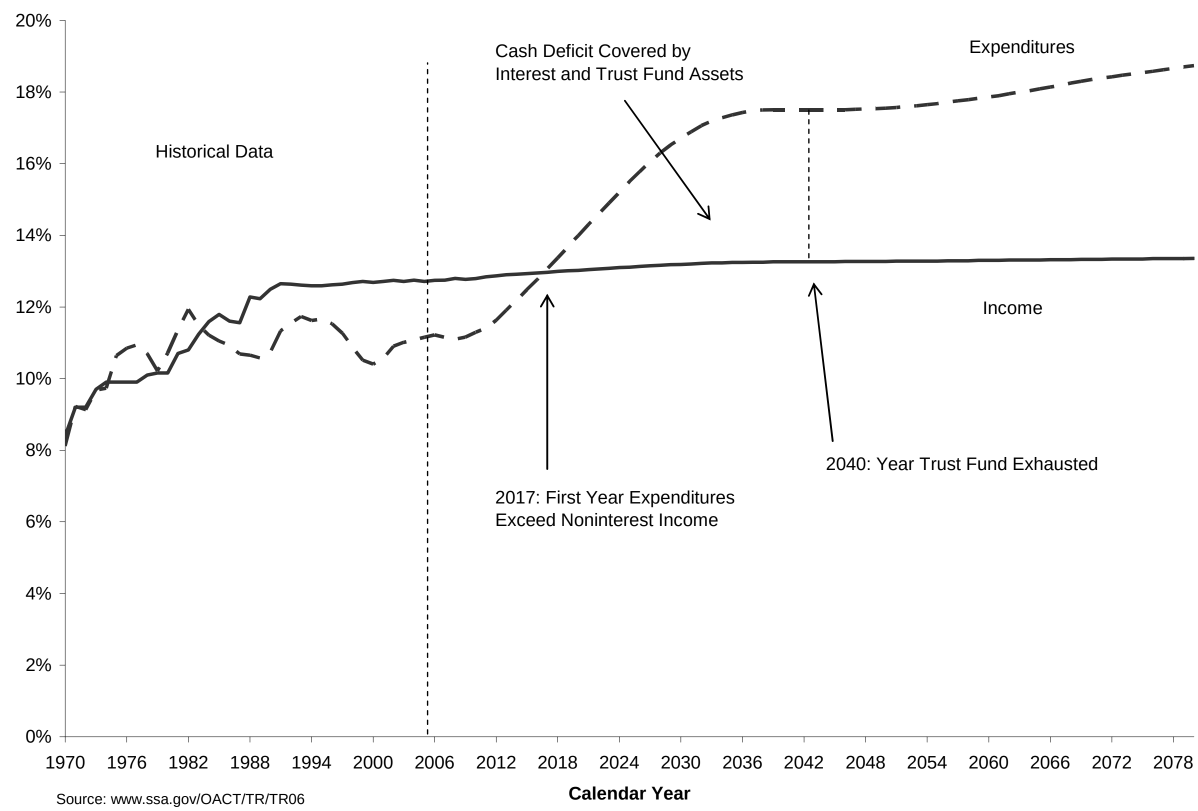
Source: www.ssa.gov/OACT/TR/TR06

Currently, Social Security tax revenues exceed benefit payments and will continue to do so until 2017, when revenues are projected to fall below benefit payments, after which the gap between expenditures and revenues continues to widen.

Income and Expenditures as a Percent of Taxable Payroll. Chart 3 shows annual income (excluding interest but including both payroll and benefit taxes) and expenditures expressed as percentages of taxable payroll, commonly referred to as the income rate and cost rate, respectively.

The OASDI cost rate is projected to decline slightly until about 2008. It then begins to increase rapidly and first exceeds the income rate in 2017, producing cashflow deficits thereafter. As described above, surpluses that occur prior to 2017 are "loaned" to the General Fund and accumulate, with interest, reserve spending authority for the trust fund. The reserve spending authority represents an obligation for the General Fund. Beginning in 2017, Social Security will start using interest credits to meet full benefit obligations. The Government will need to raise taxes, reduce benefits, increase borrowing from the public, and/or cut spending for other programs to meet its obligations to the trust fund. By 2040, the trust fund reserves (and thus reserve spending authority) are projected to be exhausted. Even if a trust fund's assets are exhausted, however, tax income will continue to flow into the fund. Present tax rates would be sufficient to pay 74 percent of scheduled benefits after trust fund exhaustion in 2040 and 70 percent of scheduled benefits in 2080.

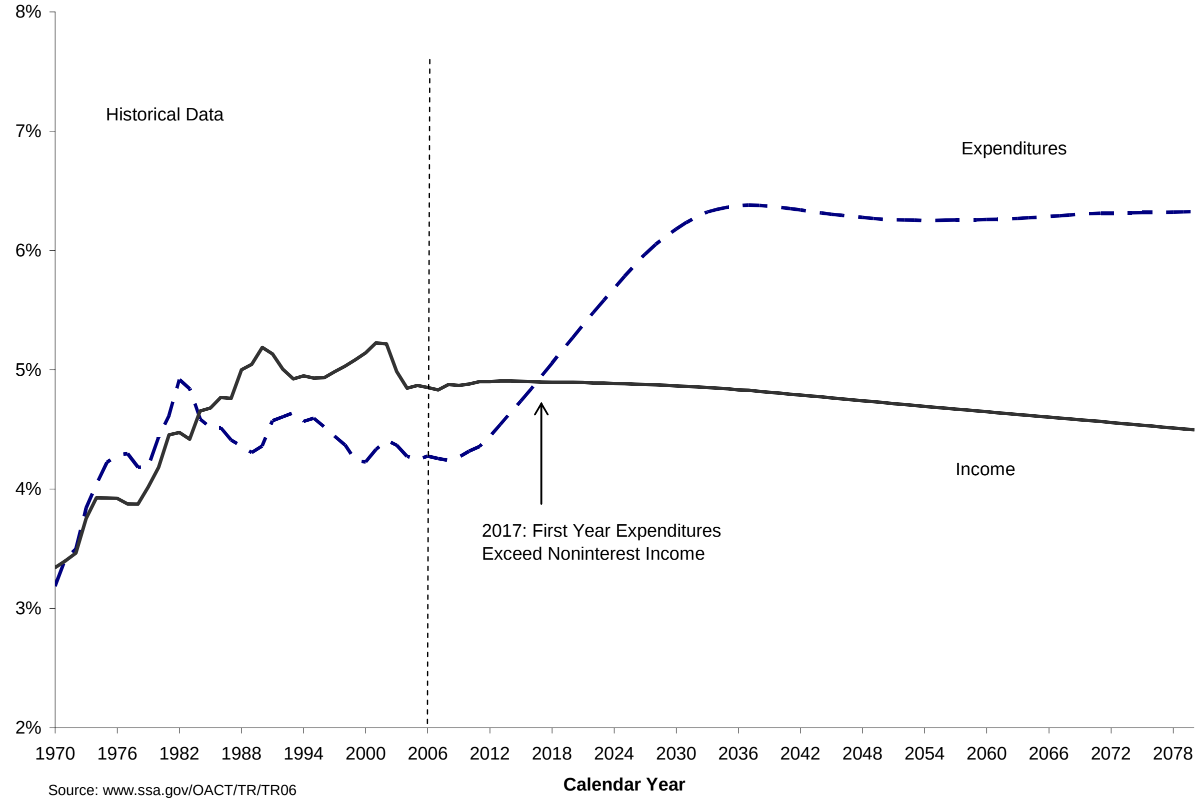
Chart 3—OASDI Income (Excluding Interest) and Expenditures as a Percent of Taxable Payroll 1970-2080



Source: www.ssa.gov/OACT/TR/TR06

Income and Expenditures as a Percent of GDP. Chart 4 shows estimated annual income (excluding interest) and expenditures, expressed as percentages of GDP, the total value of goods and services produced in the United States. This alternative perspective shows the size of the OASDI Program in relation to the capacity of the national economy to sustain it. The gap between expenditures and income widens continuously with expenditures generally growing as a share of GDP and income declining slightly relative to GDP. Social Security's expenditures are projected to grow from 4.3 percent of GDP in 2006 to 6.3 percent in 2080. In 2080, expenditures are projected to exceed income by 1.8 percent of GDP.

Chart 4—OASDI Income (Excluding Interest) and Expenditures as a Percent of GDP 1970-2080



Source: www.ssa.gov/OACT/TR/TR06

Sensitivity Analysis. Actual future income from OASDI payroll taxes and other sources and actual future expenditures for scheduled benefits and administrative expenses will depend upon a large number of factors: the size and composition of the population that is receiving benefits, the level of monthly benefit amounts, the size and characteristics of the work force covered under OASDI, and the level of workers' earnings. These factors will depend, in turn, upon future marriage and divorce rates, birth rates, death rates, migration rates, labor force participation and unemployment rates, disability incidence and termination rates, retirement age patterns, productivity gains, wage increases, cost-of-living increases, and many other economic and demographic factors.

This section presents estimates that illustrate the sensitivity of long-range expenditures and income for the OASDI Program to changes in *selected individual assumptions*. In this analysis, the intermediate assumption is used as the reference point, and one assumption at a time is varied. The variation used for each individual assumption reflects the levels used for that assumption in the low cost (Alternative I) and high cost (Alternative III) projections. For example, when analyzing sensitivity with respect to variation in real wages, income and expenditure projections using the intermediate assumptions are compared to the outcome when projections are done by changing only the real wage assumption to either low cost or high cost alternatives.

The low cost alternative is characterized by assumptions that generally improve the financial status of the program (relative to the intermediate assumption) such as slower improvement in mortality (beneficiaries die younger). In contrast, assumptions under the high cost alternative generally worsen the financial outlook. One exception occurs with the CPI assumption (see below).

Table 2 shows the effects of changing individual assumptions on the present value of estimated OASDI expenditures in excess of income (the *shortfall* of income relative to expenditures in present value terms). The assumptions are shown in parentheses. For example, the intermediate assumption for the annual rate of *reduction in age-sex-adjusted death rates* is 0.72 percent. For the low cost alternative, a slower reduction rate (0.30 percent) is assumed as it means that beneficiaries die at a younger age relative to the intermediate assumption, resulting in lower expenditures. Under the low cost assumption, the shortfall drops from $6,449 billion to $5,000 billion, a 22 percent smaller shortfall. The high cost death rate assumption (1.26 percent) results in an increase in the shortfall, from $6,449 billion to $8,195 billion, a 27 percent increase in the shortfall. Clearly, alternative death rate assumptions have a substantial impact on estimated future cashflows in the OASDI Program.

A higher fertility rate means more workers relative to beneficiaries over the projection period, thereby lowering the shortfall relative to the intermediate assumption. An increase in the rate from 2.0 to 2.3 results in an 12 percent smaller shortfall (i.e., expenditures less income), from $6,449 billion to $5,699 billion.

Higher real wage growth results in faster income growth relative to expenditure growth. Table 2 shows that a real wage differential that is 0.5 greater than the intermediate assumption of 1.1 results in a drop in the shortfall from $6,449 billion to $5,542 billion, a 14 percent decline.

The CPI change assumption operates in a somewhat counterintuitive manner, as seen in Table 2. A lower rate of change results in a higher shortfall. This arises as a consequence of holding the real wage assumption constant while varying the CPI so that wages (the income base) are affected sooner than benefits. If the rate is assumed to be 1.8 percent rather than 2.8 percent, the shortfall rises about 7 percent, from $6,449 billion to $6,876 billion.

The effect of net immigration is similar to fertility in that, over the 75-year projection period, higher immigration results in proportionately more workers (taxpayers) than beneficiaries. The low-cost assumption for net immigration results in a 7 percent drop in the shortfall, from $6,449 billion to $5,982 billion, relative to the intermediate case; and the high-cost assumption results in a 5 percent higher shortfall.

Finally, Table 2 shows the sensitivity of the shortfall to variations in the real interest rate or, in present value terminology, the sensitivity to alternative discount rates. Assuming a higher discount rate results in a lower present value. The shortfall of $4,850 billion is 25 percent lower when the real interest rate is 3.6 percent rather than 2.9 percent, and 40 percent higher when the real interest rate is 2.1 percent rather than 2.9 percent.

Table 2
Present Values of Estimated OASDI Expenditures in Excess of Income Under Various Assumptions, 2006-2080

(In billions of dollars)

	Shortfall		
Assumption	Low	Intermediate	High
Average annual reduction in death rates ..	5,000 (0.30)	6,449 (0.72)	8,195 (1.26)
Total fertility rate	5,699 (2.3)	6,449 (2.0)	7,189 (1.7)
Real wage differential................................	5,542 (1.6)	6,449 (1.1)	7,091 (0.6)
CPI change..	6,015 (3.8)	6,449 (2.8)	6,876 (1.8)
Net immigration	5,982 (1,300,000)	6,449 (900,000)	6,782 (672,500)
Real interest rate	4,850 (3.6)	6,449 (2.9)	9,034 (2.1)

Numbers in parentheses are the values of the assumptions used in the respective scenario.

Source: 2006 OASDI Trustees Report and SSA.

Medicare Projections

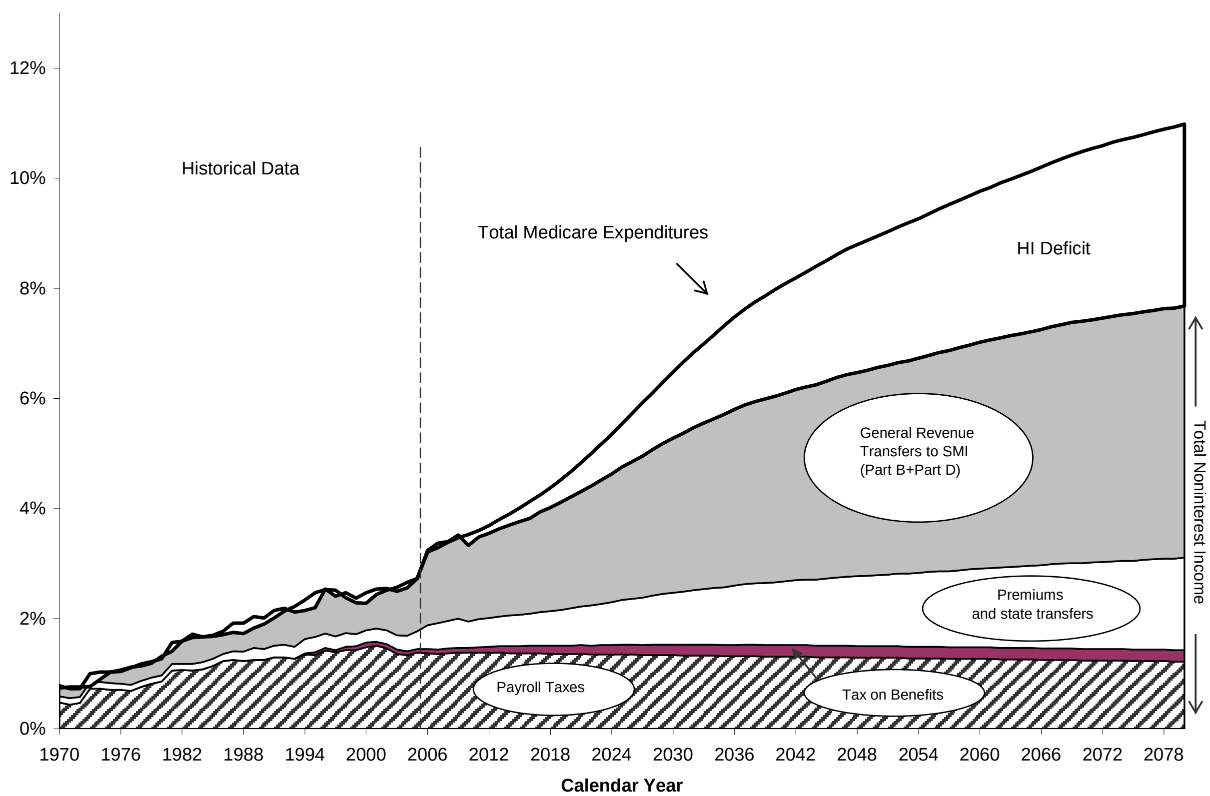
Recent Medicare Legislation. On December 8, 2003, President Bush signed into law the Medicare Prescription Drug, Improvement, and Modernization Act of 2003. The 2003 law will have a major impact on the operations and finances of Medicare. The law added a prescription drug benefit to Medicare beginning in 2006 and a new prescription drug account in the SMI Trust Fund. The benefit could be obtained through a private drug-only plan, a private preferred-provider organization or health maintenance organization, or through an employer-sponsored retiree health plan. The preferred-provider organizations are new to the Medicare Program and will operate on a regional basis. The Federal Government will assume some of the costs of providing prescription drug coverage to people eligible for both Medicare and Medicaid.

The legislation also includes provisions not related to the prescription drug benefit. It includes increases in Medicare provider reimbursements, higher Medicare Part B premiums for people at higher income levels, and an expansion of tax-deductible health savings accounts. The 2003 legislation is expected to have a significant effect on future Medicare finances as seen below and earlier in the Statement of Social Insurance.

Health Care Cost Growth. In addition to the growth in the number of beneficiaries per worker, the Medicare Program has the added pressure of expected growth in the use and cost of health care per person. Continuing development and use of new technology is expected to cause health care expenditures to grow faster than GDP in the long run. For the intermediate assumption, health care expenditures per beneficiary are assumed to grow, on average, about one percentage point faster than per capita GDP over the long range.

Total Medicare. It is important to recognize the rapidly increasing long-range cost of Medicare and the large role of general revenues and beneficiary premiums in financing the SMI Program. Chart 5 shows expenditures and current-law noninterest revenue sources for HI and SMI combined as a percentage of GDP. The total expenditure line shows Medicare costs rising to 11 percent of GDP by 2080. Revenues from taxes and premiums (including State transfers under Part D) are expected to increase from 1.8 percent of GDP in 2005 to 3.1 percent of GDP in 2080. Payroll tax income declines gradually as a percent of GDP as growth in the number of workers paying such taxes slows and wages as a portion of compensation declines, offset by higher premiums combined for Parts B and D of SMI as a percent of GDP. General revenue contributions for SMI, as determined by current law, are projected to rise as a percent of GDP from 1.0 percent to 5.0 percent over the same period. Thus, revenues from taxes and premiums (including State transfers) will fall substantially as a share of total noninterest Medicare income (from 65 percent in 2005 to 40 percent in 2080) while general revenues will rise (from 35 percent to 60 percent). The gap between total noninterest Medicare income (including general revenue contributions) and expenditures begins around 2010 and then steadily continues to widen, reaching 3.3 percent of GDP by 2080.

Chart 5—Total Medicare (HI and SMI) Expenditures and Noninterest Income as a Percent of GDP 1970-2080

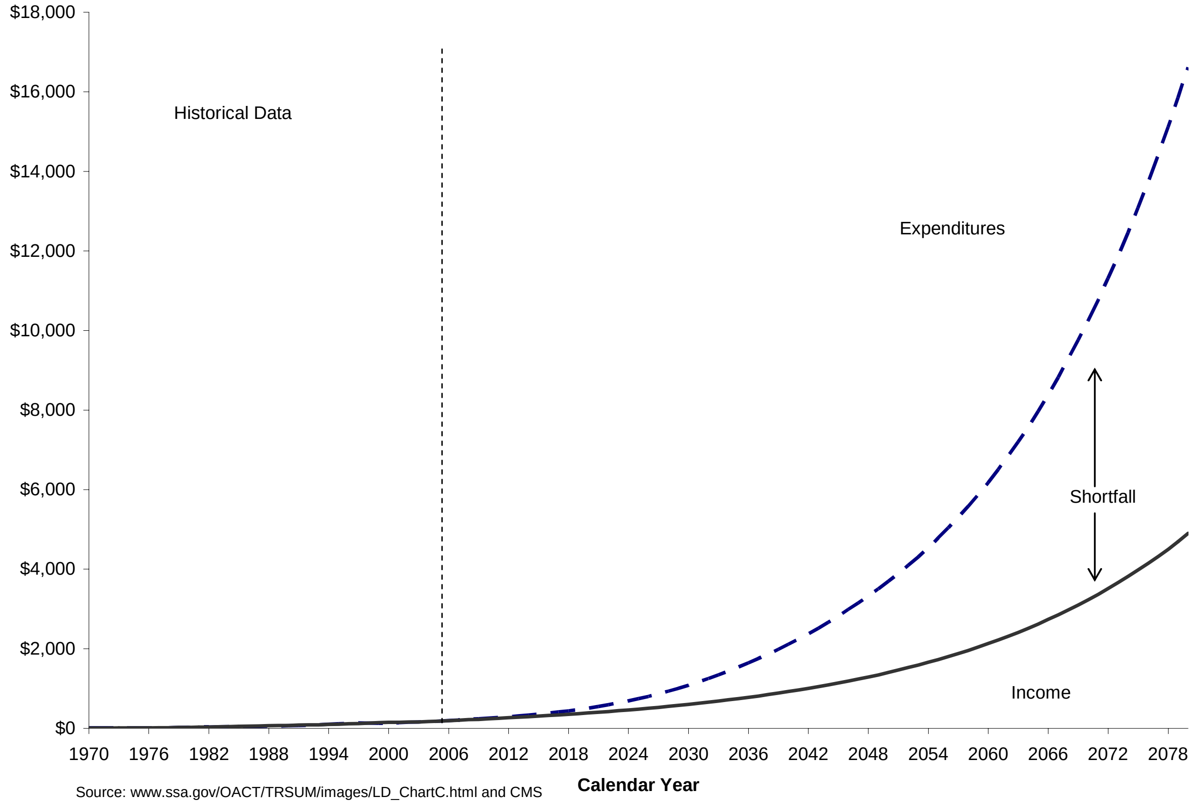


Source: www.ssa.gov/OACT/TRSUM/trsummary.html

Medicare, Part A (Hospital Insurance)—Nominal Income and Expenditures. Chart 6 shows historical and actuarial estimates of HI annual income (excluding interest) and expenditures for 1970-2080 in nominal dollars. The estimates are for the open-group population. The figure reveals a widening gap between projected income and expenditures.

Chart 6—Medicare Part A Income (Excluding Interest) and Expenditures 1970-2080

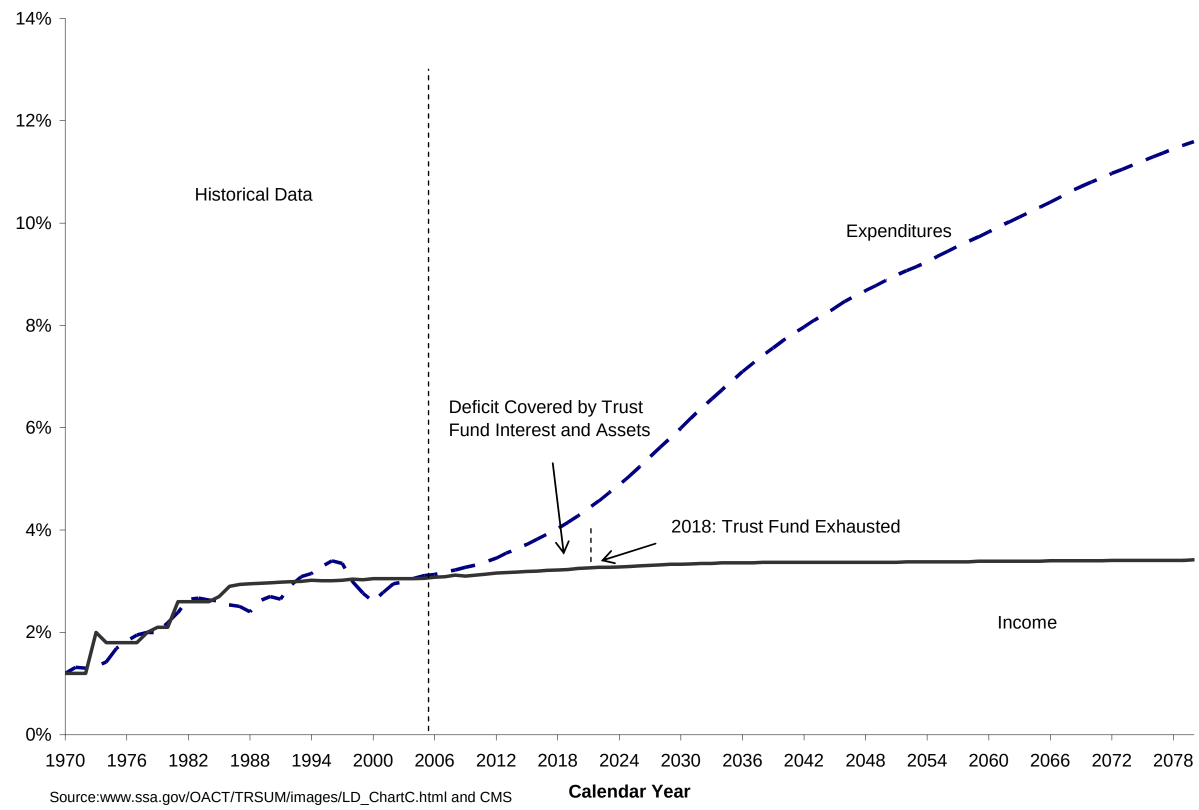
(In billions of nominal dollars)



Source: www.ssa.gov/OACT/TRSUM/images/LD_ChartC.html and CMS

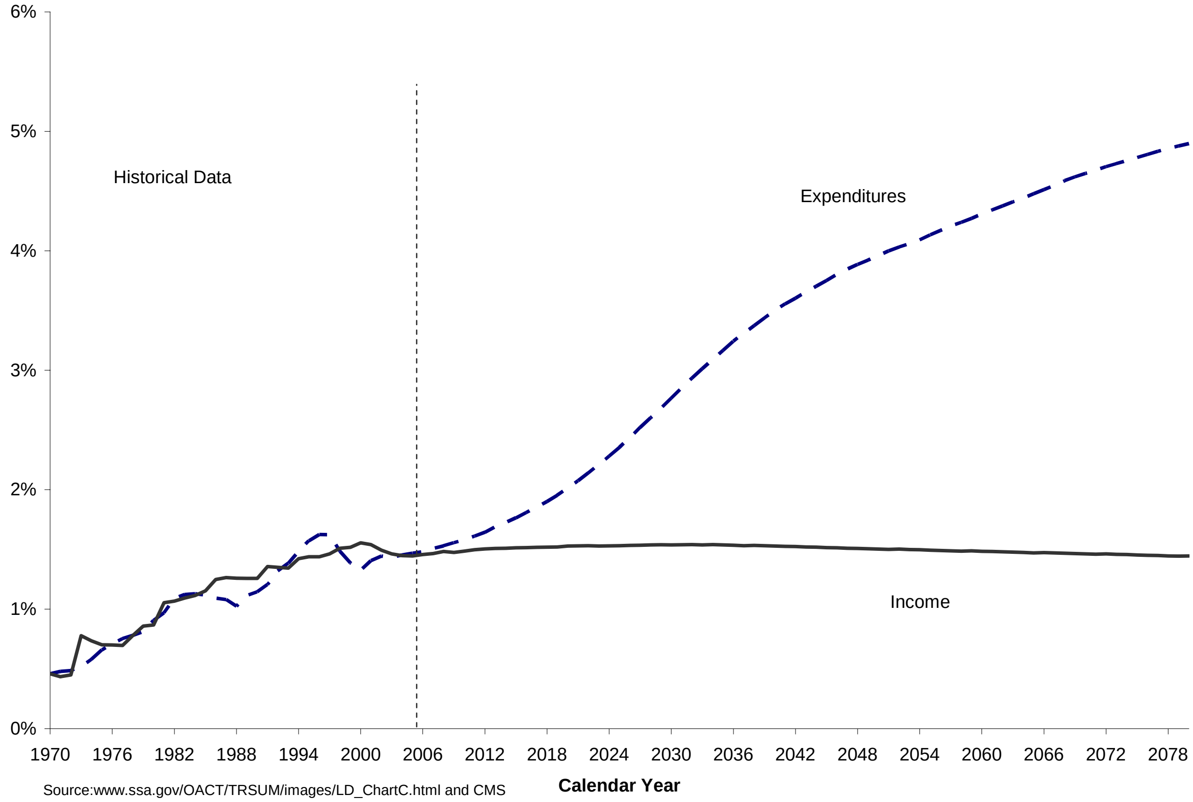
Medicare, Part A Income and Expenditures as a Percent of Taxable Payroll. Chart 7 illustrates income (excluding interest) and expenditures as a percentage of taxable payroll over the next 75 years. The chart shows that the expenditure rate exceeds the income rate beginning in 2004, and cash deficits continue thereafter. Trust fund interest earnings and assets provide enough resources to pay full benefit payments until 2018 with general revenues used to finance interest and loan repayments to make up the difference between cash income and expenditures during that period. Pressures on the Federal budget will thus emerge well before 2018. Present tax rates would be sufficient to pay 80 percent of scheduled benefits after trust fund exhaustion in 2018 and 29 percent of scheduled benefits in 2080.

Chart 7—Medicare Part A Income (Excluding Interest) and Expenditures as a Percent of Taxable Payroll 1970-2080



Medicare Part A Income and Expenditures as a Percent of GDP. Chart 8 shows estimated annual income (excluding interest) and expenditures, expressed as percentages of GDP, the total value of goods and services produced in the United States. This alternative perspective shows the size of the HI Program in relation to the capacity of the national economy to sustain it. Medicare Part A's expenditures are projected to grow from 1.5 percent of GDP in 2005, to 2.8 percent in 2030, and to 4.9 percent by 2080. The gap between expenditures and income widens continuously with expenditures growing as a share of GDP and income declining slightly relative to GDP. By 2080, expenditures are projected to exceed income by 3.5 percent of GDP.

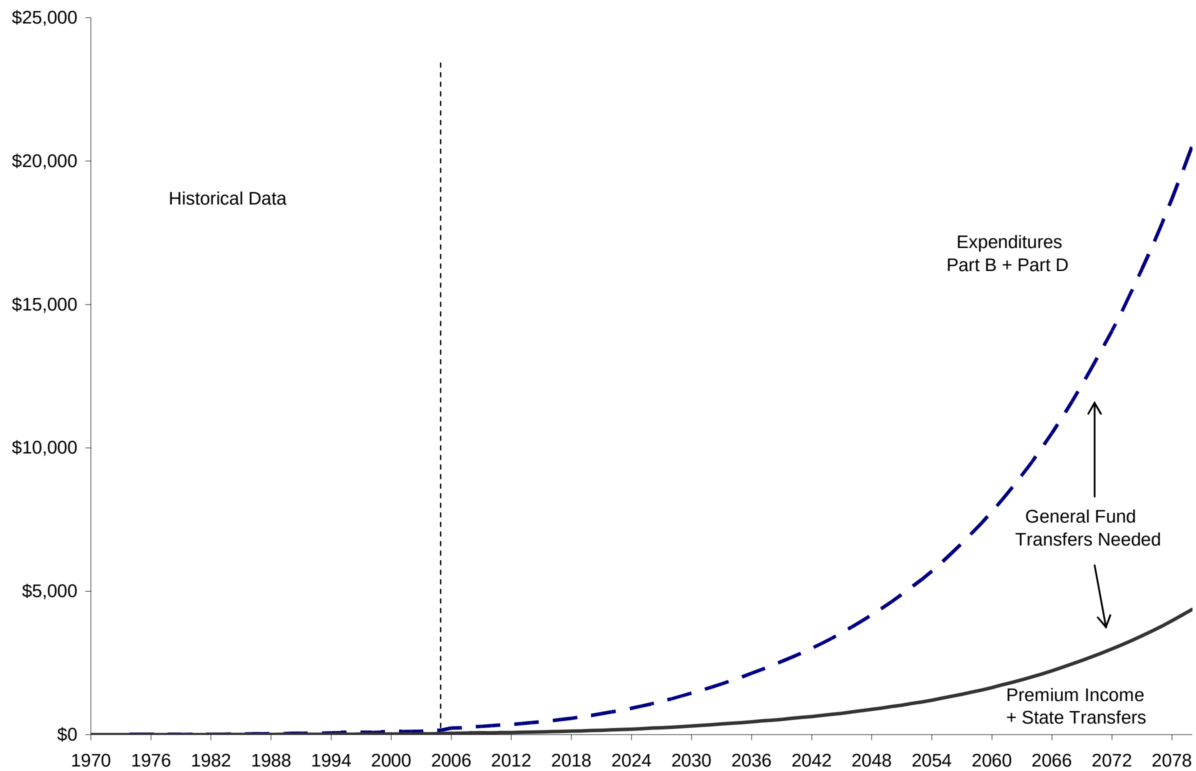
Chart 8—Medicare Part A Income (Excluding Interest) and Expenditures as a Percent of GDP 1970-2080



Medicare, Parts B and D (Supplementary Medical Insurance). Chart 9 shows historical and actuarial estimates of Medicare Part B and Part D premiums (and Part D State transfers) and expenditures for each of the next 75 years, in nominal dollars. The gap between premiums and State transfer revenues and program expenditures, a gap that will need to be filled with transfers from general revenues, grows throughout the projection period.

Chart 9—Medicare Part B and Part D Premium and State Transfer Income and Expenditures 1970-2080

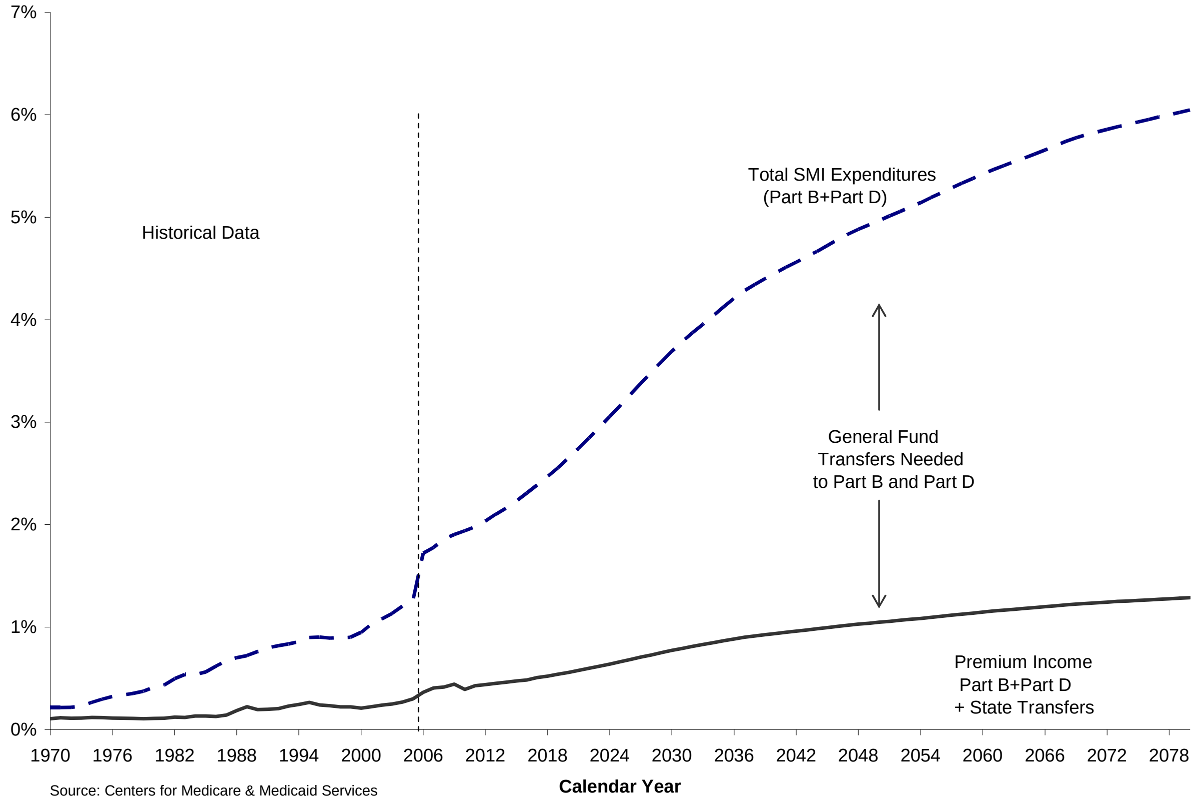
(In billions of nominal dollars)



Source: Centers for Medicare & Medicaid Services

Medicare Part B and Part D Premium and State Transfer Income and Expenditures as a Percent of GDP. Chart 10 shows expenditures for the Supplementary Medical Insurance Program over the next 75 years expressed as a percentage of GDP, providing a perspective on the size of the SMI Program in relation to the capacity of the national economy to sustain it. In 2005, SMI expenditures were $157 billion, which was 1.26 percent of GDP. After 2005, this percentage is projected to increase steadily reaching 6.1 percent in 2080. This reflects growth in the volume and intensity of Medicare services provided per beneficiary throughout the projection period, including the prescription drug benefits, together with the effects of the baby boom retirement. Premium and State transfer income grows from about 0.3 percent in 2005 to nearly 1.5 percent of GDP in 2080, so the portion financed by General Fund transfers to SMI is projected to be about 75 percent throughout the projection period.

Chart 10—Medicare Part B and Part D Premium and State Transfer Income and Expenditures as a Percent of GDP 1970-2080



Medicare Sensitivity Analysis. This section illustrates the sensitivity of long-range cost and income estimates for the Medicare Program to changes in *selected individual assumptions*. As with the OASDI analysis, the intermediate assumption is used as the reference point, and one assumption at a time is varied. The variation used for each individual assumption reflects the levels used for that assumption in the low cost and high cost projections (see description of sensitivity analysis for OASDI).

Table 3 shows the effects of changing various assumptions on the present value of estimated HI expenditures in excess of income (the *shortfall* of income relative to expenditures in present value terms). The assumptions are shown in parentheses. Clearly, net HI expenditures are extremely sensitive to alternative assumptions about the growth in health care cost. For the low cost alternative, the slower growth in health costs causes the shortfall to drop from $11,290 billion to $4,459 billion, a 61 percent smaller shortfall. The high cost assumption results in a near doubling of the shortfall, from $11,290 billion to $22,387 billion.

Variations in the next four assumptions in Table 3 result in relatively minor changes in net HI expenditures. The higher or lower fertility assumptions cause a less than 2 percent change in the shortfall relative to the intermediate case. The higher real wage growth rate results in about a 7 percent greater shortfall while a lower growth rate reduces the shortfall by about 9 percent. Wages are a key cost factor in the provision of health care. Higher wages also result in greater payroll tax income. HI expenditures exceed HI income by a wide and increasing margin in the future (Charts 6 to 8). As a result, an assumed higher real wage differential has a larger impact on HI expenditures than HI income, thereby increasing the shortfall of income relative to expenditures. CPI and net immigration changes have very little effect on net HI expenditures. Higher immigration increases the net shortfall modestly as higher payroll tax revenue is more than offset by higher medical care expenditures.

Table 3 also shows that the present value of net HI expenditures is 25 percent lower if the real interest rate is 3.6 percent rather than 2.9 percent and 40 percent higher if the real interest rate is 2.1 percent rather than 2.9 percent.

Table 3
Present Values of Estimated Medicare Part A Expenditures in Excess of Income Under Various Assumptions, 2006-2080

(In billions of dollars)

	Shortfall		
Assumption[1]	**Low**	**Intermediate**	**High**
Average annual growth in health costs[2]	4,459 (3.1)	11,290 (4.1)	22,387 (5.1)
Total fertility rate[3]	11,078 (2.3)	11,290 (2.0)	11,510 (1.7)
Real wage differential	10,521 (0.6)	11,290 (1.1)	12,286 (1.6)
CPI change	11,234 (1.8)	11,290 (2.8)	11,337 (2.8)
Net immigration	11,157 (672,500)	11,290 (900,000)	11,498 (1,300,000)
Real interest rate	8,464 (3.6)	11,290 (2.9)	15,847 (2.1)

[1] The sensitivity of the projected HI net cashflow to variations in future mortality rates is also of interest. At this time, however, relatively little is known about the relationship between improvements in life expectancy and the associated changes in health status and per beneficiary health expenditures. As a result, it is not possible at present to prepare meaningful estimates of the Part A mortality sensitivity.
[2] Annual growth rate is the aggregate cost of providing covered health care services to beneficiaries. The low cost and high cost alternatives assume that costs increase 1 percent slower or faster, respectively, than the intermediate assumption, *relative to growth in taxable payroll*.
[3] The total fertility rate for any year is the average number of children who would be born to a woman in her lifetime if she were to experience the birth rates by age observed in, or assumed for, the selected year and if she were to survive the entire childbearing period.

Table 4 shows the effects of various assumptions about the growth in health care costs on the present value of estimated SMI (Medicare Parts B and D) expenditures in excess of income. As with HI, net SMI expenditures are very sensitive to changes in the health care cost growth assumption. For the low cost alternative, the slower assumed growth in health costs reduces the Governmentwide resources needed for Part B from $13,132 billion to $9,236 billion and in Part D from $7,884 billion to $5,559 billion, about a 30 percent difference in each case. The high-cost assumption increases Governmentwide resources needed to $19,316 billion for Part B and to $11,539 billion for Part D, just over a 45 percent increase in each case.

Table 4
Present Values of Estimated Medicare Parts B and D Future Expenditures Less Premium Income and State Transfers Under Three Health Care Cost Growth Assumptions, 2006-2080

(In billions of dollars)

	Governmentwide Resources Needed		
Medicare Program[1]	Low (4.1)	Intermediate (5.1)	High (6.1)
Part B	9,236	13,132	19,316
Part D	5,559	7,884	11,539

[1] Annual growth rate is the aggregate cost of providing covered health care services to beneficiaries. The low and high scenarios assume that costs increase one percent slower or faster, respectively, than the intermediate assumption.

Source: Centers for Medicare & Medicaid Services.

Sustainability of Social Security and Medicare

75-Year Horizon

According to the 2006 Medicare Trustees Report, the HI Trust Fund is projected to remain solvent until 2018 and, according to the 2006 Social Security Trustees Report, the OASDI Trust Funds are projected to remain solvent until 2040. In each case, some general revenues must be used to satisfy the authorization of full benefit payments until the year of exhaustion. This occurs when the trust fund balances accumulated during prior years are needed to pay benefits, which leads to a transfer from general revenues to the trust funds. Moreover, under current law, General Fund transfers to the SMI Trust Fund will occur into the indefinite future and will continue to grow with the growth in health care expenditures.

The potential magnitude of future financial obligations under these three social insurance programs is therefore important from a unified budget perspective as well as for understanding generally the growing resource demands of the programs on the economy. A common way to present future cashflows is in terms of their *present value*. This approach recognizes that a dollar paid or collected next year is worth less than a dollar today, because a dollar today could be saved and earn a year's-worth of interest (see footnote 1).

Table 5 shows the magnitudes of the primary expenditures and sources of financing for the three trust funds computed on an open-group basis for the next 75 years and expressed in present values. The data are consistent with the Statements of Social Insurance included in the principal financial statements. For HI, revenues from the public are projected to fall short of total expenditures by $11,290 billion in present value terms which is the additional amount needed in order to pay scheduled benefits over the next 75 years. [5] From the trust fund perspective, the amount needed is $11,005 billion in present value after subtracting the value of the existing trust fund balances (an asset to the trust fund account but an intragovernmental transfer to the overall budget). For SMI, revenues from the public for Parts B and D combined are estimated to be $21,016 billion less than total expenditures for the two accounts, an amount that, from a budget perspective, will be needed to keep the SMI program solvent for the next 75 years. From the trust fund perspective, however, the present values of total revenues and total expenditures for the

[5] Interest income is not a factor in this table as dollar amounts are in present value terms.

SMI Program are equal due to the annual adjustment of revenue from other Government accounts to meet program costs.[6] For OASDI, projected revenues from the public fall short of total expenditures by $6,449 billion in present value dollars and, from the trust fund perspective, by $4,591billion.

From the Governmentwide perspective, the present value of the total resources needed for the Social Security and Medicare Programs equals $38,754 billion, in addition to payroll taxes, benefit taxes, and premium payments from the public. From the trust fund perspective, which counts the trust funds and the general revenue transfers to the SMI Program as dedicated funding sources additional resources in the amount of $15,572 billion in present value terms are needed, beyond the $21,015 billion in present value of required general revenue transfers already scheduled for the SMI Program and the $2,167 billion to honor the trust fund investments in Treasury securities.

Table 5
Present Values of Costs Less Revenues of 75-Year Open Group Obligations HI, SMI, and OASDI

(In billions of dollars, as of January 1, 2006)

	HI	SMI Part B	SMI Part D	OASDI	Total
Revenues from the Public:					
Taxes	10,644	-	-	32,107	42,751
Premiums, State transfers	-	4,481	2,366	-	6,847
Total	10,644	4,481	2,366	32,107	49,598
Total costs to the public	21,934	17,613	10,250	38,557	88,354
Net results for Government-wide (budget) perspective[1, 2]	11,290	13,131	7,884	6,449	38,754
Revenues from other Government accounts	-	13,131	7,884	-	21,015
Trust fund in 1/1/2006	285	23	-	1,859	2,167
Net results for trust fund perspective[1]	11,005	23	-	4,590	15,572

[1] Net results are computed as costs less revenues.
[2] Details may not add to totals due to rounding.

Source: 2006 OASDI and Medicare Trustees' Reports.

Infinite Horizon

The 75-year horizon represented in Table 5 is consistent with the primary focus of the Social Security and Medicare Trustees' Reports. For the OASDI Program, for example, an additional $6.5 trillion in present value will be needed above currently scheduled taxes to pay for scheduled benefits ($4.6 trillion from the trust fund perspective). Yet, a 75-year projection is not a complete representation of all future financial flows through the infinite horizon. For example, when calculating unfunded obligations, a 75-year horizon includes revenue from some future workers but only a fraction of their future benefits. In order to provide a more complete estimate of the long-run unfunded obligations of the programs, estimates can be extended to the infinite horizon. The open-group infinite horizon net obligation is the present value of all expected future program outlays less the present value of all expected future program tax and premium revenues. Such a measure is provided in Table 6 for the three trust funds represented in Table 5.

From the budget or Governmentwide perspective, the values in line 1 plus the values in line 4 of Table 6 represent the value of resources needed to finance each of the programs into the infinite future. The sums are shown in the last line of the table (also equivalent to adding the values in the second and fifth lines). The total resources

[6] The SMI Trust Fund also has a very small amount of existing assets.

needed for all the programs sums to almost than $86 trillion in present value terms. This need can be satisfied only through increased borrowing, higher taxes, reduced program spending, or some combination.

The second line shows the value of the trust fund at the beginning of 2006. For the HI and OASDI Programs this represents, from the trust fund perspective, the extent to which the programs are funded. From that perspective, when the trust fund is subtracted, an additional $28.1 trillion and $13.3 trillion, respectively, are needed to sustain the programs into the infinite future. As described above, from the trust fund perspective, the SMI Program is fully funded. The substantial gap that exists between premiums and State transfer revenue and program expenditures in the SMI Program ($26.2 trillion + $16.0 trillion) represents future general revenue obligations of the Federal budget.

In comparison to the analogous 75-year number in Table 5, extending the calculations beyond 2080 captures the full lifetime benefits and taxes and premiums of all current and future participants. The shorter horizon understates financial needs by capturing relatively more of the revenues from current and future workers and not capturing all of the benefits that are scheduled to be paid to them.

Table 6
Present Values of Costs Less Tax, Premium and State Transfer Revenue through the Infinite Horizon, HI, SMI, OASDI

(In trillions of dollars as of January 1, 2006)

		SMI			
(In trillions of dollars)	HI	Part B	Part D	OASDI	Total
Present value of future costs less future taxes and premiums and State transfers for current participants	12.2	10.6	6.2	15.1	44.1
Less current trust fund	0.3	-	-	1.9	2.2
Equals net obligations for past and current participants	11.9	10.6	6.2	13.2	41.9
Plus net obligations for future participants	16.2	15.6	9.8	0.1	41.7
Equals net obligations through the infinite future for all participants	28.1	26.2	16.0	13.3	83.6
Present value of future costs less the present values of future income over the infinite horizon	28.4	26.2	16.0	15.2	85.8

Source: 2006 OASDI and Medicare Trustees' Reports.

Railroad Retirement, Black Lung, and Unemployment Insurance

Railroad Retirement

The RRB was created in the 1930s to establish a retirement benefit program for the nation's railroad workers. As the social security program legislated in 1935 would not give railroad workers credit for service performed prior to 1937, legislation was enacted in 1934, 1935, and 1937 (collectively the Railroad Retirement Acts of the 1930s) to establish a railroad retirement program separate from the social security program.

Railroad retirement pays full retirement annuities at age 60 to railroad workers with 30 years of service. The program pays disability annuities based on total or occupational disability. It also pays annuities to spouses, divorced spouses, widow(er)s, remarried widow(er)s, surviving divorced spouses, children, and parents of deceased railroad workers. Medicare covers qualified railroad retirement beneficiaries in the same way as it does Social Security beneficiaries.

Payroll taxes paid by railroad employers and their employees provide a primary source of income for the Railroad Retirement and Survivors' Benefit Program. By law, railroad retirement taxes are coordinated with Social

Security taxes. Employees and employers pay tier I taxes at the same rate as Social Security taxes. Tier II taxes finance railroad retirement benefit payments that are higher than Social Security levels.

Other sources of program income include: financial interchanges with the Social Security and Medicare trust funds, earnings on investments, Federal income taxes on railroad retirement benefits, and appropriations (provided after 1974 as part of a phase out of certain vested dual benefits). Refer to Note 23—Social Insurance, for additional information on railroad retirement program financing.

The Railroad Retirement and Survivors Improvement Act of 2001 (RRSIA), liberalized benefits for 30-year service employees and their spouses, eliminated a cap on monthly benefits for retirement and disability benefits, lowered minimum service requirements from 10 to 5 years, and provided for increased benefits for widow(er)s. Per the RRSIA, amounts in the Railroad Retirement Account and the SSEB Account that are not needed to pay current benefits and administrative expenses are transferred to the National Railroad Retirement Investment Trust (NRRIT) whose sole purpose is to manage and invest railroad retirement assets. NRRIT's Board of Trustees is empowered to invest trust assets in nongovernmental assets, such as equities and debt, as well as, in Government securities. Prior to RRSIA, all investments were limited to Government securities.

Since its inception, NRRIT has received $21.3 billion from RRB (including $19.2 billion in fiscal year 2003, pursuant to RRSIA) and returned $3.6 billion. During fiscal year 2006, the NRRIT made net transfers of $947 million to the RRB to pay retirement benefits. Administrative expenses of the trust are paid out of trust assets. The balance as of September 30, 2006, and 2005, of non-federal securities and investments of the NRRIT are disclosed in Note 7—Securities and Investments.

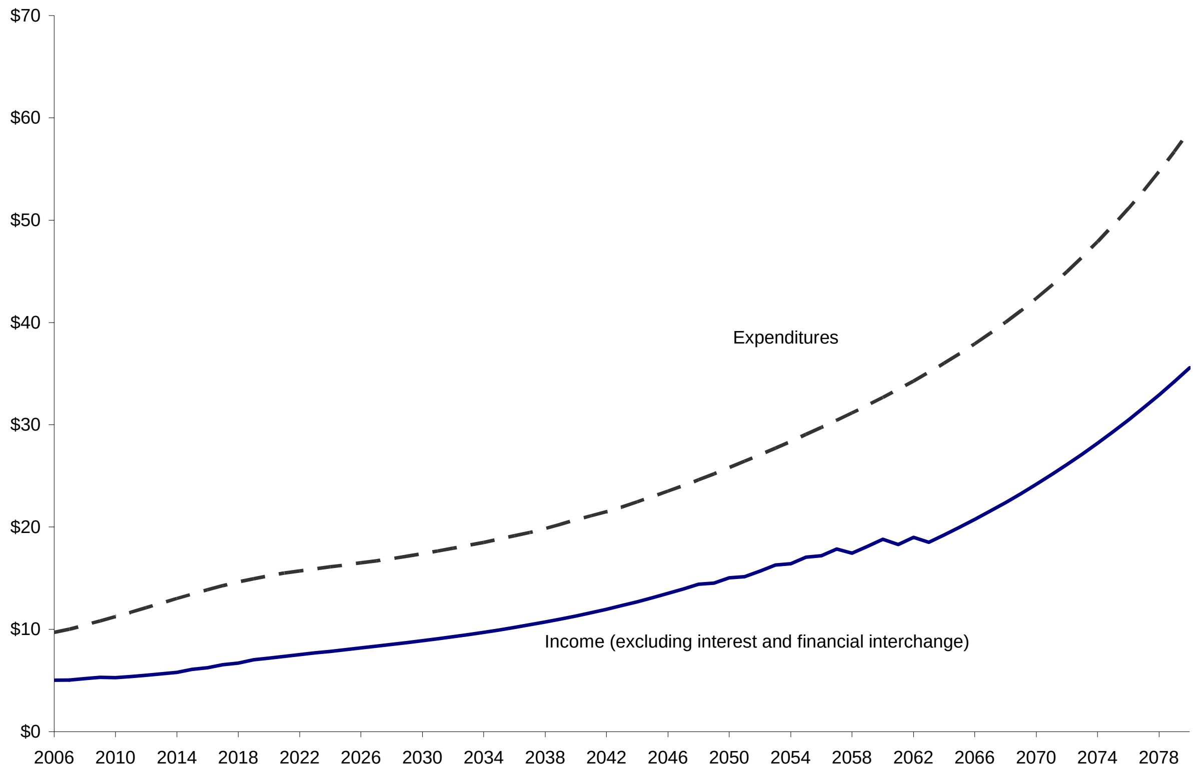
Cashflow Projections

Economic and Demographic Assumptions. The economic and demographic assumptions used for the most recent set of projections are shown in the "Railroad Retirement" section of Note 23—Social Insurance.

Nominal Income and Expenditures. Chart 11 shows, in nominal dollars, estimated railroad retirement income (excluding interest and financial interchange income) and expenditures for the period 2006-2080 based on the intermediate set of assumptions used in the RRB's actuarial evaluation of the program. The estimates are for the open-group population, which includes all persons projected to participate in the Railroad Retirement Program as railroad workers or beneficiaries during the period. Thus, the estimates include payments from, and on behalf of, those who are projected to be employed by the railroads during the period as well as those already employed at the beginning of the period. They also include expenditures made to, and on behalf of, such workers during that period.

Chart 11—Estimated Railroad Retirement Income (Excluding Interest and Financial Interchange Income) and Expenditures 2006-2080

(In billions of nominal dollars)

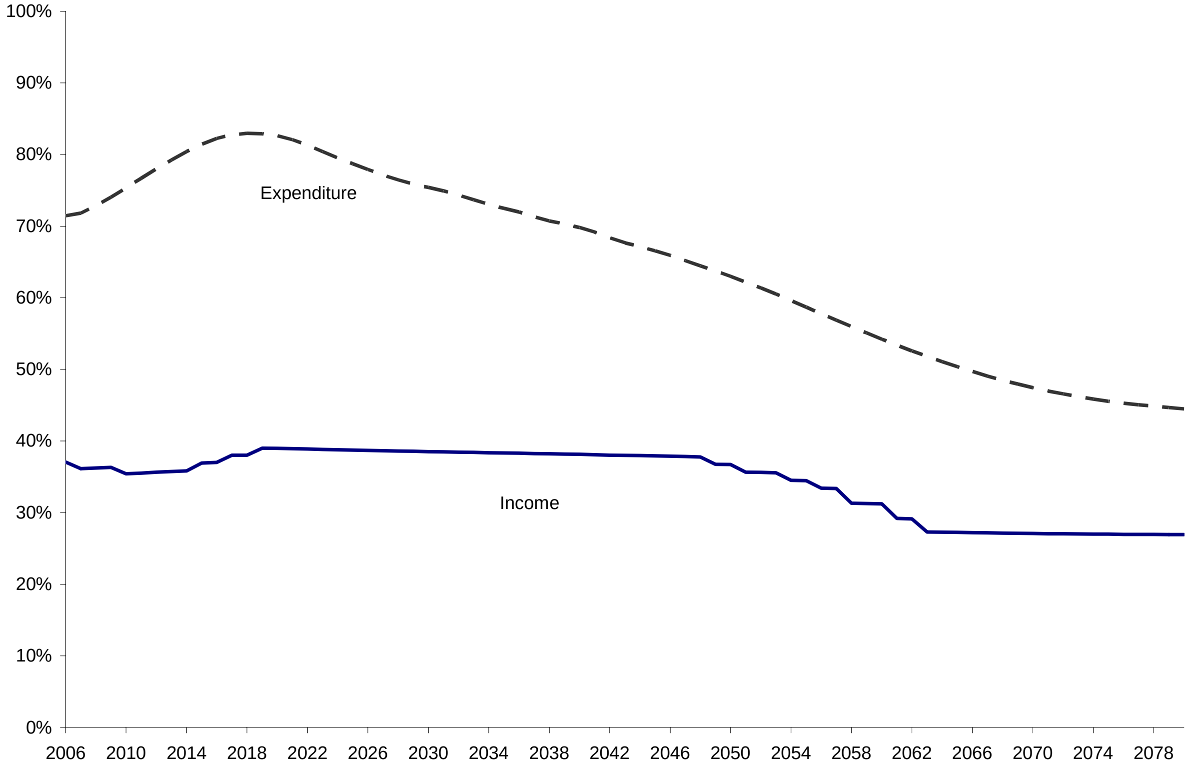


Source: Railroad Retirement Board

As Chart 11 shows, expenditures are expected to exceed tax income for the entire projection period. The imbalances continue to widen until about 2020, after which their growth slows for the next 45 years (until 2050). After 2060, the imbalances widen due in part to reductions in tax rates between 2061 to 2068.

Income and Expenditures as a Percent of Taxable Payroll. Chart 12 shows estimated expenditures and income as a percent of tier II taxable payroll. The imbalances grow until 2016 but then begin to decrease steadily as expenditures fall. Tax rates begin to decline after 2048, stabilizing after 2063. Compared to last year, projected tax rates are lower. The tier II tax rate is determined from a tax rate table based on the average account benefit ratio.

Chart 12—Estimated Railroad Retirement Income (Excluding Interest and Financial Interchange Income) and Expenditures as a Percent of Tier II Taxable Payroll 2006-2080



Source: Railroad Retirement Board

Sensitivity Analysis. Actual future income from railroad payroll taxes and other sources and actual future expenditures for scheduled benefits and administrative expenses will depend upon a large number of factors as mentioned above. Two crucial assumptions are employment growth and the interest rate. Table 7 shows the sensitivity of the shortfall in the Railroad Retirement Program to variations in these two assumptions. The low-cost employment scenario has a 4.5 percent smaller shortfall of income to expenditures, and the high-cost scenario has a 3.8 percent higher shortfall. A higher discount rate reduces future values relative to a lower rate. As seen in the table, the shortfall is 29.5 percent lower if the interest rate is 11 percent rather than 7.5 percent and 72 percent higher when the interest rate is 4 percent rather than 7.5 percent.

Table 7
Present Values of Railroad Retirement Expenditures in Excess of Income Under Various Employment and Interest Rate Assumptions

(In millions of dollars)

Assumption	Low	Middle	High
Employment[1]	96,480 (1.0%)	101,050 (2.5%)	104,876 (4.0%)
Interest rate..................	71,242 (11%)	101,050 (7.5%)	173,819 (4%)

[1] The low and middle employment scenarios have passenger service employment remaining at 43,000 and the remaining employment base declining at 1.0 percent and 2.5 percent, respectively, for the next 25 years. The high cost scenario has passenger service employment declining by 500 per year until a level of 35,000 is reached with the remaining employment base declining by 4.0 percent per year for 25 years, at a reducing rate over the next 25 years, and remaining level thereafter.

Source: Railroad Retirement Board.

Sustainability of Railroad Retirement

Table 8 shows the magnitudes of the primary expenditures and sources of financing for the Railroad Retirement Program computed on an open-group basis for the next 75 years and expressed in present values as of January 1, 2006. The data are consistent with the statements of social insurance.

From a Governmentwide perspective, revenues are expected to fall short of expenditures by approximately $101.1 billion, which represents the present value of resources needed to sustain the Railroad Retirement Program. From a trust fund perspective, when the trust fund balance and the financial interchange and transfers are included, the combined balance of the NRRIT, the Railroad Retirement Account, and the SSEB Account show a slight surplus.

Table 8
Present Values of 75-Year Projections of Revenues and Expenditures for the Railroad Retirement Program[1,2]

(In billions of present-value dollars as of January 1, 2006)

Estimated Future Income (Excluding Interest)[3] Received from or on Behalf of:	
Current participants who have attained retirement age	4.5
Current participants not yet having attained retirement age	39.7
Those expected to become participants	55.5
All participants	99.7
Estimated Future Expenditures:[4]	
Current participants who have attained retirement age	91.7
Current participants not yet having attained retirement age	84.1
Those expected to become participants	25.0
All participants	200.8
Net obligations from budget perspective (expenditures less income)	101.1
Railroad Retirement Program assets (mostly investments stated at market)[5]	30.0
Financial Interchange from Social Security Trust	72.1
Net Obligations from Trust Fund Perspective	(1.0)

[1] Represents combined values for the Railroad Retirement Account, SSEB Account, and NRRIT, based on middle employment assumption.
[2] The data used reflect the provisions of RRSIA of 2001.
[3] Future income (excluding interest) includes tier I taxes, tier II taxes, and income taxes on benefits.
[4] Future expenditures include benefits and administrative expenditures.
[5] The value of the fund reflects the 7.5 percent interest rate assumption. The RRB uses the relatively high rate due to investments in private securities.

Note: Detail may not add to totals due to rounding. Employee and beneficiary status are determined as of 1/1/2005 whereas present values are as of 1/1/2006.

Black Lung

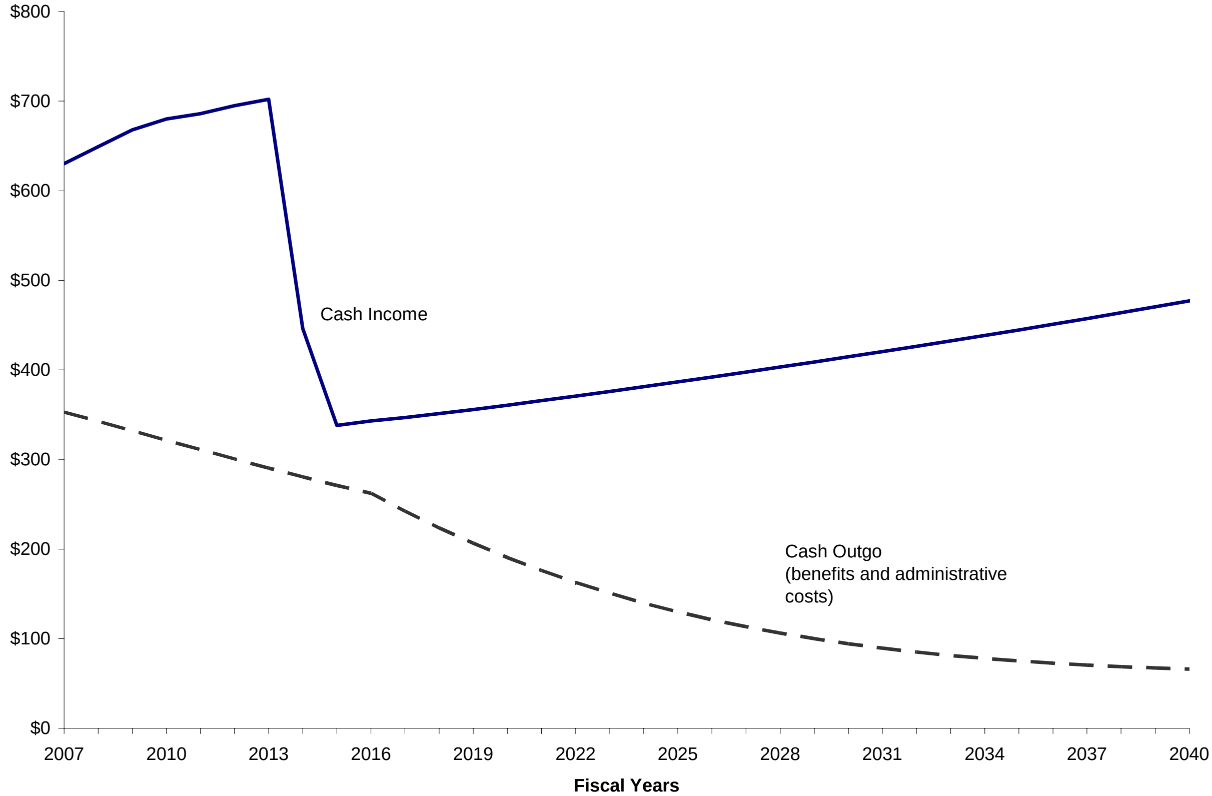
The Federal Coal Mine Health and Safety Act of 1969 created the Black Lung Disability Benefit Program to provide compensation for medical and survivor benefits for eligible coal miners who are disabled due to pneumoconiosis (black lung disease) arising out of their coal mine employment. The DOL operates the Black Lung Disability Benefit Program. The 1977 Black Lung Amendments established a Black Lung Disability Trust Fund (BLDTF) to provide benefit payments to eligible coal miners disabled by pneumoconiosis when no responsible mine operator can be assigned the liability. The beneficiary population has been declining as the incidence of black lung disease has fallen, and the group of miners affected by the disease (and their widows) has been dying at a more rapid rate than new awards have been made.

Excise taxes on coal mine operators, based on the sale of coal, is the primary source of financing black lung disability payments and related administrative costs. The Black Lung Benefits Revenue Act provides for repayable advances to the BLDTF from the General Fund of the Treasury in the event that BLDTF resources are not adequate to meet program obligations. On September 30, 2006, total liabilities of the BLDTF exceed assets by $9.6 billion. This deficit fund balance represents the accumulated shortfall of excise taxes necessary to meet benefit payment and interest expenses. This shortfall was funded by repayable advances to the BLDTF which are repayable with interest. Estimates for future interest on advances are based on the interest rates on outstanding advances ranging from 4.5 percent to 13.8 percent and new borrowings ranging from 4.9 percent to 5.8 percent.

From the budget or consolidated financial perspective, Chart 13 shows projected black lung expenditures (excluding interest) and excise tax collections for the period 2007-2040. The significant assumptions used in the most recent set of projections are shown in the “Black Lung” section of Note 23—Social Insurance. Analysts project that a scheduled reduction in taxes on coal sales will decrease cash inflows by 52 percent between the years 2013 to 2015. After 2015, cash surpluses continue to widen due to a declining beneficiary population and increasing revenues. Including projected interest payments that the program must make, however, the picture changes dramatically.

Chart 13—Estimated Black Lung Income and Expenditures (Excluding Interest) 2007-2040

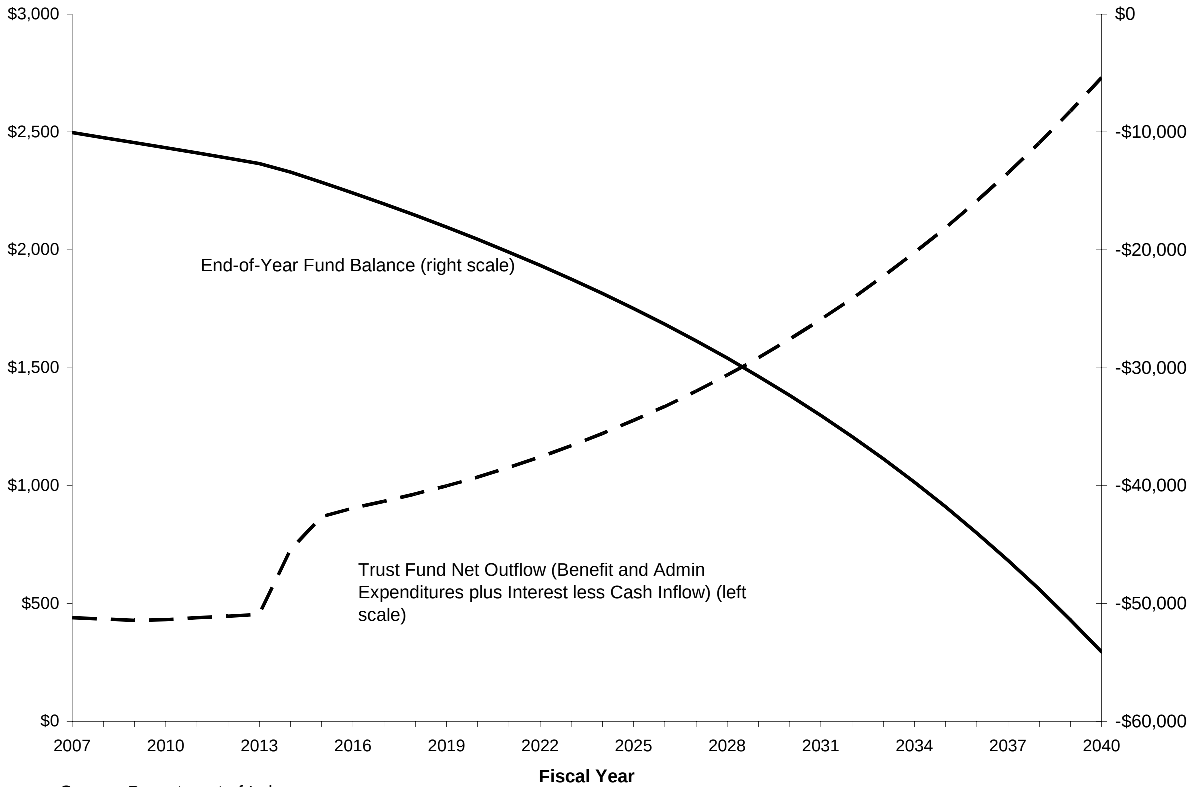
(In millions of nominal dollars)



Source: Department of Labor

Chart 14 shows the projected financial status of the program from a trust fund perspective that includes interest outflows from the program to the general fund. Trust fund net outflows (benefits plus interest payments less cash income from excise taxes) grow without bound, as a result of projected interest payments on the large accumulated liability to the general fund. This deficit fund balance represents the accumulated shortfall between excise taxes and benefit payment plus interest expenses.

Chart 14—Estimated Black Lung Trust Fund Net Outflow and End of Year Fund Balance 2007-2040



Source: Department of Labor

Table 9 shows present values of 35-year projections of expenditures and revenues for the Black Lung Program computed as of September 30, 2006, using a discount rate equivalent to 6.34 percent. (The discount rate is higher than the current Government borrowing rate because the program borrowed from the General Fund during periods of relatively high interest rates). From a Governmentwide (budget) perspective, the present value of expenditures is expected to be less than the present value of income by $3.7 billion (a surplus). From a trust fund perspective, a large balance ($9.6 billion) is owed to the General Fund. From that perspective, when that accumulated balance is combined with the cashflow surplus, the program shows a negative balance of $5.9 billion in present value dollars.

Table 9
Present Values of 35-Year Projections of Revenues and Expenditures for the Black Lung Program

(In billions of present value dollars, as of September 30, 2006)

Estimated future tax income	6.9
Estimated future expenditures	3.2
Net obligations from budget perspective (expenditures less income)	(3.7)
Accumulated balance due General Fund	9.6
Net obligations from trust fund perspective	5.9

Source: Department of Labor projections and Treasury Department calculations.

Unemployment Insurance

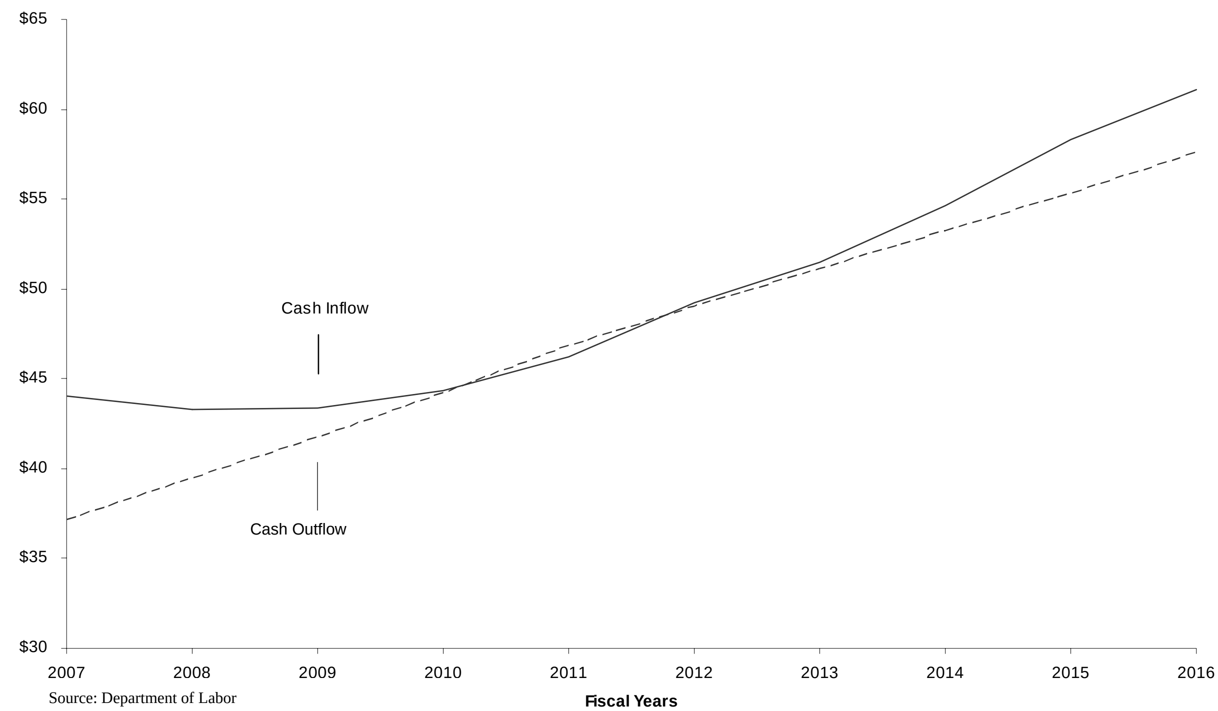
The Unemployment Insurance Program was created in 1935 to provide temporary partial wage replacement to unemployed workers who lose their jobs. The program is administered through a unique system of Federal and State partnerships established in Federal law but administered through conforming State laws by State agencies. DOL interprets and enforces Federal law requirements and provides broad policy guidance and program direction, while program details such as benefit eligibility, duration, and amount of benefits are established through individual State unemployment insurance statutes and administered through State unemployment insurance agencies.

The program is financed through the collection of Federal and State unemployment taxes that are credited to the Unemployment Trust Fund (UTF) and reported as Federal tax revenue. The fund was established to account for the receipt, investment, and disbursement of unemployment taxes. Federal unemployment taxes are used to pay for Federal and State administration of the Unemployment Insurance Program, veterans' employment services, State employment services, and the Federal share of extended unemployment insurance benefits. Federal unemployment taxes also are used to maintain a loan account within the UTF, from which insolvent State accounts may borrow funds to pay unemployment insurance benefits.

Chart 15 shows the projected cash contributions and expenditures over the next 10 years under expected economic conditions (described below). The significant assumptions used in the projections include total unemployment rates, civilian labor force levels, percent of unemployed receiving benefits, total wages, distribution of benefit payments by State, State tax rate structures, State taxable wage bases, and interest rates on UTF investments. These projections, excluding interest earnings, indicate positive net cash inflows for the next 4 years. There is a crossover back to a net outflow in fiscal year 2012, after which net inflows resume for the remainder of the projection period.

Chart 15—Estimated Unemployment Fund Cashflow Using Expected Economic Conditions 2007-2016

(In billions of nominal dollars)



Source: Department of Labor

Table 10 shows present values of 10-year projections of revenues and expenditures for the Unemployment Insurance Program using a discount rate of 6.04 percent, the average of the interest rates underlying the 10-year projections. Three sets of numbers are presented in order to show the effects of varying economic conditions as reflected in different assumptions about the unemployment rate. For expected economic conditions, the estimates are based on an unemployment rate of 4.8 percent during fiscal year 2007, increasing to 4.9 percent in fiscal year 2009 and thereafter. Under the mild recessionary scenario, the unemployment rate peaks at 7.43 percent in fiscal year 2009 and declines gradually until reaching 4.9 percent in 2015. Finally, under the deep recession scenario, the unemployment rate is assumed to peak at 10.14 percent in 2010 and gradually fall to 5.25 percent by the end of the projection period.

Each scenario uses an open group that includes current and future participants of the Unemployment Insurance Program. Table 10 shows that, as economic conditions worsen, while tax income is projected to increase as higher layoffs result in higher employer taxes, benefit outlays increase much faster. From the Governmentwide (budget) perspective, under expected conditions, the present value of income exceeds the present value of expenditures by $16 billion. From the same perspective, under a deep recession scenario, the present value of expenditures exceeds the present value of income by $51 billion. From a trust fund perspective, the program has more than $66 billion in assets. When combined with the present value of net cash income under expected economic conditions, the program has a surplus of $82 billion.

Table 10
Present Values of 10-Year Projections of Revenues and Expenditures for Unemployment Insurance Under Three Alternative Scenarios for Economic Conditions

(In billions of present value dollars, as of October 1, 2006)

	Economic Conditions		
	Expected	Mild Recession	Deep Recession
Future cash income	357.3	415.6	475.1
Future expenditures	341.3	420.1	526.3
Net obligations from budget perspective (expenditures less income)	(16.0)	4.5	51.2
Trust fund assets	66.1	66.1	66.1
Net obligations from trust fund perspective[1]	(82.1)	(61.6)	(14.9)

[1]Net obligations from the trust fund perspective=net obligations from the budget perspective-trust fund assets. The negative values in this line are indicative of surpluses.

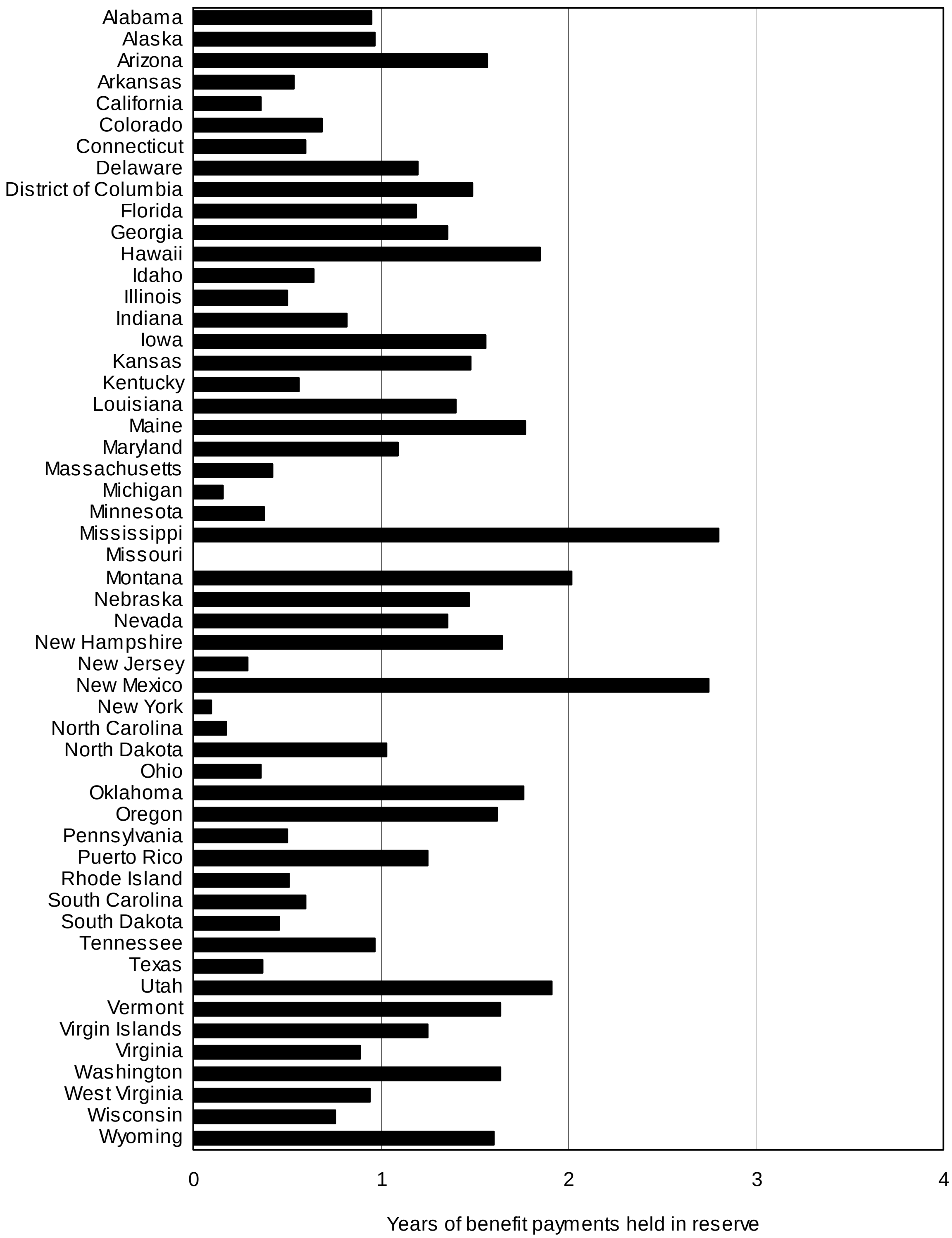
Source: Data for the present value calculations are from the Department of Labor.

Unemployment Trust Fund Solvency

Each State's accumulated UTF net assets or reserve balance should provide a defined level of benefit payments over a defined period. To be minimally solvent, a State's reserve balance should provide for 1 year's projected benefit payment needs based on the highest levels of benefit payments experienced by the State over the last 20 years. A ratio of 1.0 or greater prior to a recession indicates a State is minimally solvent. States below this level are vulnerable to exhausting their funds in a recession. States exhausting their reserve balance must borrow funds from the Federal Unemployment Account (FUA) to make benefit payments. The Missouri state account had loans payable to FUA at the end of fiscal year 2006. In addition, Texas had outstanding debts to other sources. During periods of high-sustained unemployment, balances in the FUA may be depleted. In these circumstances, FUA is authorized to borrow from the Treasury General Fund.

Chart 16 presents the State by State results of this analysis as of September 30, 2006. As the table illustrates, 27 State funds were below the minimal solvency ratio on September 30, 2006.

Chart 16—Unemployment Trust Fund Solvency as of September 30, 2006



Deferred Maintenance

Deferred maintenance is the estimated cost to bring Government-owned property to an acceptable condition, resulting from not performing maintenance on a timely basis. Deferred maintenance excludes the cost of expanding the capacity of assets or upgrading them to serve needs different from those originally intended. The consequences of not performing regular maintenance could include increased safety hazards, poor service to the public, higher costs in the future, and inefficient operations. Estimated deferred maintenance costs are not accrued in the Statements of Net Cost or recognized as a liability on the balance sheets.

The amounts disclosed for deferred maintenance are allowed to be measured using the following three methods:

- Condition assessment surveys are periodic inspections of the Government-owned property to determine the current condition and estimated cost to bring the property to an acceptable condition.
- Life-cycle cost forecast is an acquisition or procurement technique that considers operation, maintenance, and other costs in addition to the acquisition cost of assets.
- Management analysis method is founded on inflation-adjusted reductions in maintenance funding since the base year.

The amounts disclosed on the table below have all been measured using the condition assessment survey method. The standards for acceptable operating condition and the changes in these standards and changes in asset condition vary widely between the Federal entities.

Some deferred maintenance has been deemed critical. Such amounts and conditions are defined by the individual agencies with responsibility for the safekeeping of these assets. Low and high estimates are based on the materiality of the estimated cost of returning the asset to the acceptable condition versus the total value of the corresponding asset.

Deferred Maintenance as of September 30

	Deferred Maintenance Cost Range					
	Low Estimate		High Estimate		Critical Maintenance	
(In billions of dollars)	2006	2005	2006	2005	2006	2005
Asset Category:						
Buildings, structures, and facilities	25.3	23.2	32.1	33.7	11.7	11.4
Furniture, fixtures, and equipment	0.4	-	0.4	0.1	0.1	0.1
Other general property, plant, and equipment	1.6	1.1	1.6	1.1	0.1	-
Heritage assets	1.7	1.7	2.9	2.9	-	0.1
Total deferred maintenance	29.0	26.0	37.0	37.8	11.9	11.6

Please refer to the individual financial statements of DOD, USDA, DOE, VA, DOI, and NASA for detailed significant information on deferred maintenance, including the standards used for acceptable operating condition and changes in asset condition. These agencies comprise 81 percent of the Government's total reported net property, plant, and equipment of $688.5 billion as of September 30, 2006.

Unexpended Budget Balances

Unexpended budget balances consist of the unobligated and obligated, but unliquidated, budget balances.

Unobligated budget balances, including amounts for trust funds, are the cumulative amount of budget balances that are not obligated and that remain available for obligation. In 1-year accounts, the unobligated balance is not available for new obligations after the end of the fiscal year. In multiyear accounts, the unobligated balance may be carried forward and remains available for obligation for the period specified. In no-year accounts, the unobligated balance is carried forward until specifically rescinded by law or until the purposes for which it was provided have been accomplished. The total unobligated budget balances for fiscal years 2006 and 2005 are $381.1 billion (estimated) and $458.0 billion, respectively.

Obligated budget balances are the cumulative budget balances that have been obligated but not liquidated. The obligated balance can be carried forward for a maximum of 5 years after the appropriation has expired. The total obligated budget balances for fiscal years 2006 and 2005 are $1,013.8 billion (estimated) and $911.3 billion, respectively.

The President's Budget with fiscal year 2006 actuals is expected to be published in February 2007; thus the unobligated and obligated amounts reported for fiscal year 2006 are estimates from the President's Budget issued in February 2006. The amounts initially reported as unexpended budget balances at the end of fiscal year 2005 were different from the actual balances reflected in the President's Budget that was issued in February 2006 by approximately $83.1 billion (net) and $16.3 billion (net) for unobligated and obligated balances, respectively, due to compilation differences. The unobligated balance that was previously reported erroneously included about $56.4 billion of non-budgetary financing accounts and $27.1 billion of expired accounts and excluded $0.4 billion amounts from certain verifying agencies. The obligated balance that was previously reported erroneously included about $42.1 billion of non-budgetary financing accounts, and excluded $0.8 billion from certain verifying agencies, and $(25) billion in adjustments to agencies' reported balances.

Tax Burden

The Internal Revenue Code provides for progressive tax rates, whereby higher incomes are generally subject to higher tax rates. The tables present the latest available information on income tax and related income, deductions, and credit for individuals by income level and for corporations by size of assets.

Individual Income Tax Returns for Tax Year 2004

Adjusted Gross Income (AGI)	Number of Taxable Returns (In thousands)	AGI (In millions of dollars)	Total Income Tax (In millions of dollars)	Average AGI per Return (In whole dollars)	Average Income Tax per Return (In whole dollars)	Income Tax as a Percentage of AGI
Under $15,000	37,315	200,248	3,306	5,366	89	1.7%
$15,000 under $30,000	29,581	650,044	23,749	21,975	803	3.7%
$30,000 under $50,000	24,536	957,783	62,190	39,036	2,535	6.5%
$50,000 under $100,000	28,196	1,984,569	178,486	70,385	6,330	9.0%
$100,000 under $200,000	9,750	1,291,062	176,173	132,417	18,069	13.6%
$200,000 or more	3,007	1,681,201	386,515	559,096	128,538	23.0%
Total	132,385	6,764,907	830,419			

Corporation Income Tax Returns for Tax Year 2003

Total Assets	Income Subject to Tax (In millions of dollars)	Total Income Tax after Credits (In millions of dollars)	Percentage of Income Tax after Credits to Taxable Income
Zero assets	7,476.0	1,987.0	26.6%
$1 under $500	8,159.0	1,435.0	17.6%
$500 under $1,000	3,541.0	785.0	22.2%
$1,000 under $5,000	10,482.0	2,994.0	28.6%
$5,000 under $10,000	6,240.0	2,045.0	32.8%
$10,000 under $25,000	9,033.0	2,941.0	32.6%
$25,000 under $50,000	8,208.0	2,677.0	32.6%
$50,000 under $100,000	10,321.0	3,297.0	31.9%
$100,000 under $250,000	20,870.0	6,516.0	31.2%
$250,000 or more	615,006.0	152,840.0	24.9%
Total	699,336.0	177,517.0	25.6%

Tax Gap

The tax gap is the aggregate amount of tax (i.e., excluding interest and penalties) that is imposed by the tax laws for any given tax year but is not paid voluntarily and timely. The Internal Revenue Service (IRS) currently projects that the annual Federal gross tax gap is estimated at $345.0 billion. This estimate is based on the results of the National Research Program (NRP). The NRP was a study conducted to measure the compliance rate of the individual filers based on examination of a statistical sample of their filed returns for tax year 2001. The tax gap arises from three types of noncompliance: not filing timely tax returns (the nonfiling gap), underreporting the correct amount of tax on timely-filed returns (the underreporting gap), and not paying on time the full amount reported on timely-filed returns (the underpayment gap). Of these three components, only the underpayment gap is observed; the nonfiling gap and the underreporting gap must be estimated. Each instance of noncompliance by a taxpayer contributes to the tax gap, whether or not the IRS detects it, and whether or not the taxpayer is even aware of the noncompliance. The tax gap does not include underpayments by corporate taxpayers or include taxes that should have been paid on income from the illegal sector of the economy.

Underreporting of income tax, employment taxes, and other taxes represents 83 percent of the tax gap. The single largest subcomponent of underreporting involves individuals understating their income, taking improper deductions, overstating business expenses, and erroneously claiming credits. Individual underreporting represents about half of the total tax gap. Individual income tax also accounts for about half of all tax liabilities.

The collection gap is the cumulative amount of assessed tax, penalties, and interest that the IRS expects to remain uncollectible. In essence, it represents the difference between the total balance of unpaid assessments and the net taxes receivable reported on the IRS's balance sheet. The tax gap and the collection gap are related and overlapping concepts, but they have significant differences. The collection gap is a cumulative balance sheet concept for a particular point in time, while the tax gap is like an income statement item for a single year. Moreover, the tax gap estimates include all noncompliance, while the collection gap includes only amounts that have been assessed (a small portion of all noncompliance).

Other Claims for Refunds

Management has estimated amounts that may be paid out as other claims for tax refunds. This estimate represents an amount (principal and interest) that may be paid for claims pending judicial review by the Federal courts or, internally, by appeals. The total estimated payout (including principal and interest) for claims pending judicial review by the Federal courts is $14.8 billion and $12.0 billion for fiscal years 2006 and 2005, respectively. For those under appeal, the estimated payout is $7.0 billion and $11.1 billion for fiscal years 2006 and 2005, respectively. There are also unasserted claims for refunds of certain excise taxes. Although these refund claims have been deemed to be probable, they do not meet the criteria in SFFAS No. 5 for reporting the amounts in the balance sheets or for disclosure in the Notes to the Financial Statements. However, they meet the criteria in SFFAS No. 7 for inclusion as supplemental information. To the extent judgments against the Government for these claims prompt other similarly situated taxpayers to file similar refund claims, these amounts could become significantly greater.

Risk Assumed

Risk assumed information is important for all Federal insurance and guarantee programs, except those relating to social insurance, life insurance and loan guarantee programs. Risk assumed is generally measured by the present value of unpaid expected losses net of associated premiums based on the risk inherent in the insurance or guarantee coverage in force. In addition to the liability for unpaid insurance claims included in Note 14—Insurance Program Liabilities, for events that have already occurred, the Federal government is also required to report as supplementary information risk assumed amounts and the periodic changes in those amounts.

The assessments of losses expected based on the risk assumed are based on actuarial or financial methods applicable to the economic, legal and policy environment in force at the time the assessments are made. Management has estimated the loss amounts based on the risk assumed as well as the periodic changes for the following insurance programs.

Please refer to the individual financial statements of the PBGC and the National Credit Union Administration for other significant detailed information.

Risk Assumed Information as of September 30

(In billions of dollars)	2006	2005
Present Value of unpaid expected losses, net of associated premiums:		
Pension Benefit Guaranty Corporation.....	73.4	108.5
All other..	-	0.1
Total..	73.4	108.6
Periodic changes in risk assumed amounts:		
Pension Benefit Guaranty Corporation......	(35.1)	12.7
All other..	-	(0.2)
Total..	(35.1)	12.5

Unmatched Transactions and Balances

(In millions of dollars)	Fiscal Year 2006	Fiscal Year 2005
Change in Intra-Governmental Unmatched Balances		
Debt/Investments	1,231.4	(4,881.5)
Interest Payable/Receivable	77.7	81.6
Loans Payable/Receivable	(1,178.0)	(9,891.3)
Benefit Program Contributions Payable/Receivable	(128.8)	5,021.1
Accounts Payable/Receivable	10,271.5	(13,096.3)
Advances from/to Others & Deferred Credits/Prepayments	(855.5)	9,047.6
Transfers Payable/Receivable	(379.8)	1,627.4
	9,038.5	(12,091.4)
Unmatched Intra-Governmental Transactions		
Federal Securities Interest Revenue/Expense–Investment Exchange	2,206.2	1,578.9
Borrowings Interest Revenue/Expense–Exchange	397.0	669.6
Borrowings Gains/Losses	(16.5)	(10.3)
Transfers - In/Out Without Reimbursement	7,386.3	6,352.4
Appropriations Transfers–In/Out	(5,554.0)	(5,495.8)
Imputed Financing Source/Cost	(7.6)	87.2
Benefit Program Revenue/Cost	(950.3)	(1,672.8)
Unexpended Appropriations Transferred In/Out	(601.4)	3,058.3
	2,859.7	4,567.5
General Fund Transactions and Timing Adjustments	(13,579.9)	9,589.6
Intra-Agency Reporting Errors*	(5,357.5)	1,019.6
Top Level Journal Vouchers	(3,951.5)	(7,198.5)
Unmatched Transactions and Balances, Net	(10,990.7)	(4,113.2)

*Includes reporting errors for DHS (5,371.0) million in fiscal year 2006 and (2.0) million in fiscal year 2005.

The Statement of Operations and Changes in Net Position includes an amount for unmatched transactions and balances that result from the consolidation of Federal reporting entities. Transactions between Federal entities must be eliminated in consolidation to reveal the financial position of the U.S. Government. Many of the amounts included in the table represent intragovernmental activity and balances that differed between federal agency trading partners and often totaled significantly more than the net amounts shown. In addition, included in the net amount labeled "General Fund Transactions and Timing Adjustments" are certain intragovernmental accounts, primarily related to unreconciled transactions with the General Fund, totaling hundreds of billions of dollars. The table also reflects other consolidating adjustments and other adjustments that contributed to the unmatched transactions and balances amount.

Unmatched transactions and balances between Federal entities impact not only in the period in which differences originate but also in the periods where differences are reconciled. As a result, it would not be proper to conclude that increases or decreases in the unmatched amounts shown in the table above reflect improvements or deteriorations in the Government's ability to reconcile intra-governmental transactions. The Federal community considers the identification and accurate reporting of intra-governmental activity a priority

United States Government Stewardship Information (Unaudited) for the Years Ended September 30, 2006, and September 30, 2005

Stewardship Investments

Stewardship investments focus on Government programs aimed at providing long-term benefits by improving the Nation's productivity and enhancing economic growth. These investments can be provided through direct Federal spending or grants to State and local governments for certain education and training programs, research and development, and federally financed but not federally-owned property, such as bridges and roads. When incurred, these investments are included as expenses in determining the net cost of operations. Stewardship investments for the current year and for the immediately preceding 4 years are shown below in Table 11. The amounts reported in fiscal year 2006 for investments in prior years (fiscal years 2005-2002) are restated due to agencies continuously reviewing, correcting, and updating this data.

Table 11
Stewardship Investments
for the Years Ended September 30

(In billions of dollars)	Fiscal Year 2006	Restated Fiscal Year 2005	Restated Fiscal Year 2004	Restated Fiscal Year 2003	Restated Fiscal Year 2002
Investments in non-federal physical property	52.3	49.7	49.4	48.1	48.2
Investments in human capital	107.8	88.0	76.9	71.1	61.5
Research and development:					
Investments in basic research	26.2	25.4	23.9	22.3	20.5
Investments in applied research	20.7	21.1	20.8	19.2	18.1
Investments in development	80.5	66.6	61.1	50.1	45.6
Total investments	287.5	250.8	232.1	210.8	193.9

Non-Federal Physical Property

The Government makes grants and provides funds for the purchase, construction, and/or major renovation of State and local government physical properties. Cost for non-federal physical property programs are included as expenses in the Statements of Net Cost and are reported as investments in Table 11. They are measured on the same accrual basis of accounting used in the *Financial Report* statements.

DOT, HUD, and the Environmental Protection Agency (EPA) had $43.5 billion (83 percent), $3.6 billion (7 percent), and $3.1 billion (6 percent), respectively, of the total non-federal physical property investments in fiscal year 2006 as shown in Table 11. These same agencies also had similar investment amounts (and percentage contributions) in each of the preceding 4 years.

Within DOT, the Federal Highway Administration invested $39.7 billion during fiscal year 2006, primarily via reimbursement from the Highway Trust Fund, of states' construction costs related to interstate and national highways. The States' contribution is 10 percent for the Interstate System and 20 percent for most other programs. These highway programs have not typically resulted in significant transfers of property to State or local governments.

The significant programs administered by HUD relate to grants for property renovation and public housing programs. The significant programs administered by the EPA relate to grants for wastewater and related water-quality programs. Neither of these programs typically transfers property to State or local governments.

Human Capital

The Government runs several programs that invest in human capital. Those investments go toward increasing and maintaining a healthy economy by educating and training the general public. Costs do not include training expenses for Federal workers.

Education, DOL, and VA had $93.1 billion (86 percent), $6.0 billion (6 percent), and $3.6 billion (3 percent), respectively, of the total human capital investments in fiscal year 2006 as shown in Table 11. These same agencies also had similar investment amounts (and percentage contributions) in each of the preceding 4 years.

Education administers a wide variety of programs related to general public education and training programs that are intended to increase or maintain national economic productive capacity. Within Education, approximately 47 percent of the annual investments relate to Federal student aid, either in the form of direct or guaranteed loans or grants to eligible undergraduate and graduate students. The remaining investments primarily relate to grants for Elementary, Secondary, and Special Education programs as well as for various departmental initiatives (e.g., charter schools, foreign language assistance, etc.).

The significant human capital programs administered by DOL relate to grants for job training and employment programs. The significant human capital programs administered by VA also relate to grants for job training and rehabilitation programs for veterans.

Research and Development

Federal investments in research and development (R&D) comprise those expenses for basic research, applied research, and development that are intended to increase or maintain national economic productive capacity or yield other future benefits.

- Investments in basic research are for systematic studies to gain knowledge or understanding of the fundamental aspects of phenomena and of observable facts without specific applications toward processes or products in mind.
- Investments in applied research are for systematic studies to gain knowledge or understanding necessary for determining the means by which a recognized and specific need may be met.
- Investments in development are the systematic use of the knowledge and understanding gained from research for the production of useful materials, devices, systems, or methods, including the design and development of prototypes and processes.

With regard to basic and applied research, HHS had $15.7 billion (60 percent) and $10.9 billion (52 percent), of the total basic and applied research investments, respectively, in fiscal year 2006 as shown in Table 11. HHS also had similar R&D investment amounts (and percentage contributions) in each of the preceding 4 years.

Within HHS, the National Institutes of Health (NIH) conducts almost all of the department's basic and applied research. NIH conducts many types of basic and applied medical research, including basic and disease-related research, observational, population-based, behavioral and clinical research; and health services research.

With regard to development, DOD had $56.7 billion (70 percent) of total development investments in fiscal year 2006 as shown in Table 11. DOD development focuses on advanced technology, weapons demonstrations, and engineering, manufacturing and operational systems development. This development is aimed to improve all aspects of war-fighting, including ground, air and space, tactical, and strategic weaponry.

Appendix: Significant Government Entities Included and Excluded from the Financial Statements

This *Financial Report* includes the executive branch with their corresponding departments and entities, the legislative and judicial branches, and other independent establishments and Government corporations. Excluded are privately owned Government-sponsored enterprises such as the Federal Home Loan Banks and the Federal National Mortgage Association. The Federal Reserve System is excluded because organizations and functions pertaining to monetary policy are traditionally separate from, and independent of, other central Government organizations and functions.

Significant Entities Included in these Statements:

(in Statement of Net Cost order):

Department of Defense (DOD)
www.defenselink.mil
Department of Health and Human Services (HHS)
www.hhs.gov
Social Security Administration (SSA)
www.ssa.gov
Department of Veterans Affairs (VA)
www.va.gov
Department of Agriculture (USDA)
www.usda.gov
Department of Education (ED)
www.ed.gov
Department of the Treasury (Treasury)
www.ustreas.gov
Department of Transportation (DOT)
www.dot.gov
Department of Energy (DOE)
www.energy.gov
Department of Homeland Security (DHS)
www.dhs.gov
Department of Labor (DOL)
www.dol.gov
Department of Housing and Urban Development (HUD)
www.hud.gov
Department of Justice (DOJ)
www.usdoj.gov
Office of Personnel Management (OPM)
www.opm.gov
National Aeronautics and Space Administration (NASA)
www.nasa.gov
Department of the Interior (DOI)
www.doi.gov
Department of State (State)
www.state.gov
U.S. Agency for International Development (USAID)
www.usaid.gov
Environmental Protection Agency (EPA)
www.epa.gov
Department of Commerce (DOC)
www.doc.gov
Federal Communications Commission (FCC)
www.fcc.gov
Railroad Retirement Board (RRB)
www.rrb.gov
National Science Foundation (NSF)
www.nsf.gov
Federal Deposit Insurance Corporation (FDIC)
www.fdic.gov
Small Business Administration (SBA)
www.sba.gov
Nuclear Regulatory Commission (NRC)
www.nrc.gov
General Services Administration (GSA)
www.gsa.gov
National Credit Union Administration (NCUA)
www.ncua.gov
Tennessee Valley Authority (TVA)
www.tva.gov
Export-Import Bank of the United States (Ex-Im Bank)
www.exim.gov
Pension Benefit Guaranty Corporation (PBGC)
www.pbgc.gov
U.S. Postal Service (USPS)
www.usps.gov

Other Significant Entities

Farm Credit System Insurance Corporation (FCSIC)
www.fcsic.gov
U.S. Securities and Exchange Commission (SEC)
www.sec.gov
Smithsonian Institution
www.si.edu
Executive Office of the President
Federal Trade Commission (FTC)
www.ftc.gov

Government Accountability Office (GAO)
www.gao.gov
Government Printing Office (GPO)
www.gpo.gov
Library of Congress (LC)
www.loc.gov
National Archives and Records Administration (NARA)
www.nara.gov
National Transportation Safety Board (NTSB)
www.ntsb.gov

Significant Entities Excluded from these Statements:

Army and Air Force Exchange Service
Board of Governors of the Federal Reserve System (Including the Federal Reserve Banks)
Federal National Mortgage Association (Fannie Mae)
Farm Credit System
Federal Home Loan Banks
Federal Retirement Thrift Investment Board (Including the Thrift Savings Fund)
Financing Corporation
Federal Home Loan Mortgage Corporation (Freddie Mac)
Marine Corps Exchange
Navy Exchange Service Command
Resolution Funding Corporation
Student Loan Marketing Association (SLMA or Sallie Mae)

GAO
Accountability * Integrity * Reliability

Comptroller General of the United States

United States Government Accountability Office
Washington, DC 20548

The President
The President of the Senate
The Speaker of the House of Representatives

The Secretary of the Treasury, in coordination with the Director of the Office of Management and Budget (OMB), is required annually to submit financial statements for the U.S. government to the President and the Congress. GAO is required to audit these statements.[1] This is our report on the accompanying U.S. government's consolidated financial statements for the fiscal years ended September 30, 2006 and 2005,[2] and our associated reports on internal control and compliance with significant laws and regulations.

The federal government is responsible for (1) preparing annual consolidated financial statements in conformity with U.S. generally accepted accounting principles (GAAP); (2) establishing, maintaining, and assessing internal control to provide reasonable assurance that the control objectives of the Federal Managers' Financial Integrity Act (FMFIA) [3] are met; and (3) complying with significant laws and regulations. Also, the 24 Chief Financial Officers (CFO) Act agencies are responsible for implementing and maintaining financial management systems that substantially comply with Federal Financial Management Improvement Act of 1996 (FFMIA)[4] requirements. Our objective was to audit the consolidated financial statements for the fiscal years ended September 30, 2006 and 2005. Appendix I discusses the scope and methodology of our work.

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[1]The Government Management Reform Act of 1994 has required such reporting, covering the executive branch of government, beginning with financial statements prepared for fiscal year 1997. 31 U.S.C. 331(e). The federal government has elected to include certain financial information on the legislative and judicial branches in the consolidated financial statements as well.

[2]The consolidated financial statements for the fiscal years ended September 30, 2006 and 2005 consist of the Statements of Net Cost, Statements of Operations and Changes in Net Position, Reconciliations of Net Operating Cost and Unified Budget Deficit, Statements of Changes in Cash Balance from Unified Budget and Other Activities, Balance Sheets, and as of January 1, 2006, the Statement of Social Insurance, including the related notes to these financial statements.

[3]31 U.S.C. 3512 (c), (d) (commonly referred to as FMFIA). This act requires executive agency heads to evaluate and report annually to the President and the Congress on the adequacy of their internal control and accounting systems and on actions to correct significant problems.

[4]31 U.S.C. 3512 note (Federal Financial Management Improvement Act).

A significant number of material weaknesses[5] related to financial systems, fundamental recordkeeping and financial reporting, and incomplete documentation continued to (1) hamper the federal government's ability to reliably report a significant portion of its assets, liabilities, costs, and other related information; (2) affect the federal government's ability to reliably measure the full cost as well as the financial and nonfinancial performance of certain programs and activities; (3) impair the federal government's ability to adequately safeguard significant assets and properly record various transactions; and (4) hinder the federal government from having reliable financial information to operate in an economical, efficient, and effective manner. We found the following:

- Certain material weaknesses in financial reporting and other limitations on the scope of our work resulted in conditions that continued to prevent us from expressing an opinion on the accompanying consolidated financial statements for the fiscal years ended September 30, 2006 and 2005.[6]

- The federal government did not maintain effective internal control over financial reporting (including safeguarding assets) and compliance with significant laws and regulations as of September 30, 2006.

- Our work to test compliance with selected provisions of significant laws and regulations in fiscal year 2006 was limited by the material weaknesses and scope limitations discussed in this report.

DISCLAIMER OF OPINION ON THE CONSOLIDATED FINANCIAL STATEMENTS

Because of the federal government's inability to demonstrate the reliability of significant portions of the U.S. government's accompanying consolidated financial statements for fiscal years 2006 and 2005, principally resulting from certain material weaknesses, and other limitations on the scope of our work, described in this report, we are unable to, and we do not, express an opinion on such financial statements.

As a result of these limitations, readers are cautioned that amounts reported in the consolidated financial statements and related notes may not be reliable. These material weaknesses and other scope limitations also affect the reliability of certain information contained in the accompanying Management's Discussion and Analysis and other financial management information—including information used to manage the government day to day and budget information reported by federal agencies—that is taken from the same data sources as the consolidated financial statements.

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[5]A material weakness is a condition that precludes the entity's internal control from providing reasonable assurance that misstatements, losses, or noncompliance material in relation to the financial statements or to stewardship information would be prevented or detected on a timely basis.
[6]We previously reported that certain material weaknesses prevented us from expressing an opinion on the consolidated financial statements of the U.S. government for fiscal years 1997 through 2005.

We have not audited and do not express an opinion on the Management's Discussion and Analysis, Stewardship Information, Supplemental Information, or other information included in the accompanying fiscal year *2006 Financial Report of the United States Government (Financial Report)*.

In fiscal year 2006, the federal government adopted the following new federal accounting standards, as discussed in the notes:

- accounting for and reporting of earmarked funds[7] (Notes 1 and 20),
- reporting heritage assets and stewardship land[8] (Notes 1, 24, and 25),
- changes in disclosure of certain information in the consolidated financial statements[9] (Note 1), and
- presentation of the Statement of Social Insurance (SOSI) as a basic financial statement[10] (Notes 1 and 23).

The SOSI presents the actuarial present value of the federal government's estimated future revenue to be received from or on behalf of the participants and estimated future expenditures to be paid to or on behalf of participants, using a projection period sufficient to illustrate the long-term sustainability of the social insurance programs. In preparing the SOSI, management considers and selects assumptions and data that it believes provide a reasonable basis for the assertions in the statement. However, because of the large number of factors that affect the SOSI and the fact that such assumptions are inherently subject to substantial uncertainty (arising from the likelihood of future changes in general economic, regulatory, and market conditions, as well as other more specific future events, significant uncertainties, and contingencies), there will be differences between the estimates in the SOSI and the actual results, and those differences may be material.

In addition to the inherent uncertainty that underlies the expenditure projections prepared for all parts of Medicare, the Supplementary Medical Insurance (SMI) Part D projections have an added uncertainty in that they were prepared using very little program experience upon which to base the estimates and the SMI Part B projections assume significant reductions in physician payments, as required under current law, which may or may not occur. The Congress has overridden scheduled reductions in physician payments for each of the last 4 years and recently passed legislation to override scheduled reductions for

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[7]Federal Accounting Standards Advisory Board (FASAB) Statement of Federal Financial Accounting Standards (SFFAS) 27, *Identifying and Reporting Earmarked Funds* (Washington, D.C.: Dec. 28, 2004).
[8]SFFAS 29, *Heritage Assets and Stewardship Land* (Washington, D.C.: June 7, 2005).
[9]SFFAS 32, *Consolidated Financial Report of the United States Government Requirements: Implementing Statement of Federal Financial Accounting Concepts 4 "Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government"* (Washington, D.C.: Sept. 28, 2006).
[10]SFFAS 25, *Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment* (July 2003), and SFFAS 26, *Presentation of Significant Assumptions for the Statement of Social Insurance: Amending SFFAS 25* (Washington, D.C.: Oct. 29, 2004).

2007.[11] It is not possible to anticipate what other actions the Congress might take, either in the near or long-term, to alter the scheduled reductions in physician payments. If scheduled reductions continue to be overridden in the future, actual SMI Part B expenditures could be materially more than the amounts presented in the SOSI.

Significant Matters of Emphasis

Before discussing the material weaknesses that contributed to our disclaimer of opinion and the additional limitations on the scope of our work we identified, two significant matters require emphasis—the nation's fiscal imbalance and restatements to the fiscal year 2005 consolidated financial statements.

The Nation's Fiscal Imbalance

While we are unable to express an opinion on the U.S. government's consolidated financial statements, the following key items deserve emphasis in order to put the information contained in the financial statements and the Management's Discussion and Analysis section of the *2006 Financial Report of the United States Government* into context. Despite improvement in both the fiscal year 2006 reported net operating cost and the cash-based budget deficit, the U.S. government's total reported liabilities, net social insurance commitments, and other fiscal exposures continue to grow and now total approximately $50 trillion, representing approximately four times the Nation's total output (GDP) in fiscal year 2006, up from about $20 trillion, or two times GDP in fiscal year 2000. As this long-term fiscal imbalance continues to grow, the retirement of the "baby boom" generation is closer to becoming a reality with the first wave of boomers eligible for early retirement under Social Security in 2008. Given these and other factors, it seems clear that the nation's current fiscal path is unsustainable and that tough choices by the President and the Congress are necessary in order to address the nation's large and growing long-term fiscal imbalance.

Restatements to the Consolidated Financial Statements

As discussed in Notes 4, 6, 17, and 26, the federal government restated certain of its fiscal year 2005 consolidated financial statements to correct errors. Restatements relating to property, plant, and equipment resulted from misstatements by the Department of Defense, which had received a disclaimer on its originally issued as well as its restated fiscal year 2005 financial statements. Certain other restatements that were made to the consolidated financial statements related to errors that occurred during the preparation of the fiscal year 2005 Reconciliation of Net Operating Cost and Unified Budget Deficit. Because of the material weaknesses over property, plant, and equipment and over the preparation of the consolidated financial statements discussed in this report, the restated amounts may not be reliable.

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[11] The Tax Relief and Health Care Act of 2006, H.R. 6111, 109th Cong. As of December 12, 2006, the President had not signed the legislation.

Limitations on the Scope of Our Work

For fiscal years 2006 and 2005, there were limitations on the scope of our work in addition to the material weaknesses that contributed to our disclaimer of opinion. First, Treasury and OMB depend on certain federal agencies' representations to provide their representations to us regarding the U.S. government's consolidated financial statements. Treasury and OMB were unable to provide us with adequate representations regarding the U.S. government's consolidated financial statements primarily because of insufficient representations provided to them by two CFO Act agencies. Second, Treasury was unable to provide the final consolidated financial statements and supporting documentation in time for us to complete all of our planned auditing procedures related to the compilation of these financial statements.

Material Weaknesses Contributing to Our Disclaimer of Opinion

The federal government did not maintain adequate systems or have sufficient, reliable evidence to support certain material information reported in the accompanying consolidated financial statements, as briefly described below. The underlying material weaknesses in internal control, which generally have existed for years, contributed to our disclaimer of opinion. Appendix II describes the material weaknesses in more detail and highlights the primary effects of these material weaknesses on the accompanying consolidated financial statements and on the management of federal government operations. The material weaknesses that contributed to our disclaimer of opinion were the federal government's inability to:

- satisfactorily determine that property, plant, and equipment and inventories and related property, primarily held by DOD, were properly reported in the consolidated financial statements;

- reasonably estimate or adequately support amounts reported for certain liabilities, such as environmental and disposal liabilities, or determine whether commitments and contingencies were complete and properly reported;

- support significant portions of the total net cost of operations, most notably related to DOD, and adequately reconcile disbursement activity at certain agencies;

- adequately account for and reconcile intragovernmental activity and balances between federal agencies;

- ensure that the federal government's consolidated financial statements were (1) consistent with the underlying audited agency financial statements, (2) balanced, and (3) in conformity with GAAP; and

- identify and either resolve or explain material differences that exist between certain components of the budget deficit reported in Treasury's records, used to prepare the Reconciliation of Net Operating Cost and Unified Budget Deficit and Statement of

Changes in Cash Balance from Unified Budget and Other Activities, and related amounts reported in federal agencies' financial statements and underlying financial information and records.

Due to the material weaknesses and the additional limitations on the scope of our work discussed above, there may also be additional issues that could affect the consolidated financial statements that have not been identified.

ADVERSE OPINION ON INTERNAL CONTROL

Because of the effects of the material weaknesses discussed in this report, in our opinion, the federal government did not maintain effective internal control as of September 30, 2006, to meet the following objectives: (1) transactions are properly recorded, processed, and summarized to permit the preparation of the financial statements and stewardship information in conformity with GAAP, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition; and (2) transactions are executed in accordance with laws governing the use of budget authority and with other significant laws and regulations that could have a direct and material effect on the financial statements and stewardship information. Consequently, the federal government's internal control did not provide reasonable assurance that misstatements, losses, or noncompliance material in relation to the financial statements or to stewardship information would be prevented or detected on a timely basis. Our adverse opinion on internal control over financial reporting and compliance is based upon the criteria established under FMFIA.

In addition to the material weaknesses that contributed to our disclaimer of opinion, which were discussed above, we found the following four other material weaknesses in internal control as of September 30, 2006. These weaknesses are discussed in more detail in Appendix III, including the primary effects of the material weaknesses on the accompanying consolidated financial statements and on the management of federal government operations. These other material weaknesses were the federal government's inability to:

- implement effective credit reform estimation and related financial reporting processes;
- determine the full extent to which improper payments exist;
- identify and resolve information security control weaknesses and manage information security risks on an ongoing basis; and
- effectively manage its tax collection activities.

Individual federal agency financial statement audit reports identify additional reportable conditions[12] in internal control, some of which were reported by agency auditors as being material weaknesses at the individual agency level. These additional reportable conditions do not represent material weaknesses at the governmentwide level. Also, due to the issues noted throughout this report, additional material weaknesses may exist that have not been reported.

COMPLIANCE WITH SIGNIFICANT LAWS AND REGULATIONS

Our work to test compliance with selected provisions of significant laws and regulations related to financial reporting was limited by the material weaknesses and scope limitations discussed in this report. U.S. generally accepted government auditing standards and OMB guidance require auditors to report on the agency's compliance with significant laws and regulations. Certain individual agency audit reports contain instances of noncompliance. None of these instances were material to the accompanying consolidated financial statements.

We caution that other noncompliance may have occurred and not been detected. Further, the results of our limited procedures may not be sufficient for other purposes. Our objective was not to, and we do not, express an opinion on compliance with significant laws and regulations.

AGENCY FINANCIAL MANAGEMENT SYSTEMS

To achieve the financial management improvements envisioned by the CFO Act, FFMIA, and the President's Management Agenda, federal agencies need to modernize their financial management systems to generate reliable, useful, and timely financial and performance information throughout the year and at year-end. As discussed throughout this report, serious financial management weaknesses have contributed significantly to our inability to determine the reliability of the consolidated financial statements. In this regard, for fiscal year 2006, auditors for the majority of the CFO Act agencies reported material weaknesses or other reportable conditions in internal control over financial reporting. The size and complexity of the federal government and the long-standing nature of its financial management systems weaknesses continue to present a formidable management challenge in providing accountability to the nation's taxpayers.

FFMIA requires auditors, as part of the CFO Act agencies' financial statement audits, to report whether agencies' financial management systems substantially comply with (1) federal financial management systems requirements, (2) applicable federal accounting standards, and (3) the federal government's *Standard General Ledger* at the transaction level. For fiscal year 2006, auditors for 17 of the 24 CFO Act agencies reported that the agencies' financial management systems did not substantially comply with one or more

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[12]Reportable conditions are matters coming to our attention that, in our judgment, should be communicated because they represent significant deficiencies in the design or operation of internal control that could adversely affect the federal government's ability to meet the internal control objectives described in this report.

of these three FFMIA requirements. As a result, the financial management systems at the majority of federal agencies are still unable to routinely produce reliable, useful, and timely financial information, and the federal government's capacity to manage with timely and objective data is limited, thereby hampering its ability to effectively administer and oversee its major programs.

OMB CIRCULAR NO. A-123, *Management's Responsibility for Internal Control*

OMB revised OMB Circular No. A-123, *Management's Responsibility for Internal Control*, which GAO has supported.[13] In fiscal year 2006, agencies began to implement the more rigorous requirements of the revised OMB Circular No. A-123, which include management identification, assessment, testing, correction, and documentation of internal controls over financial reporting for each account or group of accounts, as well as an annual assurance statement from the agency head as to whether internal control over financial reporting is effective.

OMB recognized that due to the complexity of some agencies, implementation of these new requirements may span more than 1 year. Accordingly, certain agencies have adopted multi-year implementation plans. OMB stated that it will continue to work with the Chief Financial Officers Council to identify potential areas for additional guidance and share agencies' best practices. It will be important that OMB monitor and oversee federal agencies' implementation of these new requirements.

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We provided a draft of this report to Treasury and OMB officials, who provided technical comments, which have been incorporated as appropriate. Treasury and OMB officials expressed their continuing commitment to address the problems this report outlines.

David M. Walker
Comptroller General
of the United States

December 1, 2006

[13]See GAO, *Financial Management: Effective Internal Control Is Key to Accountability*, GAO-05-321T (Washington, D.C.: Feb. 16, 2005).

APPENDIX I

Objectives, Scope, and Methodology

The Government Management Reform Act of 1994 expanded the requirements of the Chief Financial Officers (CFO) Act by making the inspectors general of 24 major federal agencies[14] responsible for annual audits of agencywide financial statements prepared by these agencies and GAO responsible for the audit of the U.S. government's consolidated financial statements. The Accountability of Tax Dollars (ATD) Act of 2002[15] requires most other executive branch agencies to prepare and have audited annual financial statements. The Office of Management and Budget (OMB) and the Department of the Treasury (Treasury) have identified 35 agencies[16] that are significant to the U.S. government's consolidated financial statements. Our work was performed in coordination and cooperation with the inspectors general and independent public accountants for these 35 agencies to achieve our joint audit objectives. Our audit approach focused primarily on determining the current status of the material weaknesses that contributed to our disclaimer of opinion and the other material weaknesses affecting internal control that we had previously reported in our report on the consolidated financial statements for fiscal year 2005.[17] Our work included separately auditing the following significant federal agency components:

- We audited and expressed an unqualified opinion on the Internal Revenue Service's (IRS) fiscal years 2006 and 2005 financial statements. In fiscal years 2006 and 2005, IRS collected about $2.5 trillion and $2.3 trillion, respectively, in tax payments and paid about $277 billion and $267 billion, respectively, in refunds to taxpayers.[18] In fiscal year 2006, we continued to report material internal control weaknesses, which resulted in ineffective internal control. Our tests of compliance with selected provisions of significant laws and regulations disclosed one area of noncompliance. We also found that IRS's financial management systems did not substantially comply with the requirements of the Federal Financial Management Improvement Act of 1996.

- We audited and expressed an unqualified opinion on the Schedules of Federal Debt managed by Treasury's Bureau of the Public Debt (BPD) for the fiscal years ended September 30, 2006 and 2005.[19] The schedules reported for these 2 fiscal years

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[14]31 U.S.C. 901(b), 3521(e). The 1994 act authorized the Office of Management and Budget to designate agency components that also would receive a financial statement audit. 31 U.S.C. 3515(c); see footnote 1.
[15]Pub. L. No. 107-289, 116 Stat. 2049 (Nov. 7, 2002); see 31 U.S.C. 3515.
[16]See *Treasury Financial Manual*, volume I, part 2, chapter 4700, for a listing of the 35 agencies.
[17]For our report on the U.S. government's consolidated financial statements for fiscal year 2005, see U.S. Department of the Treasury, *2005 Financial Report of the United States Government* (Washington, D.C. Dec. 2005), pp. 135-154, which can be found on GAO's Internet site at www.gao.gov.
[18]GAO, *Financial Audit: IRS's Fiscal Years 2006 and 2005 Financial Statements*, GAO-07-136 (Washington, D.C.: Nov. 9, 2006).
[19]GAO, *Financial Audit: Bureau of the Public Debt's Fiscal Years 2006 and 2005 Schedules of Federal Debt*, GAO-07-127 (Washington, D.C.: Nov. 7, 2006).

(1) approximately $4.8 trillion (2006) and $4.6 trillion (2005) of federal debt held by the public;[20] (2) about $3.7 trillion (2006) and $3.3 trillion (2005) of intragovernmental debt holdings;[21] and (3) about $222 billion (2006) and $181 billion (2005) of interest on federal debt held by the public. We reported that as of September 30, 2006, BPD had effective internal control over financial reporting and compliance with significant laws and regulations relevant to the Schedule of Federal Debt. Further, we reported that there was no reportable noncompliance in fiscal year 2006 with selected provisions of significant laws we tested.

- We audited and expressed unqualified opinions on the December 31, 2005 and 2004, financial statements of the funds administered by the Federal Deposit Insurance Corporation (FDIC), including the Bank Insurance Fund, the Savings Association Insurance Fund, and the FSLIC Resolution Fund.[22] We reported that as of December 31, 2005, FDIC had effective internal control over financial reporting and compliance with significant laws and regulations. In addition, we performed certain procedures and tests of internal control over certain material balances of the funds administered by FDIC as of September 30, 2006.

- We audited and expressed unqualified opinions on the fiscal years 2006 and 2005 financial statements of the United States Securities and Exchange Commission (SEC).[23] In fiscal year 2006, we reported that SEC had effective controls over financial reporting and compliance with significant laws and regulations. Further, we reported that there was no reportable noncompliance with selected provisions of significant laws and regulations we tested.

We considered the CFO Act agencies' and certain other federal agencies' fiscal years 2006 and 2005 financial statements and the related auditors' reports prepared by the inspectors general or contracted independent public accountants. Financial statements and audit reports for these agencies provide information about the operations of each of these entities. We did not audit, and we do not express an opinion on, any of these individual federal agency financial statements.

We considered the Department of Defense's (DOD) assertion that DOD management prepared and submitted pursuant to the provisions of the National Defense Authorization Act for Fiscal Year 2002.[24] In accordance with section 1008 of this act, DOD reported that its fiscal year 2006 financial statements were not completely reliable. DOD cited deficiencies in several areas affecting its financial statements, including, among others,

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[20]The public holding federal debt is comprised of individuals, corporations, state and local governments, the Federal Reserve Banks, and foreign governments and central banks.
[21]Intragovernmental debt holdings represent federal debt issued by Treasury and held by certain federal government accounts such as the Social Security and Medicare trust funds.
[22]GAO, *Financial Audit: Federal Deposit Insurance Corporation Funds' 2005 and 2004 Financial Statements*, GAO-06-146 (Washington, D.C.: March 2, 2006).
[23]GAO, *Financial Audit: Securities and Exchange Commission's Financial Statements for Fiscal Years 2006 and 2005,* GAO-07-134 (Washington, D.C.: Nov. 15, 2006).
[24]Pub. L. No. 107-107, §1008, 115 Stat. 1012, 1204 (Dec. 28, 2001).

(1) property, plant, and equipment; (2) inventory and operating material and supplies; (3) environmental liabilities; (4) intragovernmental eliminations; and (5) disbursement activity. DOD also acknowledges that it makes material amounts of unsupported accounting entries.

We performed sufficient audit work to provide this report on the consolidated financial statements, internal control, and the results of our assessment of compliance with selected provisions of significant laws and regulations. We considered the limitations on the scope of our work in forming our conclusions. Our work was performed in accordance with U.S. generally accepted government auditing standards.

APPENDIX II

Material Weaknesses Contributing to Our Disclaimer of Opinion

The continuing material weaknesses discussed below contributed to our disclaimer of opinion on the federal government's consolidated financial statements. The federal government did not maintain adequate systems or have sufficient, reliable evidence to support information reported in the accompanying consolidated financial statements, as described below.

Property, Plant, and Equipment and Inventories and Related Property

The federal government could not satisfactorily determine that property, plant, and equipment (PP&E) and inventories and related property were properly reported in the consolidated financial statements. Most of the PP&E and inventories and related property are the responsibility of the Department of Defense (DOD). As in past years, DOD did not maintain adequate systems or have sufficient records to provide reliable information on these assets. Other agencies, most notably the National Aeronautics and Space Administration, reported continued weaknesses in internal control procedures and processes related to PP&E.

Without reliable asset information, the federal government does not fully know the assets it owns and their location and condition and cannot effectively (1) safeguard assets from physical deterioration, theft, or loss; (2) account for acquisitions and disposals of such assets; (3) ensure that the assets are available for use when needed; (4) prevent unnecessary storage and maintenance costs or purchase of assets already on hand; and (5) determine the full costs of programs that use these assets.

Liabilities and Commitments and Contingencies

The federal government could not reasonably estimate or adequately support amounts reported for certain liabilities. For example, DOD was not able to estimate with assurance key components of its environmental and disposal liabilities. In addition, DOD could not support a significant amount of its estimated military postretirement health benefits liabilities included in federal employee and veteran benefits payable. These unsupported amounts related to the cost of direct health care provided by DOD-managed military treatment facilities. Further, the federal government could not determine whether commitments and contingencies, including those related to treaties and other international agreements entered into to further the U.S. government's interests, were complete and properly reported.

Problems in accounting for liabilities affect the determination of the full cost of the federal government's current operations and the extent of its liabilities. Also, improperly stated environmental and disposal liabilities and weak internal control supporting the process for their estimation affect the federal government's ability to determine priorities for cleanup and disposal activities and to appropriately consider future budgetary resources needed to carry out these activities. In addition, when disclosures of commitments and contingencies are incomplete or incorrect, reliable information is not available about the extent of the federal government's obligations.

Cost of Government Operations and Disbursement Activity

The previously discussed material weaknesses in reporting assets and liabilities, material weaknesses in financial statement preparation, as discussed below, and the lack of adequate disbursement reconciliations at certain federal agencies affect reported net costs. As a result, the federal government was unable to support significant portions of the total net cost of operations, most notably related to DOD.

With respect to disbursements, DOD and certain other federal agencies reported continued weaknesses in reconciling disbursement activity. For fiscal years 2006 and 2005, there was unreconciled disbursement activity, including unreconciled differences between federal agencies' and the Department of the Treasury's records of disbursements and unsupported federal agency adjustments, totaling billions of dollars, which could also affect the balance sheet.

Unreliable cost information affects the federal government's ability to control and reduce costs, assess performance, evaluate programs, and set fees to recover costs where required. Improperly recorded disbursements could result in misstatements in the financial statements and in certain data provided by federal agencies for inclusion in *The Budget of the United States* (hereafter referred to as "the President's budget") concerning obligations and outlays.

Accounting for and Reconciliation of Intragovernmental Activity and Balances

Federal agencies are unable to adequately account for and reconcile intragovernmental activity and balances. The Office of Management and Budget (OMB) and Treasury require the chief financial officers (CFO) of 35 executive departments and agencies to reconcile, on a quarterly basis, selected intragovernmental activity and balances with their trading partners. In addition, these agencies are required to report to Treasury, the agency's inspector general, and GAO on the extent and results of intragovernmental activity and balances reconciliation efforts as of the end of the fiscal year.

A substantial number of the agencies did not adequately perform the required reconciliations for fiscal years 2006 and 2005. For these fiscal years, based on trading partner information provided in the Governmentwide Financial Report System (GFRS), Treasury produced a "Material Difference Report" for each agency showing amounts for certain intragovernmental activity and balances that significantly differed from those of its corresponding trading partners as of the end of the fiscal year. After analysis of the "Material Difference Reports" for fiscal year 2006, we noted that a significant number of CFOs were unable to adequately explain the differences with their trading partners or did not provide adequate documentation to support responses on the CFO Representations. For both fiscal years 2006 and 2005, amounts reported by federal agency trading partners for certain intragovernmental accounts were significantly out of balance. In addition, for fiscal year 2006, about 31 percent of the significant agencies identified by Treasury and OMB did not perform the required audit procedures on their intragovernmental trading partner data included in the footnotes to their closing packages.[25] As a result of the above, the federal government's ability to determine the impact of these differences on the amounts reported in the consolidated financial statements is significantly impaired.

OMB recently issued Memorandum No. M-07-03, *Business Rules for Intragovernmental Transactions* (November 13, 2006), which has also been incorporated in the Treasury Financial Manual.[26] The OMB memorandum added criteria for resolving intragovernmental disputes and major differences between trading partners for certain intragovernmental transactions by creating the Chief Financial Officers Council's Intragovernmental Dispute Resolution Committee.[27] Resolving the intragovernmental transactions problem remains a difficult challenge and will require a strong commitment by federal agencies to fully implement the recently issued business rules and continued strong leadership by OMB.

Preparation of Consolidated Financial Statements

While further progress was demonstrated in fiscal year 2006, the federal government continued to have inadequate systems, controls, and procedures to ensure that the consolidated financial statements are consistent with the underlying audited agency financial statements, balanced, and in conformity with U.S. generally accepted accounting principles (GAAP). In addition, as discussed in our scope limitation section of this report, Treasury could not provide the final fiscal year 2006 consolidated financial statements and supporting documentation in time for us to complete all of our planned auditing procedures. During our fiscal year 2006 audit, we found the following:[28]

- Treasury showed progress by demonstrating that amounts in the Statement of Social Insurance were consistent with the underlying federal agencies' audited financial statements and that the Balance Sheet and the Statement of Net Cost were consistent with federal agencies' financial statements prior to eliminating intragovernmental activity and balances. However, Treasury's process for compiling the consolidated financial statements did not ensure that the information in the remaining three

[25]GFRS uses a closing package methodology that has been developed to capture each federal agency's information and link the agencies' audited financial statements to the governmentwide consolidated financial statements.
[26]Treasury Financial Manual, Bulletin No. 2007-03, *Intragovernmental Business Rules*.
[27]The U.S. Chief Financial Officers Council is an organization of the CFOs and Deputy CFOs of the largest federal agencies and senior officials of the Office of Management and Budget and the Department of the Treasury who work collaboratively to improve financial management in the U.S. Government.
[28]Most of the issues we identified in fiscal year 2006 existed in fiscal year 2005, and many have existed for a number of years. In April 2006, we reported in greater detail on the issues we identified in GAO, *Financial Audit: Significant Internal Control Weaknesses Remain in Preparing the Consolidated Financial Statements of the U.S. Government*, GAO-06-415 (Washington, D.C.: April 21, 2006). This report includes numerous recommendations to Treasury and OMB.

principal financial statements and notes were fully consistent with the underlying information in federal agencies' audited financial statements and other financial data.

- To make the fiscal years 2006 and 2005 consolidated financial statements balance, Treasury recorded net decreases of $11 billion and $4.1 billion, respectively, to net operating cost on the Statement of Operations and Changes in Net Position, which it labeled "Other - Unmatched transactions and balances."[29] An additional net $10.4 billion and $3.2 billion of unmatched transactions were recorded in the Statement of Net Cost for fiscal years 2006 and 2005, respectively. Treasury is unable to fully identify and quantify all components of these unreconciled activities.

- The federal government did not have an adequate process to fully identify and report items needed to reconcile the operating results, which for fiscal year 2006 showed a net operating cost of $449.5 billion, to the budget results, which for the same period showed a unified budget deficit of $247.7 billion.

- Treasury's elimination of certain intragovernmental activity and balances continues to be impaired by the federal agencies' problems in handling their intragovernmental transactions. As previously discussed, amounts reported for federal agency trading partners for certain intragovernmental accounts were significantly out of balance. This resulted in the need for unsupported intragovernmental elimination entries by Treasury in order to force the Statements of Operations and Changes in Net Position into balance. In addition, differences in other intragovernmental accounts, primarily related to transactions with the General Fund, have not been reconciled, still remain unresolved, and total hundreds of billions of dollars. Therefore, the federal government continues to be unable to determine the impact of unreconciled intragovernmental activity and balances on the consolidated financial statements.

- We have consistently reported that certain financial information required by GAAP was not disclosed in the consolidated financial statements. In 2006, the Federal Accounting Standards Advisory Board issued a new standard that eliminated or lessened the disclosure requirements for the consolidated financial statements related to certain information that Treasury had not been reporting.[30] There continued, though, to be other disclosures required by GAAP that are not disclosed in the consolidated financial statements. Treasury has plans to address certain of the omitted disclosures in future years' consolidated financial statements. Because of certain of the material weaknesses noted in this report, we were unable to determine if the omitted information was material to the consolidated financial statements.

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[29]Although Treasury was unable to determine how much of the unmatched transactions and balances, if any, relate to operations, it reported this amount as a component of net operating cost in the accompanying consolidated financial statements.

[30]SFFAS No. 32, *Consolidated Financial Report of the United States Government Requirements: Implementing Statement of Federal Financial Accounting Concepts 4 "Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government"* (Washington, D.C.: Sept. 28, 2006).

- Treasury continued to make progress in addressing certain other internal control weaknesses in Treasury's process for preparing the consolidated financial statements. However, internal control weaknesses continued to exist involving a lack of (1) appropriate documentation of certain policies and procedures for preparing the consolidated financial statements, (2) adequate supporting documentation for certain adjustments made to the consolidated financial statements, and (3) effective management reviews.

- The consolidated financial statements include financial information for the executive, legislative, and judicial branches, to the extent that federal agencies within those branches have provided Treasury such information. However, as we have reported in past years, there continue to be undetermined amounts of assets, liabilities, costs, and revenues that are not included, and the federal government did not provide evidence or disclose in the consolidated financial statements that the excluded financial information was immaterial.

- As in previous years, Treasury did not have adequate systems and personnel to address the magnitude of the fiscal year 2006 financial reporting challenges it faced, such as (1) GFRS undergoing further development[31] and not yet being fully operational, and (2) weaknesses in Treasury's process for preparing the consolidated financial statements noted above. We found that personnel at Treasury's Financial Management Service had excessive workloads that required an extraordinary amount of effort and dedication to compile the consolidated financial statements; however, there were not enough personnel with specialized financial reporting experience to help ensure reliable financial reporting by the reporting date.

- During fiscal year 2006, Treasury, in coordination with OMB, developed and began implementing corrective action plans and milestones for short-term and long range solutions for certain internal control weaknesses we have previously reported regarding the process for preparing the consolidated financial statements. Resolving some of these internal control weaknesses will be a difficult challenge and will require a strong commitment from Treasury and OMB as they execute and implement their corrective action plans.

<u>Outlays and Receipts—Components of the Budget Deficit</u>

Both the Reconciliation of Net Operating Cost and Unified Budget Deficit and Statement of Changes in Cash Balance from Unified Budget and Other Activities report the budget deficit for fiscal years 2006 and 2005 of $247.7 billion and $318.6 billion, respectively.[32]

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[31]See GAO, *Financial Management Systems: Lack of Disciplined Processes Puts Effective Implementation of Treasury's Governmentwide Financial Report System at Risk*, GAO-06-413 (Washington, D.C.: April 21, 2006).
[32]The budget deficit, receipts, and outlays amounts are reported in Treasury's Monthly Treasury Statement and the President's Budget.

The budget deficit is calculated by subtracting actual budget outlays (outlays) from actual budget receipts (receipts).

For several years, we have been reporting material unreconciled differences between the total net outlays reported in selected federal agencies' Statement of Budgetary Resources (SBR) and Treasury's central accounting records used to compute the budget deficit[33] reported in the consolidated financial statements. OMB and Treasury have been working with federal agencies to reduce these material unreconciled differences. Such efforts have resulted in significantly reducing the net outlay differences in fiscal year 2006. However, billions of dollars of differences still exist in this and other components of the deficit because the federal government does not have effective processes and procedures for identifying, resolving, and explaining material differences in the components of the deficit between Treasury's central accounting records and information reported in agency financial statements and underlying agency financial information and records. Until these differences are timely reconciled by the federal government, their effect on the U.S. government's consolidated financial statements will be unknown.

In fiscal year 2006, we again noted that several agencies' auditors reported internal control weaknesses (1) affecting the agencies' SBRs, and (2) relating to monitoring, accounting, and reporting of budgetary transactions. These weaknesses could affect the reporting and calculation of the net outlay amounts in the agencies' SBRs. In addition, such weaknesses also affect the agencies' ability to report reliable budgetary information to Treasury and OMB and may affect the unified budget outlays reported by Treasury in its *Combined Statement of Receipts, Outlays, and Balances*,[34] and certain amounts reported in the President's Budget.

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[33]See GAO's audit report on its audit of the federal government's fiscal year 2005 financial statements that was incorporated in the *2005 Financial Report of the U.S. Government* published by Treasury. Also, see GAO, *Financial Audit: Process for Preparing the Consolidated Financial Statements of the U.S. Government Needs Improvement*, GAO-04-45 (Washington, D.C.: Oct. 30, 2003).

[34]Treasury's *Combined Statement of Receipts, Outlays, and Balances* presents budget results and cash related assets and liabilities of the federal government with supporting details. Treasury represents this report as the recognized official publication of receipts and outlays of the federal government based on agency reporting.

APPENDIX III

Other Material Weaknesses

The federal government did not maintain effective internal control over financial reporting (including safeguarding assets) and compliance with significant laws and regulations as of September 30, 2006. In addition to the material weaknesses discussed in Appendix II that contributed to our disclaimer of opinion, we found the following four other material weaknesses in internal control.

Loans Receivable and Loan Guarantee Liabilities

Federal agencies accounting for the majority of the reported balances for direct loans and loan guarantee liabilities continue to have internal control weaknesses related to their credit reform estimation and related financial reporting processes. While progress in addressing these long-standing weaknesses was reported by federal credit agencies, these issues and the complexities associated with estimating the costs of lending activities significantly increase the risk that material misstatements in agency and governmentwide financial statements could occur and go undetected. Further, these weaknesses continue to adversely affect the federal government's ability to support annual budget requests for these programs, make future budgetary decisions, manage program costs, and measure the performance of lending activities.

Improper Payments

Under the leadership of OMB, agencies have continued to make progress in addressing improper payments. Improvements, though, are still needed to fully address the requirements of the Improper Payments Information Act of 2002 (IPIA).[35] Major challenges remain in meeting the goals of the act and ultimately better ensuring the integrity of payments.[36] The IPIA requires federal agencies to review all programs and activities, identify those that may be susceptible to significant improper payments, [37] estimate and report the annual amount of improper payments for those programs, and implement actions to cost-effectively reduce improper payments. In addition, OMB has established a program-specific initiative under the President's Management Agenda for 15 federal agencies to hold federal agency managers accountable for meeting the goals of IPIA and to ensure that the necessary attention and resources are dedicated to meeting the IPIA requirements.

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[35] Pub. L. No. 107-300, 116 Stat. 2350 (Nov. 26, 2002).

[36] See GAO, *Improper Payments: Incomplete Reporting under the Improper Payments Information Act Masks the Extent of the Problem*, GAO-07-254T (Washington, D.C.: Dec. 5, 2006).

[37] IPIA defines improper payments as any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements. It includes any payment to an ineligible recipient, any payment for an ineligible service, any duplicate payment, payments for services not received, and any payment that does not account for credit for applicable discounts. OMB's guidance defines significant improper payments as those in any particular program that exceed both 2.5 percent of program payments and $10 million annually.

For fiscal year 2006, federal agencies' estimates of improper payments, based on available information, totaled about $42 billion, a net increase of about $4 billion, or an 11 percent increase from the prior year improper payment estimate of $38 billion.[38] This increase was primarily attributable to 10 newly reported programs with improper payment estimates totaling about $2.3 billion and certain federal agencies reporting an increase in estimates for programs that had previously reported.

We found that some agencies have not annually reviewed all programs and activities, have not estimated improper payments for all risk-susceptible programs, or have not estimated improper payments for all components of risk-susceptible programs. For example, we noted that in fiscal year 2006, improper payment estimates were not made for 9 risk-susceptible federal programs, including Medicaid with total program outlays of about $183 billion for fiscal year 2006. Further, we noted some agencies reported noncompliance issues and major management challenges related to IPIA implementation, including the methodologies used to estimate improper payments, adequacy of agency documentation, management oversight, and contract management.

Information Security

Although progress has been made, serious and widespread information security control weaknesses continue to place federal assets at risk of inadvertent or deliberate misuse, financial information at risk of unauthorized modification or destruction, sensitive information at risk of inappropriate disclosure, and critical operations at risk of disruption. GAO has reported information security as a high-risk area across government since February 1997. Such information security control weaknesses could result in compromising the reliability and availability of data that are recorded in or transmitted by federal financial management systems. A primary reason for these weaknesses is that federal agencies have not yet fully institutionalized comprehensive security management programs, which are critical to identifying information security control weaknesses, resolving information security problems, and managing information security risks on an ongoing basis. The Congress has shown continuing interest in addressing these risks, as evidenced by hearings on the implementation of the Federal Information Security Management Act of 2002[39] and information security. In addition, the administration has taken important actions to improve information security, such as requiring agencies in OMB Memorandum M-06-16[40] to perform specific actions to protect certain personally identifiable information and issuing extensive guidance on information security.

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[38]In their fiscal year 2006 Performance and Accountability Reports (PARs), selected federal agencies updated their fiscal year 2005 improper payment estimates to reflect changes since issuance of their fiscal year 2005 PARs. These updates increased the governmentwide improper payment estimate for fiscal year 2005 from $38 billion to $39 billion.
[39]Title III of the E-Government Act of 2002, Pub. L. No. 107-347, 116 Stat. 2899, 2946 (Dec. 17, 2002).
[40]OMB Memorandum No. M-06-16, *Protection of Sensitive Agency Information* (June 23, 2006).

Tax Collection Activities

Material internal control weaknesses and systems deficiencies continue to affect the federal government's ability to effectively manage its tax collection activities,[41] an issue that has been reported in our financial statement audit reports for the past 9 years. Due to errors and delays in recording taxpayer information, payments, and other activities, taxpayers were not always credited for payments made on their taxes owed, which could result in undue taxpayer burden. In addition, the federal government did not always follow up on potential unreported or underreported taxes and did not always pursue collection efforts against taxpayers owing taxes to the federal government.

Weaknesses in controls over tax collection activities continue to affect the federal government's ability to efficiently and effectively account for and collect revenue. Additionally, weaknesses in financial reporting of revenues affect the federal government's ability to make informed decisions about collection efforts. As a result, the federal government is vulnerable to loss of tax revenue and exposed to potentially billions of dollars in losses due to inappropriate refund disbursements.

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[41]GAO, *Financial Audit: IRS's Fiscal Years 2006 and 2005 Financial Statements*, GAO-07-136 (Washington, D.C.: Nov. 9, 2006).