2004

Financial Report of the United States Government

Contents

List of Social Insurance Charts

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A MESSAGE FROM THE SECRETARY OF THE TREASURY

I am pleased to present the fiscal year 2004 Financial Report of the United States Government, reflecting the Treasury Department's long-standing responsibility and commitment to report on the Nation's finances. Our objective in preparing these consolidated financial statements is to provide the Congress and the public with a reliable, timely and useful report on the cost of the Government's operations, the sources used to fund them, and the implications of the Government's financial commitments.

In fiscal year 2004, government revenues were $1.9 trillion, an increase of more than $100 billion over fiscal year 2003 and the first increase in revenues in four years. The net cost of the government's operations was $2.5 trillion, including all accrued costs. Total revenues less operating costs resulted in a net operating cost of slightly more than $615 billion, down from $668 billion last year. The budget deficit for 2004 was $412 billion. The primary component of the difference between the budget deficit and the net operating cost was actuarial expenses associated with post-retirement health care and pensions, and veterans' compensation.

Since Treasury issued the first audited government-wide report for fiscal year 1997, we have made great strides in accelerating the timeliness of government financial reporting and improving its reliability. By accelerating the issuance of this year's report to December 15, just 75 days after the end of the fiscal year, we have made much progress towards matching the timeliness of private sector financial reporting. This acceleration is notable this year because 22 of the 24 major departments and agencies completed their audited financial statements by November 15, within 45 days of the end of the fiscal year. In addition, Treasury has just implemented a new reporting system, which compiles information from agency financial statements and is designed to ensure consistency in reporting and compliance with generally accepted accounting principles.

These are important milestones in Federal financial reporting, and I am pleased with the progress we have made this year. At the same time, I recognize that we will not benefit from the Report's full value in informing the public and supporting critical decision making until our reporting credibility is unquestioned. As we look toward our nation's financial future, Treasury is dedicated to achieving this credibility.

John W. Snow

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MANAGEMENT'S DISCUSSION AND ANALYSIS

Introduction

The accompanying *2004 Financial Report of the United States Government (Financial Report)* is prepared to give the President, Congress, and the American people information about the financial results and position of the Federal Government. It provides, on an accrual basis of accounting as prescribed by U. S. generally accepted accounting principles (GAAP), a broad, comprehensive view of the Federal Government's finances. This report states the Government's financial position and condition, its revenues and costs, assets and liabilities, and other obligations and commitments. Finally, it discusses important financial issues and significant conditions that may affect future operations.

The *Financial Report* required by 31 U.S.C. § 331(e)(1) is to be submitted to Congress by March 31 and is subject to audit by the Government Accountability Office (GAO). It consists of Management's Discussion and Analysis (MD&A, not subject to audit), 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, Stewardship Information (not subject to audit), Notes to the Financial Statements, and Supplemental Information (not subject to audit). Each section is preceded by a description of its contents.

Executive Summary

Accelerated Reporting Results

A record 22 of the 24 major Federal agencies issued their financial reports within 45 days after the end of fiscal year 2004. This marks a significant milestone in federal financial reporting since just a few years ago Federal agencies took 5 months or more to produce this information. The Office of Management and Budget (OMB) set a deadline for agencies to complete Performance and Accountability Reports, including audited financial statements, by 45 days from the end of the fiscal year. The new deadline emphasizes the need for timely and accurate financial information for decision-making.

The accelerated reporting of agency financial statements provided the foundation for the earlier issuance of this report. For the first time since the report was issued in 1998, the *Financial Report's* issuance was accelerated to December 15th. This year's improvement in timeliness was concurrent with the efforts across Government to implement new financial management disciplines, processes, and systems to produce more timely and accurate information. This year's more timely reporting is the end result of multiple years of planning and executing across Government. Federal agencies will continue to build upon this year's accomplishments to meet the overall objective of using timely and accurate financial information to make program management decisions.

Financial Results

Each year the Administration issues two reports that detail financial results; one on the budget basis and this one on the accrual basis. The two reports complement each other. The budget report contains receipt and outlay information primarily on the cash basis and compares the results to the appropriations for the year. The *Financial Report* uses those transactions as its base and also contains non-cash based revenues and expenses. For example, these revenues produce accounts receivable balances and the expenses produce liabilities for items such as pensions, accounts payable, and environmental clean up costs. Net operating cost was $615.6 billion in fiscal year 2004, a decrease of $52 billion from $667.6 billion in fiscal year 2003. This decrease resulted from an increase in revenues of $116.7 billion which was somewhat offset by an increase in net operating cost of $64.7 billion. The increase in net cost was caused by an increase in budgetary outlays reduced by a reduction of $108.5 billion in actuarial costs.

Liabilities and Additional Responsibilities

The 2004 balance sheet shows assets of $1,397 billion and liabilities of $9,107 billion, for a negative net position of $7,710 billion. In addition, the Government's responsibilities to make future payments for social insurance and certain other programs are not shown as liabilities according to Federal accounting standards; however, they are measured in other contexts. These programmatic commitments remain Federal responsibilities and as currently structured will have a significant claim on budgetary resources in the future.

In a table on page 11 of this section, the net present value for all of the responsibilities (for current participants over a 75-year period) is $45,892 billion, including Medicare and Social Security payments, pensions and benefits for Federal employees and veterans, and other financial responsibilities. The reader needs to understand these responsibilities to get a more complete understanding of the Government's finances.

Included in the table this year is the impact of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (Medicare Prescription Drug Plan) that was enacted on December 8, 2003. Read more about the impact and growth of these programs in the MD&A's Additional Responsibilities section starting on page 10.

Economic and Budgetary Results

The economy strengthened in fiscal year 2004, with real gross domestic product (GDP) growing at a faster pace than in the prior fiscal year and employment posting a large increase after declining in each of the previous 3 fiscal years. Rising employment and income contributed to an increase in budget receipts in fiscal year 2004, the first gain in 4 years. Outlays, however, rose more than receipts and the Federal budget deficit widened in fiscal year 2004 to $412.3 billion, an increase of $37.5 billion from $374.8 billion in fiscal year 2003. This increase resulted from an increase in outlays of $135.2 billion that was offset by an increase in receipts of $97.7 billion. The increase in outlays was mainly due to increases of about $50 billion, $40 billion, and $22 billion at the Department of Defense (DOD), the Department of Health and Human Services (HHS), and the Social Security Administration (SSA), respectively.

Overall results in fiscal year 2004 were mixed. The final results show a reduction of the accrual-based net operating cost versus an increase in the budget deficit. This $89.5 billion closing of the gap between the two results is almost entirely due to a $108.5 billion reduction in the rate of increase in accrual-based cost for pension, health care, and disability liabilities for civilian and military personnel, and veterans.

Significant Reporting Items for Fiscal Year 2004

Medicare Prescription Drug Plan

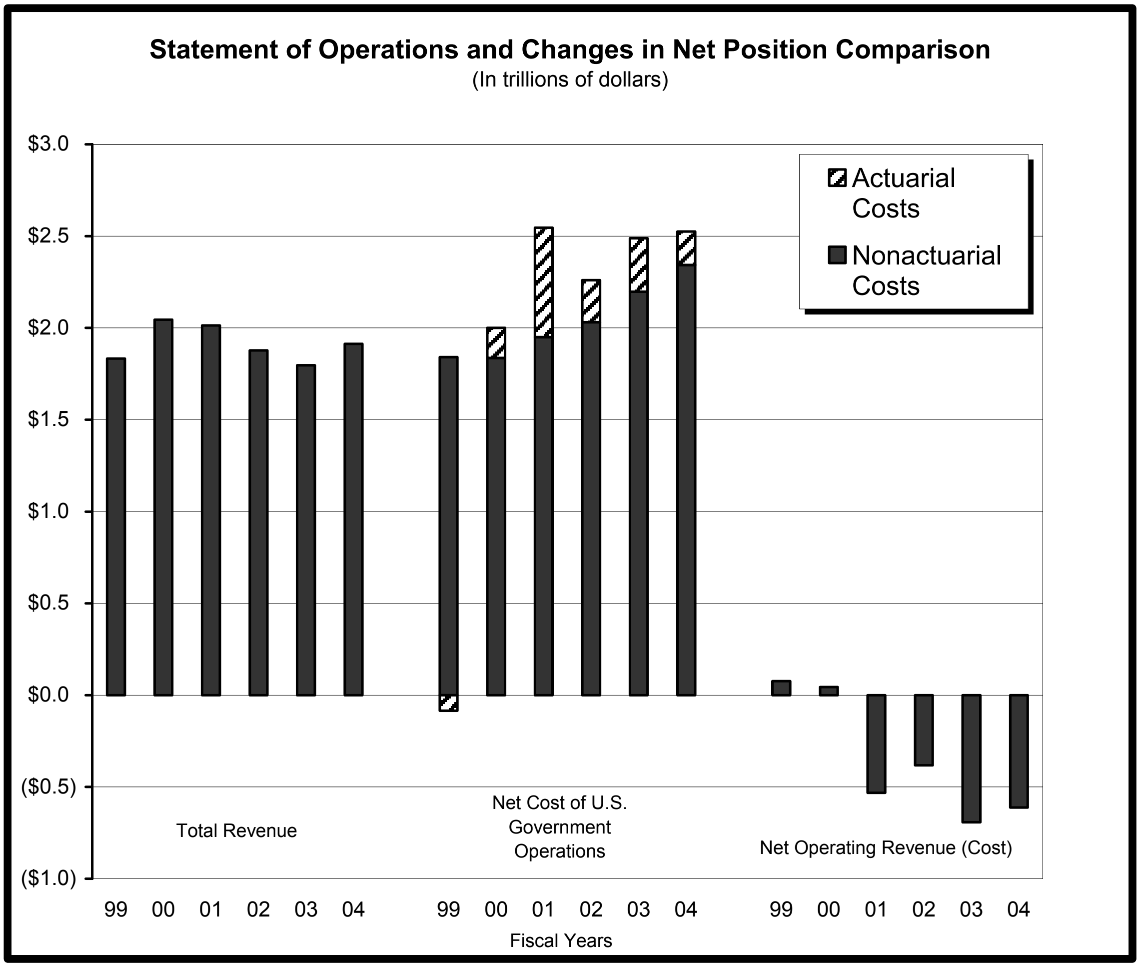
The Medicare Prescription Drug Plan provides discounts on prescription drugs for Medicare beneficiaries in 2004 and 2005 and, beginning in 2006, allows them to enroll in a stand-alone drug plan or private health plan. The 2004 Medicare Trustees' Report estimates that the 75-year period net present value of expenditures less premium income for the Prescription Drug Plan is $8,119 billion for all current and future participants (i.e., open group); the amount is $6,306 billion for all current participants (i.e., closed group). See page 8 to read more about the Medicare Prescription Drug Plan.

Debt Ceiling

At the end of fiscal year 2004, the outstanding debt subject to limit approached the $7,384 billion statutory limit. Subsequent to the end of the fiscal year, on October 14, 2004, Treasury began taking steps to avoid surpassing the debt ceiling. On November 19, 2004, legislation became effective raising the statutory debt limit by $800 billion to $8,184 billion (P.L. 108-415).

Financial Results

Revenue and Cost Summary



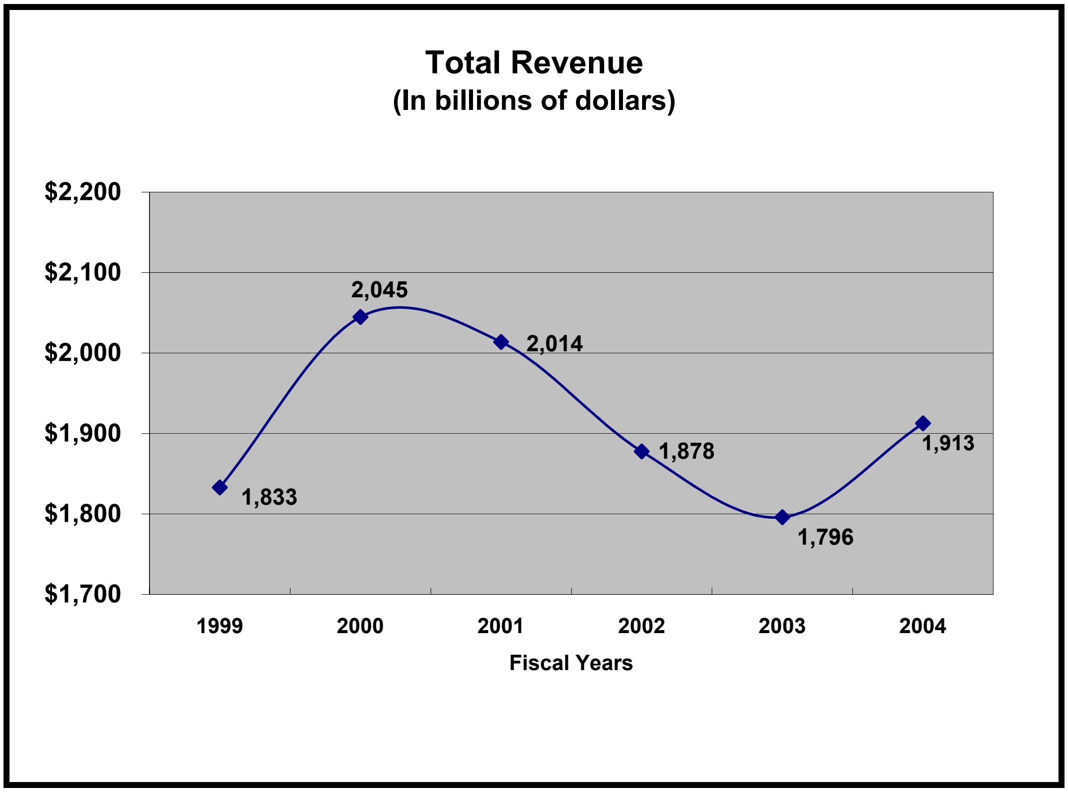
Accrual-Based Results

The financial statements (pages 60-64) present information about the financial position of the Federal Government, the net costs of its operations, and the financing sources used to fund its operations. The information in these statements gives a comprehensive view of the Government's finances. The information is reported generally on the accrual basis of accounting in which costs are recorded when a liability is incurred. This differs from the primarily cash basis used in calculating the budget results, in which outlays are recorded when bills are actually paid. See Note 1B (Basis of Accounting and Revenue Recognition) of this *Financial Report* for a discussion of how revenues are recorded.

The net operating cost as shown in these financial statements for fiscal year 2004 was $615.6 billion, compared to a budget deficit of $412.3 billion. This resulted in a $203.3 billion difference between the reported net operating cost and the budget deficit. The primary component of the difference between the budget deficit and accrual reported results is the recognition of the year's actuarial expense for pension and health liabilities for civilian and military employees and veteran's compensation of $182.1 billion. Also see a comparison of net operating cost as reported versus net operating cost excluding the change in these actuarial liabilities on page 8. These same programs were also responsible for the greater $292.8 billion difference in fiscal year 2003 which had a net operating cost of $667.6 billion and a budget deficit of $374.8 billion.

For fiscal year 2004, the $89.5 billion difference between the lower 2004 $203.3 billion and the higher 2003 $292.8 billion differences between net operating cost and the budget deficit was due to three major items: increased revenues, decreased actuarial costs, and higher outlays, primarily at DOD, HHS, and SSA. For a detailed reconciliation between the two numbers, see the Reconciliations of Net Operating Cost and Unified Budget Deficit in the Financial Statements section.

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

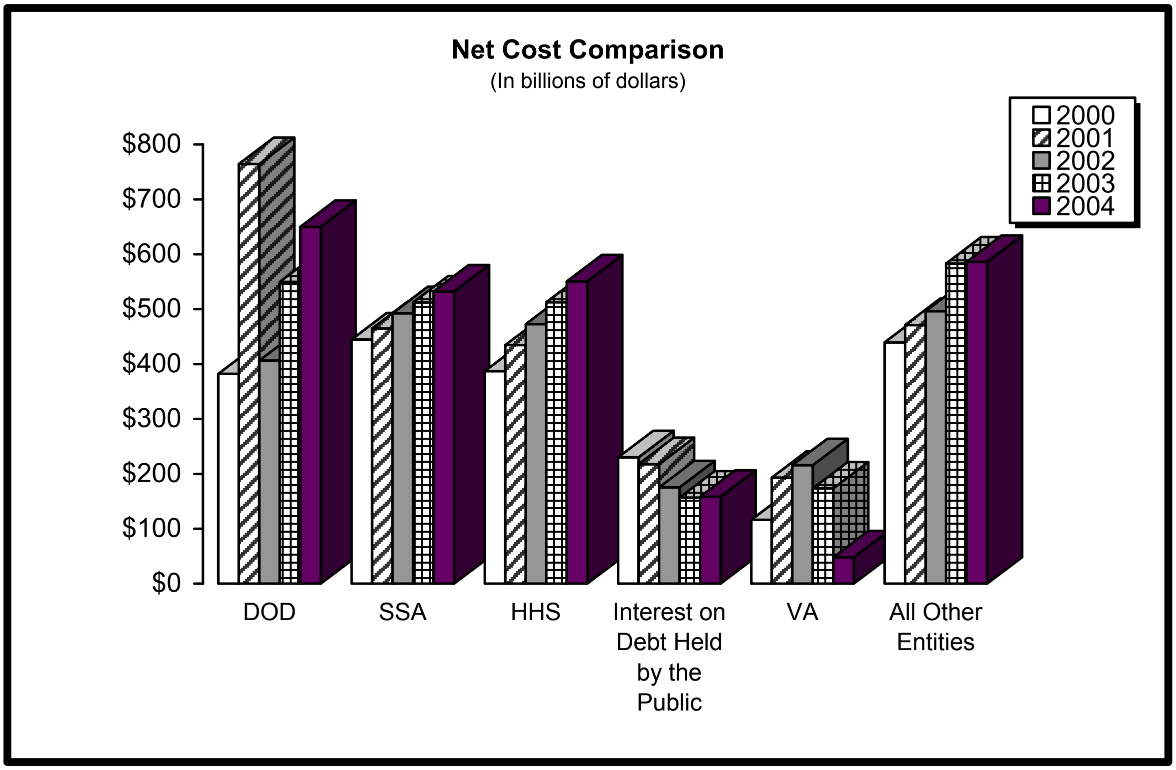


As shown in the chart above, fiscal year 2004's total revenue was $1,912.7 billion. This amount compares to $1,796 billion in 2003, an increase of $116.7 billion (or 6.5 percent). Revenue has increased in all tax categories mainly due to the addition of over 2 million new jobs to the economy (with a slight decline in the unemployment rate) and higher corporate profits.

The Government's main source of revenue comes from its ability to demand payments from the public (e.g., taxes, duties, fines, and penalties). The Government's principal source of revenue is individual income and withholding taxes. In 2004, this revenue category was $1,512.3 billion, representing 79.1 percent of total revenue, and a 2.1 percent increase from 2003. There was an increase of 43.4 percent in corporate income taxes in 2004; corporate income tax revenue was $183.8 billion, or 9.6 percent of total revenue. Corporate income taxes have not been this large since 1999.

In addition to revenue from its ability to tax, the Government's other source of revenue comes from providing goods and services to the public for a fee. This type of revenue is called "earned" revenue because it results from the exchange of transactions. Examples of earned revenue include the postage and mailing fees paid to the U.S. Postal Service and Medicare Part B premiums collected by HHS (these premiums only comprise part of Medicare Part B's funding). This revenue is used to pay for or *offset* the costs of administering these programs or services and is included in the calculation of net cost on the Statements of Net Cost. In fiscal year 2004, the Government earned

$207.1 billion from this type of revenue. This compares to $164.8 billion earned in fiscal year 2003 for an increase of $42.3 billion (or 25.7 percent). In 2003, the increase from 2002 was $8.2 billion (or 5.2 percent).



The chart above compares major elements of net cost by fiscal year. The largest change in net cost was at the Department of Veterans Affairs (VA), which decreased by $125.7 billion (or 72.4 percent). The calculation of an actuarial liability can cause an agency's total net cost to vary widely from year to year, and that was the case with VA in 2004. The calculation of the actuarial liability for future years' veterans' compensation decreased by $30 billion in 2004 and increased by $105.6 billion in 2003.

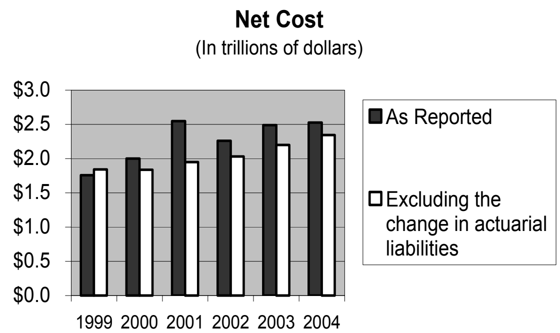
DOD had the highest agency net cost in 2004 and 2003—$649.8 billion, (18.2 percent) and $549.7 billion, respectively. The majority of this $100.1 billion increase was due to the $91.1 billion increase in the Military Retirement Fund's actuarial liability. The actuarial liability increased due to a new law (discussed further in the Liabilities section of the MD&A) which allows for increased benefits to disabled military retirees.

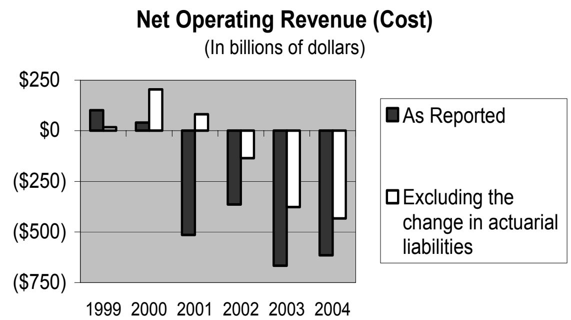
The Army General Fund increased by $24.1 billion as a result of the Presidential approval of the Emergency Wartime Supplemental Appropriations Act (P.L. 108-11). Congressional funding for the global war on terror was received through appropriated and supplemental funding in fiscal year 2004. The increase supports the incremental costs of Reserve forces on active duty in a war zone versus peacetime training. In addition, the military pay appropriations received a 3.7 percent pay increase for all soldiers and a pay raise of up to 6.25 percent for selected military pay grades. Moreover, the Navy General Fund increased by $15.7 billion due to an increase in depreciation costs from recording Military Equipment in fiscal year 2003 and continuing into fiscal year 2004. The Navy's depreciation costs also increased for buildings, structures, and utilities. These increases resulted from a change in the depreciation model that was used.

The social insurance costs at HHS and SSA continued their upward trend during 2004. From 2003 to 2004, the consolidated net costs of HHS and SSA increased by 7.4 and 3.9 percent, respectively. These increased net costs were due mainly to benefit payment increases of 9 and 3 percent at HHS and SSA, respectively. SSA also experienced a 1 percent increase in the number of its Old-Age, Survivors, and Disability Insurance program beneficiaries. To read more about the social insurance programs managed by these agencies, see the MD&A's Additional Responsibilities section and the *Financial Report's* Statements of Social Insurance in the Stewardship Information section.

The interest on debt held by the public increased slightly from $156.8 billion in fiscal year 2003 to $158.3 billion for fiscal year 2004. Along with the increase in debt principal, the interest on the debt increased slightly by

$1.5 billion (or 1 percent). Even though the principal on the debt increased due to the increased borrowing from the public, the interest on the debt held by the public rose only slightly because maturing, longer-dated, high-coupon debt was replaced by lower-coupon debt.





The charts above show that over the past 6 fiscal years, significant costs associated with certain employee benefit liabilities have had a major and variable impact on the Government's cost of operations. These incremental costs are the result of changes in interest rates and other actuarial assumptions. Also shown is that, all other costs are steadily trending upward and the net operating revenue (cost) has fluctuated from almost break-even in fiscal year 1999 to a net operating cost of $615.6 billion versus $433.5 billion in fiscal year 2004, excluding these adjustments. Actuarial liabilities include Federal employee and veteran benefits payable and are discussed in Note 11 of the Notes to the Financial Statements section.

Medicare Prescription Drug Plan

The Medicare Prescription Drug Plan, enacted on December 8, 2003, provides discounts on prescription drugs for Medicare beneficiaries in 2004 and 2005 and, beginning in 2006, allows them to enroll in a stand-alone drug plan or private health plan.

The Discount Card & Transitional Assistance Program was enacted as part of the Medicare Prescription Drug Plan. This program is voluntary and provides relief to people with Medicare to help reduce their costs for prescriptions before the new drug benefit is implemented on January 1, 2006. The two parts of this program are: (1) The Prescription Drug Discount Card Program that enables Medicare beneficiaries to obtain 10 to 25 percent discounts on prescription drugs, and (2) The Transitional Assistance Program where Medicare provides a $600 credit for the purchase of prescription drugs in 2004 and up to an additional $600 credit in 2005 to people with incomes that are not more than 135 percent of the poverty line if they do not have certain other drug coverage.

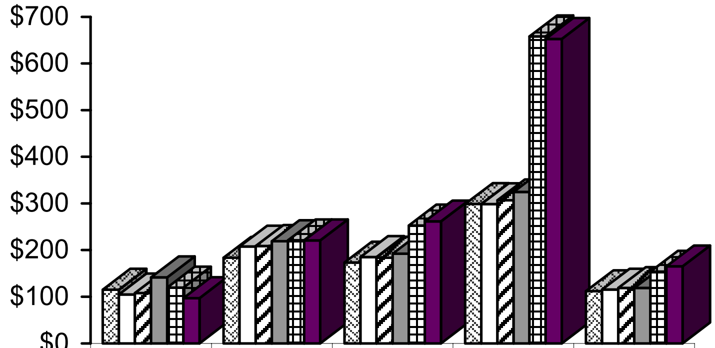
For fiscal year 2004, the Centers for Medicare & Medicaid Services (CMS) estimated that 7.3 million people were expected to enroll in the Prescription Drug Discount Card Program, and 4.7 million of these people were also expected to enroll in the Transitional Assistance Program. For fiscal year 2004, CMS estimated that the Discount Card & Transitional Assistance Program would cost the Government $2.3 billion, but the actual cost was $216 million. The 2004 Medicare Trustees' Report estimates that the 75-year period net present value of expenditures less premium income for the Prescription Drug Plan is $8,119 billion for all current and future participants (i.e., open group); for current participants (i.e., closed group), the estimated net present value is $6,306 billion.

Asset and Liability Summary

Assets

The accompanying chart depicts a 6-year comparison of the major categories of reported assets as of September 30, for fiscal years 1999 through 2004.

Assets - Key Items Comparison
(In billions of dollars)



	Cash & Other Monetary Assets	Loans Receivable, Net	Inventories & Related Property, Net	Property, Plant & Equip, Net	All Other Assets
1999	115.2	183.7	173.3	298.8	112.0
2000	104.9	207.6	185.2	298.5	115.3
2001	108.0	208.9	183.8	306.7	118.7
2002	141.6	219.2	192.2	324.7	118.8
2003	119.6	221.1	252.7	658.2	153.8
2004	97.0	220.9	261.5	652.7	165.2

Total assets decreased slightly from $1,405.4 billion to $1,397.3 billion (0.6 percent). A $22.6 billion decrease in cash was counterbalanced by a decrease in liabilities for debt held by the public. Prior to 2004, the Government maintained formal arrangements with numerous financial institutions for holding time deposits known as "compensating balances." With the passage of the Consolidated Appropriation Act of 2004, Treasury received a permanent and indefinite appropriation to compensate banks for services rendered. Therefore, compensating balances were closed, resulting in a decrease in cash.

The U.S. Government's largest asset (46.7 percent of total assets) remains net property, plant, and equipment. A change in Federal accounting standards, effective in fiscal year 2003, resulted in a net book value of $325.1 billion in military equipment at DOD being presented on the balance sheet for the first time.

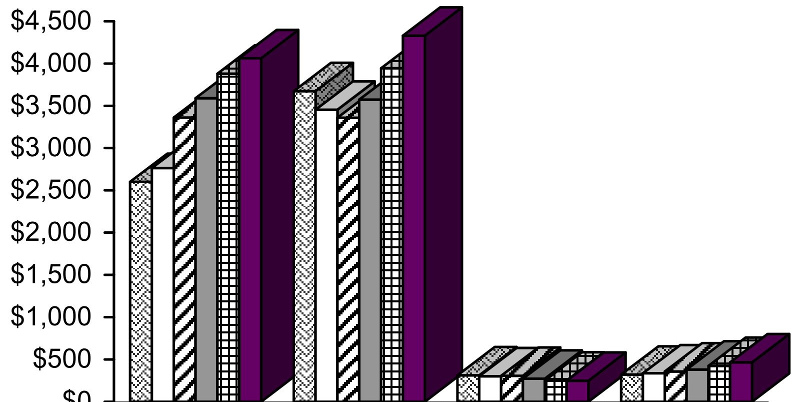
Inventories and related property, net, is the next largest asset at almost 18.7 percent of total assets and increased by $8.8 billion or 3.5 percent in 2004. DOD holds 81.5 percent of the Government's inventory. Both inventory and operating materials and supplies (a subcomponent of inventory, see Note 6) increased at DOD in 2004, primarily due to the global war on terror and the Air Force's change in the method it uses to value inventory, which included correcting prior years' valuation errors.

Liabilities

The following chart presents a 6-year comparison of the major components of liabilities reported on the balance sheets as of September 30, for fiscal years 1999 through 2004. At the end of fiscal year 2004, the U.S. Government's liabilities increased 7.1 percent from $8,499.6 billion to $9,107.1 billion.

Liabilities - Key Items Comparison

(In billions of dollars)



	Federal Employee & Veteran Benefits Payable	Fed Debt Securities Held by the Public & Accrued Interest	Environmental & Disposal Liabilities	All Other Liabilities
1999	2,600.7	3,674.2	313.2	321.1
2000	2,764.7	3,454.2	301.2	336.8
2001	3,360.8	3,359.3	306.8	358.0
2002	3,589.4	3,573.2	273.0	381.1
2003	3,880.0	3,944.9	249.9	424.8
2004	4,062.1	4,329.4	249.2	466.4

Federal debt securities held by the public and accrued interest was again the largest liability at $4,329.4 billon, 47.5 percent of total liabilities. This is a $384.5 billion, or 9.7 percent, increase over the balance at the end of fiscal year 2003. The increase in debt held by the public for the last 3 years primarily is due to total Federal spending exceeding total Federal revenues on a cash basis.

Federal employee and veteran benefits payable (44.6 percent of total liabilities) continued a 5-year trend of increases, although the 4.7 percent increase in 2004 was lower than in any of the previous 5 years. Federal employee and veteran benefits payable consists of pension, disability, and retiree health care costs for Federal civilian and military employees, as well as for veterans. In Note 11, this liability is broken down into components for pensions, retiree health care, and veterans.

There was a 13.4 percent increase in military pensions in 2004 due to the National Defense Authorization Act for fiscal year 2004. This new law allows certain disabled military retirees to concurrently receive disability payments from the VA and their DOD military retirement pay. Prior to this legislation, disability payments offset military retirement payments by an equal amount. However, civilian pensions did not rise as much as in previous years due to the effects of an actuarial gain at the Office of Personnel Management (OPM) in 2004.

Retiree health care is larger than veteran benefits for the first time since 2001. Both civilian and military retiree health care rose again this year (8.9 and 6.2 percent, respectively), but at a lesser percentage than last year (10.4 and 15.4 percent, respectively). There was a smaller actuarial loss at OPM in 2004 than in 2003, which lowered the expense portion that figures into the calculation of the liability. At DOD, there were actuarial gains in the largest part (for Medicare eligible retirees) of the health liability, which held down the rate of increase in the liability.

The liability for veteran benefits actually decreased in 2004 by 3.1 percent. The decrease was due to a refinement in the experience assumptions used at the VA to estimate the liability for compensation for male veteran beneficiaries.

Additional Responsibilities

Historically, the Government's financial situation has been evaluated primarily from a cash-based budgeting perspective that measures the flow of funds in and out of Government accounts. The accrual amounts in this report are an attempt to add currently incurred costs that are unpaid at yearend. In addition, there are several major programs that, when examined from an accrual perspective, also generate unpaid amounts. This perspective is meant to complement the cash-based budget estimates of future spending and receipts.

In addition to accrual-based results, the overall perspective depicted below includes many responsibilities disclosed throughout this report but not captured by accrual-based operating results or liability balances. An attempt is made here to go beyond the balance sheet to also examine the impact of these other responsibilities.

Overall Perspective

The schedule below reveals a more complete picture of the Government's financial responsibilities—its liabilities and responsibilities on the balance sheet as well as its responsibilities that are tracked off the balance sheet.

Overall Perspective
(in billions of dollars)

	2004 Balance Sheet	2004 Additional Responsibilities	2004 Combined Amounts	2003 Balance Sheet	2003 Additional Responsibilities	2003 Combined Amounts	$ Change
ASSETS							
Inventory, cash	$ 359	$ -	$ 359	$ 372	$ -	$ 372	$ (14)
Property, plant & equipment	653	-	653	658	-	658	(6)
Loans receivable	221	-	221	221	-	221	(0)
Other	165	-	165	154	-	154	11
Total Assets	$ 1,397	$ -	$ 1,397	$ 1,405	$ -	$ 1,405	$ (8)
LIABILITIES & NET RESPONSIBILITIES							
Social Insurance							
Medicare (Parts A, B, & D) [1]	-	(24,615)	(24,615)	-	(15,006)	(15,006)	(9,609)
Social Security (OASDI)	-	(12,552)	(12,552)	-	(11,742)	(11,742)	(810)
Other (Railroad Retirement)	-	(112)	(112)	-	(110)	(110)	(2)
Subtotal, Social Insurance	-	(37,279)	(37,279)	-	(26,858)	(26,858)	(10,421)
Fed. empl. & veterans pensions/benefits	(4,062)	-	(4,062)	(3,880)	-	(3,880)	(182)
Federal debt held by the public	(4,329)	-	(4,329)	(3,945)	-	(3,945)	(385)
Other liabilities	(716)	-	(716)	(675)	-	(675)	(41)
Other responsibilities	-	(903)	(903)	-	(862)	(862)	(41)
Total Liabilities & Net Responsibilities	$ (9,107)	$ (38,182)	$ (47,289)	$ (8,500)	$ (27,720)	$ (36,220)	$ (11,070)
BALANCE (Total Assets minusTotal Liabilities & Net Responsibilities)	($7,710)	($38,182)	($45,892)	($7,094)	($27,720)	($34,814)	($11,078)

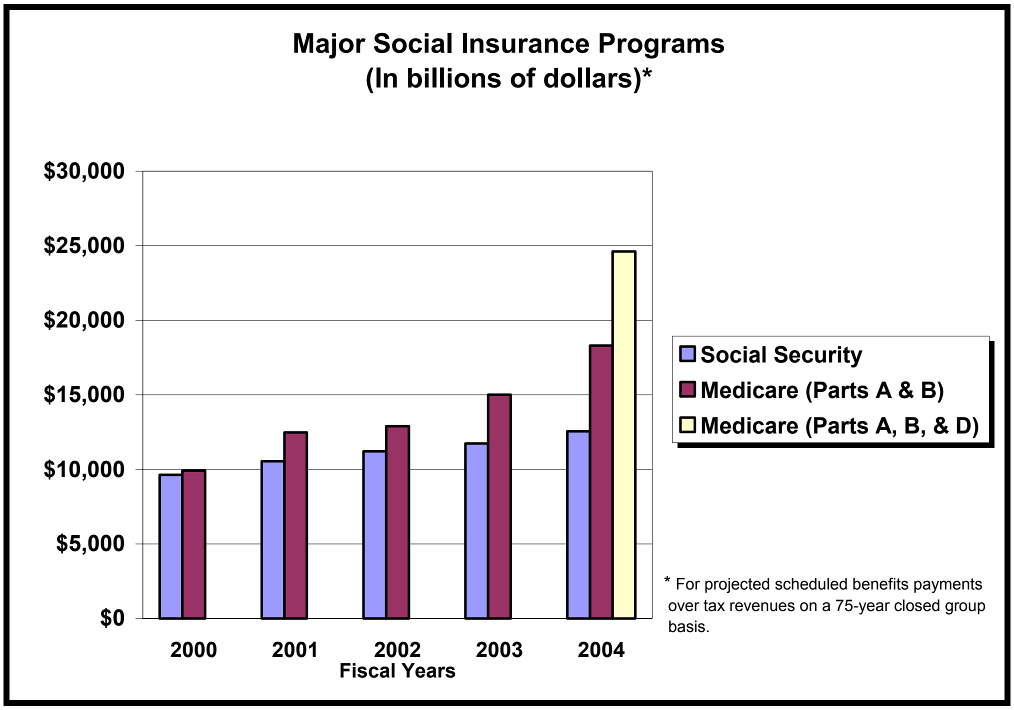
1 Part D's Medicare Prescription Drug & Transitional Assistance Accounts not included in 2003 because both established after fiscal year 2003.

Note: Details may not add to totals due to rounding.

Social Insurance Calculations

The social insurance projections in the table above are based on a 75-year period and include expenditures for scheduled future benefits over scheduled revenue for current participants, including those who have reached the eligibility age (closed group). Therefore, as depicted here, the present value for Medicare and Social Security (at January 1, 2004) is $24,615 billion and $12,552 billion, respectively. Including the $903 billion for Other responsibilities that consist of commitments and contingencies such as the Pension Benefit Guaranty Corporation insurance contingency and agency commitments for leases and undelivered orders, and $112 billion for Railroad Retirement, the final total of all the liabilities and additional responsibilities, net of assets, is $45,892 billion. Other responsibilities exist that cannot or have not yet been quantified, so this total may be incomplete.

The increase in the present value of Medicare represents a $9,609 billion increase over fiscal year 2003. For current participants (closed group), the Medicare Prescription Drug Plan (Part D) added $6,306 billion to the $9,609 billion increase over fiscal year 2003; this amount is $8,119 billion when computed for all current and future participants (open group). In the chart below, the comparative value of the estimate for Medicare versus Social Security is shown. In fiscal year 2000, Medicare and Social Security were about even. It is interesting to note that, by 2004, Medicare has grown to a level about twice the level of Social Security.

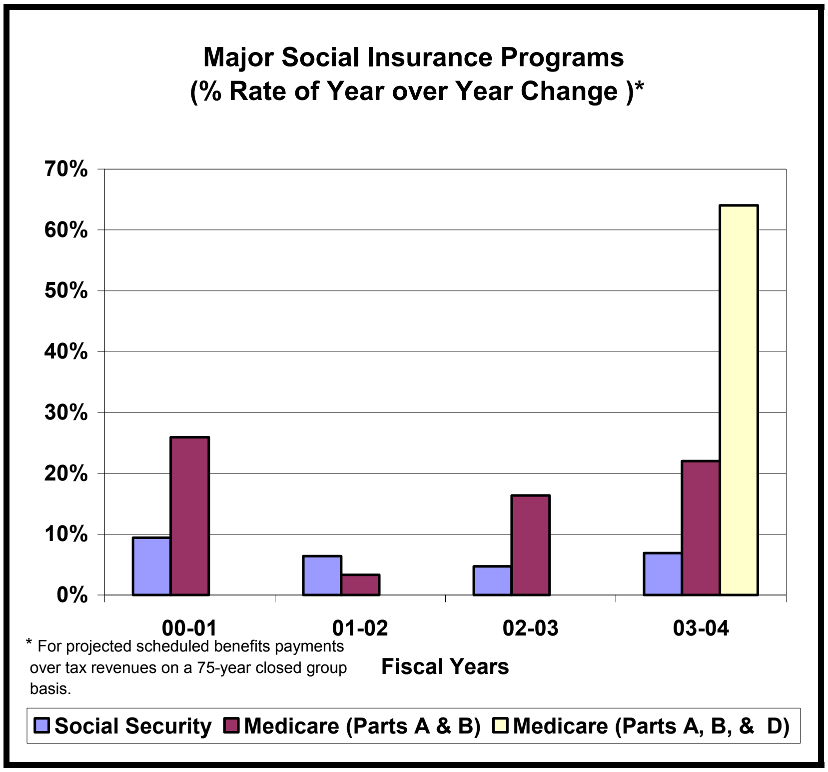


Comparison of the Growth in Social Security to the Growth in Medicare

Currently, Social Security and Medicare are the principal additional responsibilities and represent more than a third of all Federal spending. Social Security tax revenue, excluding interest, continues to exceed benefits and is expected to do so until 2018. However, Social Security revenue, including interest, is projected to exceed benefits until 2028. Thereafter, scheduled benefit payments are expected to exceed tax revenues and the gap between these revenues and benefits payments will continue to widen. The 2004 Social Security Trustees Report projects that the Social Security trust funds are projected to remain solvent until 2042. Current Social Security law does not provide for full benefit payments after the trust funds are exhausted. The 2004 Medicare Trustees Report projects that Medicare's Part A trust fund will remain solvent until 2019. Moreover, under present law, general fund transfers to Parts B and D's trust fund will occur indefinitely and continue growing with the growing cost of health care.

Impact of the Medicare Prescription Drug Plan

Medicare's growth has exceeded Social Security's and is projected to continue doing so. According to the chart below, the estimated Social Security cost has been growing at a steady pace of less than 10 percent in all of the last 4 years and less than 7 percent in the last 3 years. On the other hand, projected Medicare responsibilities have been growing at a much faster pace. Parts A and B have increased by over 15 percent in 3 of the last 4 years and by over 60 percent in 2004 with the addition of Part D.



Featured Balance Sheet Item

This new section has been added to the MD&A for the first time this year to feature one of the many balance sheet items the U.S. Government owns or is responsible for. This year's featured item is environmental and disposal liabilities.

Environmental and Disposal Liabilities

What are the balance sheet's environmental and disposal liabilities? What agencies are responsible for them? They are amounts of what it would probably cost to remove, contain, or dispose of (i.e., clean up) hazardous waste and environmental contamination caused by Federal operations. Hazardous waste can be a solid, liquid, or gas that can be potentially harmful to human health or the environment. Environmental contamination is caused by the production, storage, and use of radioactive materials and hazardous chemicals.

The Department of Energy (Energy) and DOD are chiefly responsible for environmental and disposal liabilities. For fiscal year 2004, total environmental and disposal liabilities were $249.2 billion. Energy and DOD reported 99 percent of this amount or $181.7 billion and $64.3 billion, respectively. The Government's total amount of environmental and disposal liabilities for fiscal year 2004 declined slightly by $.7 billion from fiscal year 2003's $249.9 billion.

Energy has estimated environmental and disposal liabilities on its balance sheet because it is responsible for managing the legacy of contamination from the nuclear weapons complex. The nuclear weapons complex included nuclear reactors, chemical processing buildings, metal machining plants, laboratories, and maintenance facilities. It was developed by the United States during World War II and the Cold War to research, produce, and test nuclear weapons. At all the sites where these activities took place, some environmental contamination occurred.

DOD's environmental and disposal liabilities are based on its responsibility to clean up contamination resulting from past waste disposal practices, leaks, spills, and other past activity, that has created a public health or environmental risk. Some of these responsibilities include the costs of restoring active, realigned, and closed installations, as well as other areas formerly used as defense sites. These costs also include DOD's safe and economical disposal of the U.S. stockpile of lethal and incapacitating chemical warfare agents and munitions.

Finally, DOD's environmental and disposal liabilities are also based on its responsibility to clean up nuclear powered aircraft carriers, submarines, and other nuclear ships. Read Note 12 to find out more about the U.S. Government's environmental and disposal liabilities.

Federal Debt and Federal Budget

Currently, the largest liability for the Federal Government is the Federal debt held by the public and accrued interest, which was $4,329.4 billion at the end of 2004. This was an increase of $384.5 billion over the 2003 debt of $3,944.9 billion. There are two kinds of Federal debt: debt held by the public and the debt the Government owes to itself.

Debt Held by the Public

The first kind of Federal debt is debt held by (or owed to) the public. It includes all Treasury securities (bills, notes, bonds, and other securities) held by individuals, corporations, Federal Reserve banks, foreign governments, and other entities outside the U.S. Government. This debt is included as a liability on the balance sheet.

Debt the Government Owes to Itself

The second kind is debt the Government owes to itself (intra-governmental debt), primarily in the form of special nonmarketable securities held by various parts of the Government. The laws establishing Government trust funds generally require the excess receipts of the trust funds to be invested in these special securities. This debt is not included on the balance sheet since these payments are claims of one part of the Government against another and are eliminated for consolidation purposes.

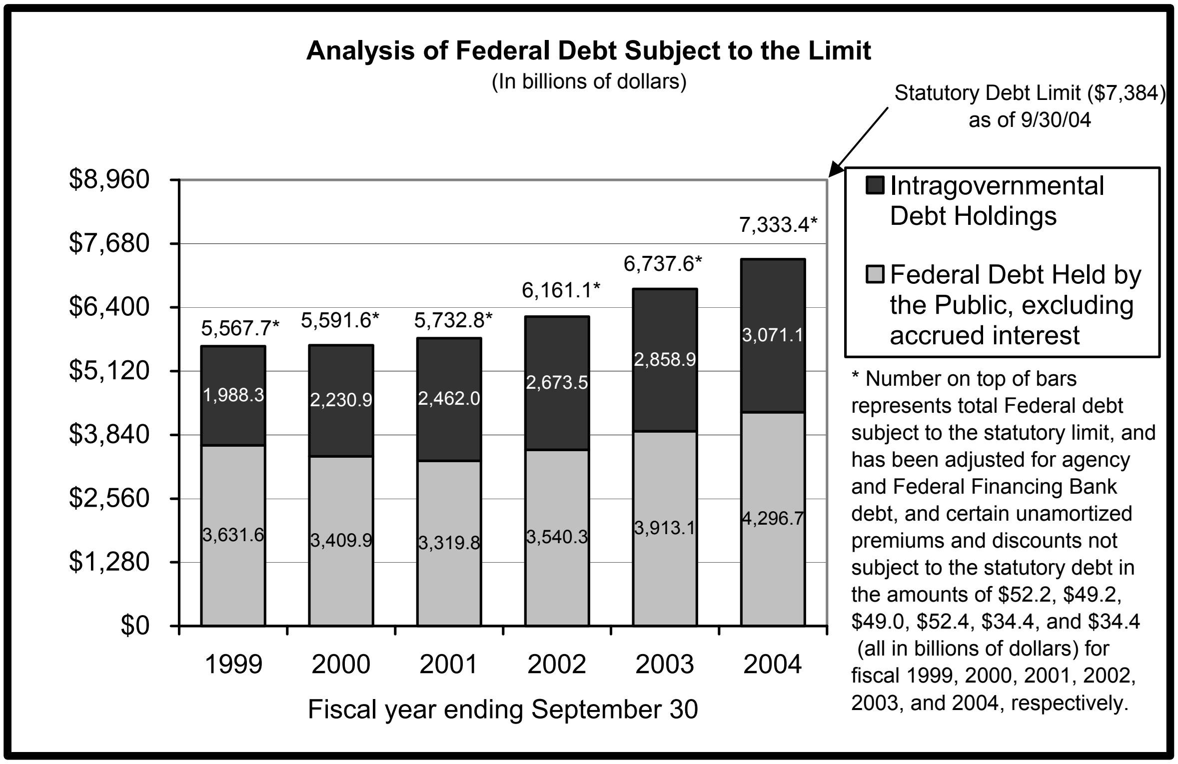
Statutory Debt Ceiling (Limit)

Both kinds of debt are included in the total debt subject to the limit set by the Congress. The Congress has traditionally established limits on the amount of Treasury securities that can be outstanding. This limit is known as the debt ceiling.

At the end of fiscal year 2004, the outstanding debt subject to the limit approached the statutory limit of $7,384 billion. Subsequent to the end of the fiscal year, on October 14, 2004, the outstanding debt reached the limit. When the debt reaches the statutory limit, Treasury uses numerous statutory tools that allow the Government to manage without increasing the outstanding debt subject to the statutory limit and to continue operations for short periods of time. In October 2004, Treasury notified Congress, as required, of its intent to use these tools.

The most significant of these tools includes not fully reinvesting the overnight investments of the Government Securities Investment Fund (or "G-Fund"). On the day that new legislation is enacted to establish a new statutory limit, Treasury fully reinvests all principal to the G-Fund. Lost interest is restored to the G-Fund on the following business day. On November 19, 2004, the President signed legislation raising the statutory debt limit by $800 billion to $8,184 billion (P.L. 108-415).

The following chart shows the amounts of debt held by the public and intra-governmental debt from 1999 through 2004.



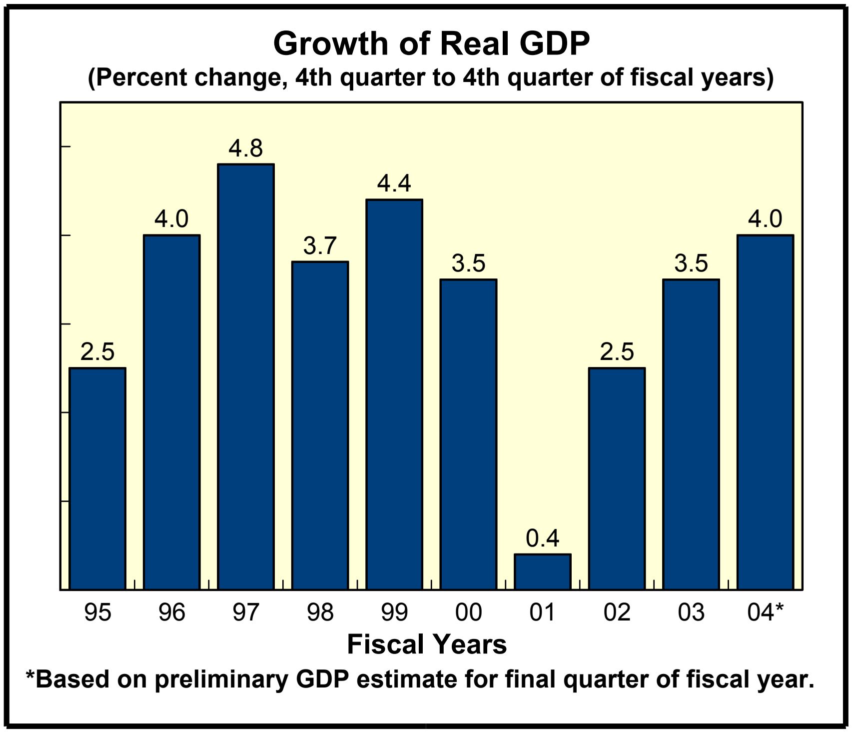
Economic and Budgetary Results

The economy strengthened in fiscal year 2004, with real GDP growing at a faster pace than in the prior fiscal year and employment posting a large increase after declining in each of the previous 3 fiscal years. Rising employment and income contributed to an increase in budget receipts in fiscal year 2004, the first gain in 4 years. Outlays rose more than receipts, and the Federal budget deficit widened in fiscal year 2004.

The Economy in Fiscal Year 2004

After rising 3.5 percent across the four quarters of fiscal year 2003, real GDP increased 4 percent during fiscal year 2004. Large gains in residential and business fixed investment contributed to the acceleration. Real residential investment rose 8.1 percent over the year, extending the strong expansion in the housing market that has been underway for roughly the past 10 years. Real business fixed investment (in capital equipment and software and in structures) grew 10.1 percent over the four quarters of fiscal year 2004, faster than the 5.8 percent increase during fiscal year 2003. Investment in equipment and software was up 12.8 percent in fiscal year 2004 while investment in structures turned up by 1.5 percent after declining in each of the previous 3 fiscal years. Strong profits growth and strength in aggregate demand have been the key drivers of the ongoing rise in business investment, supported as well by the tax incentives provided in the Jobs and Growth Tax Relief Reconciliation Act of 2003.

Higher profits and cashflow allowed businesses to increase hiring. Monthly job growth accelerated sharply midway through fiscal year 2004, averaging 84,000 per month from October 2003 through February 2004, then jumping to a monthly average of 200,000 from March through September. The economy added more than 2 million new payroll jobs during fiscal year 2004 (after allowing for the Bureau of Labor Statistics' estimate of the 2004 benchmark revision), and the unemployment rate fell to an average of 5.6 percent during the fiscal year compared to 6 percent in fiscal year 2003. Inflation was generally subdued during the 2004 fiscal year with the exception of energy prices, which continued to rise. Overall consumer prices rose 2.5 percent over the 12 months of the fiscal year while core consumer prices (excluding food and energy) increased just 2 percent.

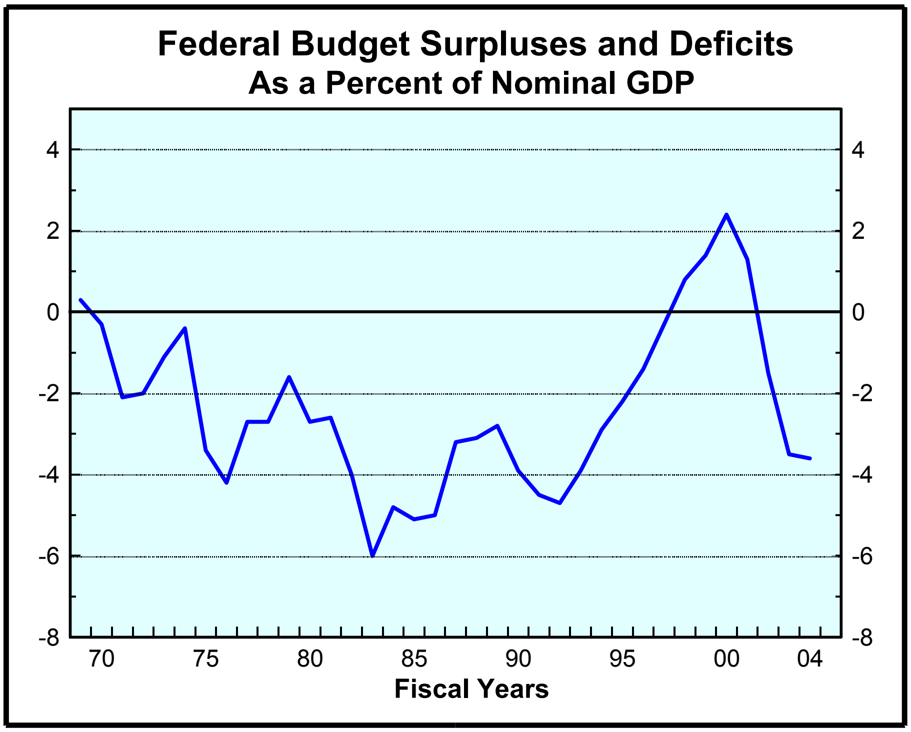


Budget Results

The Federal budget deficit in fiscal year 2004 was $412.3 billion, an increase of $35.2 billion from the $374.8 billion deficit in fiscal year 2003. The final figure came in less than had been projected in July's Mid-Session Review, which anticipated a deficit of $444.7 billion for the fiscal year. Though the $412.3 billion deficit is the highest in dollar terms, the 3.6 percent share of nominal GDP that it represents is well below the fiscal year 1983 peak of 6 percent and lower than the shares of the mid-1980s and early 1990s.

Receipts in fiscal year 2004 increased for the first time in 4 years, primarily due to gains in total taxes and in social insurance and retirement receipts. Receipts rose $97.7 billion (or 5.5 percent) to $1,879.8 billion. That was the highest level since fiscal year 2001. Outlays rose $135.2 billion in the latest fiscal year (or 6.2 percent), and the $2,292.1 billion level of outlays represented a 19.8 percent share of GDP.

Debt held by the public, excluding accrued interest, increased by $379.7 billion in fiscal year 2004 to a level of $4,292.9 billion by yearend. Though an all-time high in dollar terms, the debt level represented a relatively modest 37.2 percent of nominal GDP compared to the average 45.3 percent share that prevailed from the late 1980s through most of the 1990s.



U.S. Government Structure & Performance

Mission & Organization

Today, the U.S. Government's most visible mission of managing the security of the Nation, homeland, and economy is still derived from its original mission in the Constitution: "…to form a more perfect union, establish justice, insure domestic tranquility, provide for the common defense, promote general welfare and secure the blessings of liberty to ourselves and our posterity." Since the original mission's inception, other missions have developed as the Congress authorized the creation of other agencies to carry out various objectives established by law. Some of these objectives are to promote health care, foster income security, boost agricultural productivity, provide benefits and services to veterans, facilitate commerce, support housing, support the transportation system, protect the environment, contribute to the security over energy resources, and assist the States in providing education.

U.S. Government's Organization

The fundamental organization of the U.S. Government is established by the Constitution. Article I vested legislative powers in a Congress consisting of a Senate and a House of Representatives; Article II vested executive powers in a President and Vice President; and Article III vested judicial power in a Supreme Court and lower courts to be established by the Congress. To get an idea of how the U.S. Government is organized, even though not all-inclusive, a U.S. Government organization chart follows.

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

*Indicates a significant entity included in the *Financial Report*.
Original source: *U.S. Government Manual 2004/2005*

The United States is impressive in its position as the leading world power. The following table illustrates several notable items about the United States, as compared with other countries.

Item	United States	Estimate as of	Country Rank	Comments
Land and water area (50 states and the District of Columbia)	9.6 million sq. km	NA	3	About half the size of Russia; slightly larger than China; and about two and a half times the size of Western Europe
Population	293 million	2004 (July)	3	China (1.3B) and India (1.1B) are greater
Gross domestic product (GDP) (basis: purchasing power parity)[1]	$10.98 trillion	2003	1	China was second with $6.4 trillion
GDP per capita	$37,800	2003	2	Luxembourg was first with $55,100
Military expenditures (as a percentage of GDP)	3.9 percent	2001	30	North Korea was first with 22.9 % (2003)
Internet users	159 million	2002	1	China, Japan, and Germany had 59.1 million, 57.2 million, and 34 million, respectively
Cellular telephones	140.8 million	2002	2	China was first with 206.6 million

[1] Purchasing power parity indicates how many units of currency are needed in one country to buy the same amount of goods and services purchased with one unit of currency in another country.
Source: Central Intelligence Agency's *The World Factbook 2004*

Featured Agency: The Department of the Interior

This year is the first time that this section has been added to the MD&A to feature an agency of the U.S. Government and to acquaint the reader with just one of the U.S. Government's many missions.

One of the most fascinating agencies of the Federal Government is the Department of Interior (DOI). What is it, and what does it do? Created by Congress in 1849, DOI is our Nation's primary conservation agency and steward of our natural and cultural resources. It oversees about 507 million acres of U.S. public lands.

Created by Congress in 1849, it served initially as the Nation's custodian. Today, its mission is to protect and provide access to our Nation's natural and cultural heritage and honor the Nation's trust responsibilities to Indian Tribes and its commitments to island communities. DOI fulfills its mission through its eight bureaus.

Interior and Bureau Missions

U.S. Department of the Interior

"Protects and manages the Nation's natural and cultural heritage; provides scientific and other information about those resources; and honors special responsibilities and commitments to American Indians, Alaska Natives, and affiliated island communities."

BUREAU OF INDIAN AFFAIRS Enhance the quality of life and to promote economic opportunity in balance with meeting the responsibility to protect and improve the trust resources of American Indians, Indian tribes, and Alaska Natives.	**NATIONAL PARK SERVICE** Preserve unimpaired the natural and cultural resources and values of the National Park System for the enjoyment, education, and inspiration of this and future generations. The Park Service cooperates with partners to extend the benefits of natural and cultural resource conservation and outdoor recreation throughout this country and the world.	**U.S. FISH AND WILDLIFE SERVICE** Conserve, protect, and enhance fish and wildlife and their habitats for the continuing benefit of the American people.	**BUREAU OF LAND MANAGEMENT** Sustain the health, diversity, and productivity of the public lands for the use and enjoyment of present and future generations.
BUREAU OF RECLAMATION Manage, develop, and protect water and related resources in an environmentally and economically sound manner in the interest of the American public.	**U.S. GEOLOGICAL SURVEY** Provide the Nation with reliable, unbiased information to describe and understand the earth; minimize loss of life and property from natural disasters; manage water, biological, energy and mineral resources; and enhance and protect our quality of life.	**MINERALS MANAGEMENT SERVICES** Manage the mineral resources on the Outer Continental Shelf in an environmentally sound and safe manner and collect, verify, and distribute mineral revenues from Federal lands and Indian lands in a timely manner.	**OFFICE OF SURFACE MINING** Ensure that coal mines are operated in a manner that protects citizens and the environment during mining; assure that land is restored to beneficial use following mining; and mitigate the effects of past mining by aggressively pursuing reclamation of abandoned mine lands.

Source: Department of the Interior's FY 2003 *Annual Report on Performance and Accountability*, p. 6.

Significant Performance Accomplishments

The President's Management Agenda: Managing for Results

Fiscal responsibility requires the sound stewardship of taxpayer money. This means that once the Congress and the President decide on overall spending levels, taxpayer dollars should be managed to maximize results. The 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.

The PMA, launched in August 2001 with the broad goal of making the Government more results-oriented, focuses on achievement, efficiency, and accountability. It emphasizes improving how the Government operates by setting clear goals and action plans, and then following through on those plans. Agencies continue to manage for and achieve better results.

Strategic Management of Human Capital

The Strategic Management of Human Capital Initiative focuses on helping the Government maximize the value of its most important resource, its workforce. Agencies are now establishing and implementing personnel management practices to better achieve their missions.

Agencies are making sure their employees understand what is expected of them and how their work contributes to the achievement of the agency's mission. Appraisal systems are making clear how employees will be evaluated and distinguishing between high and low performers. Proper implementation of strong performance appraisal systems will provide the necessary foundation for establishing pay for performance systems where an individual's pay is more directly linked to his or her performance and achievements instead of longevity.

To meet current and future leadership needs, agencies are making certain they have sufficient talent pools. Over the past year, several agencies have established programs to strengthen their management and Senior Executive Service leadership ranks. 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

The Government is conducting public-private competitions to determine whether it is more efficient to have commercial work performed by Federal employees or the private sector. Agencies have worked to establish infrastructures to apply competition in the most strategic manner possible, such as by reorganizing inefficient in-house operations, developing competition plans that group related activities to generate private sector interest, and aligning competitive sourcing and human capital efforts to close competency and skill gaps. The PMA agencies project that the more than 660 assessments they completed in fiscal year 2003 will yield $1.1 billion in savings over the next 3 to 5 years. This translates to annualized savings of roughly $12,000—or roughly 15 percent—for every position studied, regardless of whether the work is being performed by the Government or by the private sector. With experience, the return on investment will only get better.

Improved Financial Performance

The ultimate goal of the Improved Financial Performance initiative of the PMA is that managers have access to timely and accurate financial information for decision-making. Audited financial statements provide assurance that agencies are accounting for the taxpayers' money in an accurate manner. This year 22 of 24 major Federal agencies issued their Performance and Accountability Reports, including audited financial statements, within 45 days from the end of the fiscal year. This marks a significant milestone in federal financial management since only a few years ago agencies took up to five months to produce similar information. Meeting this goal required agencies to implement new financial management disciplines and processes, which are the foundation for more reliable information to support day-to-day management.

By establishing greater financial discipline and better control, agencies are producing financial reports in a shorter period of time and with greater confidence in data accuracy. Since the beginning of 2003, the number of auditor-reported material weaknesses government-wide has decreased by 12 percent, and, fewer material weaknesses translate to greater confidence that financial information is correct. As agencies improve their financial business practices and install new financial management systems and reporting tools, data timeliness and accuracy will continue to improve.

There has also been ongoing improvement in the number of agencies demonstrating their ability to use timely and accurate financial information to make decisions about program management. During this past year, two additional agencies demonstrated this capability, increasing the total number of agencies to six. By using timely financial information for decision making and program management, agencies are taking steps toward improving their financial performance and overall management of Federal dollars.

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. The Government must capitalize on its more than $60 billion annual investment in IT.

Most agencies have made improvements in IT management over the last year. Over 97 percent of major systems include measurable program objectives in their justifications. Sixty-one percent of IT systems have been certified and accredited, versus 47 percent for fiscal year 2002. Sixty-two percent are at various stages of developing modernization blueprints, which are an integral part of ensuring that their IT investments support overall agency goals and are not redundant of Governmentwide IT investments. These improvements will be a central ingredient in developing a more thoughtful, productive approach to IT investment across agencies.

Specific improvements in service delivery are being achieved through the E-Gov Initiatives. For instance, Grants.gov makes it easier for potential recipients to obtain information about Federal grants by creating a single, online site for all Federal grants. Because of e-Travel, the new web-based, consolidated Federal travel management system, the Government expects to spend nearly $300 million less over the next 10 years on travel-related activities.

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 that these investments are well managed, more secure, and providing services to the American people more efficiently and effectively.

Budget and Performance Integration

Many agencies are now using meaningful program performance information to inform their budget and management decisions. In particular, a third of the Government's major agencies meet regularly to use performance information to make program management decisions. Agencies are using the information gleaned from the PART to identify programs' strengths and weaknesses and take appropriate action. The Program Assessment Rating Tool (PART) assessments have helped focus agency efforts to improve program results. Agencies have now assessed the performance of approximately 400 Federal programs, representing more than 1 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 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 program assessments are conducted, of the Administration will have better program performance information to use when making budget and management decisions. Agencies will be better able to describe to the taxpayer what his or her funding is purchasing and will be managing so that each year improvements in efficiency and service delivery can be documented.

Eliminating Improper Payments

Agencies are also taking steps to measure their improper payments, which include but are not limited to, payments made in an incorrect amount, to an ineligible recipient, for a service not received, or for improper use of Federal funds. Eliminating improper payments has been added to the PMA as a new program initiative to highlight its importance. This program initiative affects the 15 Executive Branch agencies with the most high risk programs.

With the enactment of the Improper Payments Information Act (IPIA), agencies are now developing and implementing improper payment plans that will lead to the review of every dollar the Government spends. Fiscal year 2004 begins the first year of reporting under IPIA.

Asset Management

In conjunction with Executive Order (EO) 13327, "Federal Real Property Asset Management," a new program initiative under the PMA was created in the 3rd quarter of fiscal year 2004. The Federal Real Property Asset Management initiative, which applies to the largest landholding agencies, is aimed at improving the management of real property assets on a Governmentwide level by holding agencies accountable for implementing a more effective and economical approach to real property management.

Pursuant to the EO, all major agencies designated a Senior Real Property Officer to be held accountable for the effective management of agency real properties. An interagency Federal Real Property Council has also been created to develop guidance, serve as a clearing house for best practices, and facilitate the efforts of the agency Senior Real Property Officers. Agencies must develop a complete and accurate inventory, develop and implement asset management plans, develop and monitor real property performance measures, and dispose of properties that are no longer needed.

Executive Branch Management Scorecard

The PMA is used to measure agencies' progress and overall achievement in meeting the overall goals of the PMA. These overall goals, known as standards for success, are specified for each initiative and available at www.whitehouse.gov/results/agenda/standards.pdf. A copy of the Scorecard follows.

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

The Scorecard

Executive Branch Management Scorecard										
	Current Status as of September 30, 2004					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	Y	Y	R	Y	Y	G	Y	G	G	G
COMMERCE	Y	Y	Y ↑	Y	Y	G	Y	G	G	G
DEFENSE	Y	G	R	R	Y	G	Y	Y	G	G
EDUCATION	Y	Y	G	Y	Y	G	G	G	G	G
ENERGY	G	G	G	Y	G ↑	G	G	G	G	G
EPA	Y	Y	G	G	Y	G	G	G	G	G
HHS	G ↑	G	R	Y ↑	Y	G	G	Y	G	G
HOMELAND	R	Y	R	R	Y ↑	G	G	G	Y	G
HUD	Y	R	R	R	R	G	Y	Y	G	G
INTERIOR	Y	Y	R	Y	R	G	Y	G	G	G
JUSTICE	Y ↑	Y	R	Y	Y ↑	G	G	G	G	G
LABOR	G	Y	G ↑	G ↑	G	G	G	G	G	G
STATE	G	R	Y	G ↑	G ↑	G	G	G	G	G
DOT	G	G	R	G	G	G	G	G	G	G
TREASURY	Y ↑	Y	R	R	Y ↑	G	Y	Y	G	G
VA	Y	R	R	Y	Y	G	R	R	Y	G
USAID	R	R	R	Y	Y	G	Y	G	G	G
CORPS OF ENGINEERS	Y	R	R	R	R	G	G	Y	G	Y
GSA	Y	G ↑	R	Y ↑	Y ↑	G	G	G	G	G
NASA	G	Y	R	G ↑	G	G	G	R	G	G
NSF	Y	R	G	G	Y	G	R	G	G	G
OMB	Y	R	R	R	R	G	R	G	G	R
OPM	G	G	Y	G	Y	G	Y	G	G	Y
SBA	Y	Y	R	G	G	G	Y	G	G	G
SMITHSONIAN	R	R	R	R	R	G	R	Y	Y	Y
SSA	G	Y	G	Y	G	G	G	G	Y	G

Legend: R = Red Y = Yellow G = Green
↑↓ Arrows indicate change in status since evaluation on June 30, 2004.

Systems, Controls, and Legal Compliance

Systems

The Federal Government continues to face challenges in achieving greater efficiency and effectiveness of its financial management systems. The most significant steps toward overcoming these challenges have been the agreement on core system requirements and the development of a software certification process based on those requirements. Most major agencies have purchased and some have completed the implementation of certified commercial-off-the-shelf financial management systems. Despite built-in best practices and standard business processes, many agencies have struggled with the challenges inherent to the implementation of these complex systems.

To address these challenges and to eliminate redundant investments, OMB launched the *Financial Management Line of Business (FM-LOB)* as one of the five LOB initiatives. The FM-LOB business case will reduce the cost of agency financial management systems by migrating them to Centers of Excellence (COE). The COEs may be operated by public agencies, private firms, or public/private partnerships. Some agencies will be selected in fiscal year 2005 to operate COEs. Agencies will schedule their migrations consistent with the economics of their systems' life cycles. The FM-LOB will help agencies increase their efficiency and improve business performance while ensuring integrity in accountability, financial controls, and mission effectiveness.

Controls

Internal Control

Effective internal control is a key factor in producing reliable financial information. Ensuring the proper stewardship of federal resources is a fundamental responsibility of agency managers and staff. Effective internal control helps ensure that programs are managed with integrity and resources are used efficiently and effectively.

The recent emphasis on internal control and reliable financial reporting contained in the Sarbanes-Oxley Act (SOX) of 2002 for publicly-traded companies has served as an impetus for a re-examination of internal control requirements within the Federal Government.

During fiscal year 2004, the Office of Management and Budget took action to convene representatives from the Chief Financial Officers Council (CFOC) and the President's Council on Integrity and Efficiency (PCIE) to review the SOX requirements and determine how those requirements apply to the Federal government. The joint committee found that within the current Federal environment, agencies are subject to a variety of existing legislative and regulatory requirements intended to promote and support effective internal control. At the center of these existing requirements is the Federal Managers' Financial Integrity Act of 1982 (FMFIA) and OMB Circular No. A-123, Management Accountability and Control, which requires agencies to annually evaluate and report on the effectiveness of their internal control and report material weaknesses to the President and the Congress.

In addition, FMFIA also requires an annual statement on whether the agency's financial management systems conform to Governmentwide requirements. The Federal financial management requirements are mandated by the Federal Financial Management Improvement Act of 1996 (FFMIA) and OMB Circular No. A-127, Financial Management Systems. FFMIA requires agency management and financial statement auditors to determine whether financial management systems meet systems requirements, comply with the U.S. Standard General Ledger at the transaction level, and adhere to the standards promulgated by the Federal Accounting Standards Advisory Board (FASAB).

The joint CFOC/PCIE committee recommended that OMB strengthen its existing guidance for assessing the effectiveness of internal control. Amendments to OMB guidance were developed by the joint committee to adopt the standards prescribed in GAO's Standards for Internal Control in the Federal Government (November 1999), which are consistent with the Integrated Framework of Internal Control issued by the Committee of Sponsoring Organizations of the Treadway Commission, and to require a more comprehensive and coordinated approach to assessing the effectiveness of internal control over financial reporting. OMB plans to release amendments to Circular A-123 by the end of the 2004 calendar year to be effective for fiscal year 2006.

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. As a result of their testing, auditors found no instances of material noncompliance that affected the Governmentwide financial statements. There were, however, instances that were material to an individual agency, and these were reported in the individual agencies' financial statement audit reports.

Basis of Accounting and Reporting Entity

Accounting Standards

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

Accrual Basis

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

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

Coverage

These financial statements cover the three branches of the U.S. Federal Government. A list of the significant entities included in these financial statements is in the Appendix. Information from the judicial branch is limited to budgetary activity because these entities are not required by law to submit comprehensive financial statement information to the Treasury. The Federal Reserve System is excluded because it is an independent entity within the Government, having both public purposes and private aspects. The Federal Retirement Thrift Investment Board is excluded because it charges all of its administrative expenses to the Thrift Savings Fund, which is fiduciary in nature. Therefore, it has no financial activity that would affect the Government's results. Moreover, Government-sponsored but privately-owned enterprises (e.g., the Federal Home Loan Banks, the Federal National Mortgage Association, and the Federal Home Loan Mortgage Corporation) are also excluded.

Additional Information

The Appendix contains a list of the significant Government entities included in the *Financial Report's* financial statements, along with their respective web sites. Details about the information contained in the *Financial Report* can be found in the financial statements of these entities in their individual Performance and Accountability Reports at their corresponding web sites. In addition, related U.S. Government publications such as the *Budget of the United States Government*, the *Treasury Bulletin*, the *Monthly Treasury Statement of Receipts and Outlays of the United States Government*, the *Monthly Statement of the Public Debt of the United States*, the *Economic Report of the President*, and the Trustees' Reports for the Social Security and Medicare programs may be of interest and accessed from the respective White House (OMB and Council of Economic Advisers), Treasury, SSA, and HHS web sites listed in the Appendix.

History of the Report

Financial Reports of the United States Government

The purpose of this report is to provide a longer term accrual perspective to the financial results of the Government. In this way those costs that may take years to be realized through payments, but committed to in the current period, can be recorded and become part of the discussion of the financial well being of the Nation.

The Government Management Reform Act of 1994 (GMRA) required audited financial statements from the 24 CFO Act Federal departments and agencies beginning for fiscal year 1996. GMRA also required the U.S. Government to submit consolidated financial statements audited by GAO beginning for fiscal year 1997's *Financial Report of the United States Government*.

The Treasury Department has prepared a prototype report for many years beginning in the mid-seventies. The earliest reports were accrual-based and included a balance sheet and statement of operations and were not audited, though Treasury hired private sector firms to conduct independent reviews of source data and collection procedures. (For a more complete discussion visit http://www.treas.gov/offices/economic-policy/financial_report_hist.pdf.)

In 1990, a Memorandum of Understanding between Treasury, OMB, and GAO created FASAB to develop formal Federal accounting standards and concepts. And in 1999, the American Institute of Certified Public Accountants recognized FASAB as the promulgator of GAAP for the Federal Government. FASAB continually reviews its reporting standards to enhance the usefulness of the Government's financial statements to all users.

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GAO
Accountability * Integrity * Reliability

Comptroller General
of the United States

United States Government Accountability Office
Washington, DC 20548

December 14, 2004

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 the fiscal years 2004 and 2003 is enclosed. As in the seven previous fiscal years, certain material weaknesses in internal control and in selected accounting and financial reporting practices resulted in conditions that continued to prevent us from being able to provide the Congress and American citizens an opinion as to whether the consolidated financial statements of the U.S. government are fairly stated in conformity with U.S. generally accepted accounting principles.

Proper accounting and financial reporting practices are essential in the public sector. The U.S. government is the largest, most diverse, most complex, and arguably the most important entity on earth today. Its services and programs—homeland security, national defense, Social Security, health care, mail delivery, and food inspection, to name just a few—directly affect the well-being of almost every American. Sound decisions on the current results and future direction of vital federal programs and policies are made more difficult without timely, reliable, and useful financial and performance information.

Until the problems discussed in our audit report are adequately addressed, they will continue to present a number of adverse implications for the federal government and the taxpayers, which are outlined in our report. At the same time, the need for timely, reliable, and useful financial and performance information is greater than ever. Our nation's large and growing long-term fiscal imbalance, which is driven largely by known demographic trends and rising health care costs, coupled with new homeland security and defense commitments and the recent downward trend in revenue as a share of gross domestic product, serves to sharpen the need to fundamentally review and re-examine the base of federal entitlement, discretionary, and other spending and tax policies. Clearly, tough choices will be required to address the resulting structural imbalance.

In March 2004, the Trustees of the Social Security and Medicare trust funds issued their 2004 annual reports on the current and projected status of these programs. Once again, the trustees' reports confirmed that both the Social Security and Medicare programs are unsustainable in their present form. The trustees also noted that Medicare's financial difficulties are much more severe than those confronting Social Security. In addition, the new prescription drug benefit, which is one of the largest unfunded commitments ever undertaken by the federal government, has served to significantly increase the unfunded commitments associated with the Medicare program. Specifically, in their 2004 report, the trustees estimated the present value cost to the federal government of this new benefit over the next 75 years to be $8.1 trillion as of January 1, 2004. The trustees reiterated the message contained in their previous reports that action to address the financial difficulties facing Social Security and Medicare should be taken in a timely manner and that the sooner these financial challenges are addressed, the more varied and less disruptive the solutions can be.

The federal government's gross debt[1] as of September 2004 was about $7.4 trillion, or about $25,000 for every man, woman, and child in the country. But that number excludes such items as the gap between promised and funded Social Security and Medicare benefits, veterans' health care, and a range of other unfunded commitments and contingencies that the federal government has pledged to support. If these items are factored in, the current dollar burden for every American rises to about $145,000 per person, or about $350,000 per full-time worker. GAO's fiscal policy simulations illustrate that the fiscal policies in place today—absent substantive entitlement reform or unprecedented changes in tax and/or spending policies—will result in large, escalating, and persistent deficits that are economically unsustainable over the long term. Without reform, known demographic trends, rising health care costs, and projected growth in federal spending for Social Security, Medicare, and Medicaid will result in massive fiscal pressures that, if not effectively addressed, could cripple the economy, threaten our national security, and adversely affect the quality of life of Americans in the future.

The President and the Congress face the challenge of sorting out the many claims on the federal budget without the budget enforcement mechanisms or fiscal benchmarks that guided the federal government through the years of deficit reduction into a brief period of federal surpluses. While a number of steps will be necessary to address this challenge, truth and transparency in federal government financial reporting and budgeting are essential elements of any attempt to address the nation's long-term fiscal challenges. The fiscal risks just mentioned can be managed only if they are properly accounted for and publicly disclosed, including the many existing commitments facing the government. In addition, new budget control mechanisms will be required, along with effective approaches to successfully engage in a fundamental review, reassessment, and reprioritization of the base of federal government programs and policies that I have mentioned previously. In this regard, we should not assume that all defense and homeland security expenditures are both necessary and prudent. Furthermore, the use of across-the-board adjustments to address the spending imbalance serves to avoid making the necessary difficult choices, is inequitable, and simply will not get the job done.

[1]The federal government's gross debt consists of debt held by the public and intragovernmental debt holdings.

In identifying improved financial performance as one of its five governmentwide initiatives, the President's Management Agenda recognized that a clean (unqualified) financial audit opinion is a basic prescription for any well-managed organization. The Principals of the Joint Financial Management Improvement Program (JFMIP)[2] defined certain measures, in addition to receiving an unqualified financial statement opinion, for achieving financial management success. These additional measures include being able to routinely provide timely, accurate, and useful financial and performance information and having no material internal control weaknesses or material noncompliance with laws and regulations and the requirements of the Federal Financial Management Improvement Act of 1996.

For fiscal year 2004, the Office of Management and Budget (OMB) accelerated the financial statements reporting date for agencies to November 15, 2004, as compared with January 30, 2004, for fiscal year 2003. Twenty-two of 23 Chief Financial Officers (CFO) Act agencies were able to issue their fiscal year 2004 financial statements by the accelerated reporting date. As such, these results represent a significant improvement over fiscal year 2003 in the timeliness of CFO Act agencies' issuance of their financial statements.

For fiscal year 2004, 18 of 23 CFO Act agencies were able to attain unqualified audit opinions on their financial statements. A trend during fiscal year 2004 that merits concern and close scrutiny was the growing number of CFO Act agencies that restated certain of their financial statements for fiscal year 2003 to correct errors. At least 10[3] of the 23 CFO Act agencies fell into this category in fiscal year 2004, as compared with at least 4 CFO Act agencies that had restatements in fiscal year 2003, covering their fiscal year 2002 financial statements. At least 2 CFO Act agencies had restatements in both years. Frequent restatements to correct errors can undermine public trust and confidence in both the entity and all responsible parties.

With accelerated reporting, which we support in concept, it is even more imperative that federal agency management continue to work toward fully resolving the pervasive and generally long-standing material weaknesses that have been reported at the agency level for the past 9 fiscal years. Otherwise, federal agencies may risk incurring additional costs while at the same time sacrificing reliability to achieve accelerated reporting. In addition, continued leadership from OMB and Treasury will be important to resolve the issues that have served to prevent us from expressing an opinion on the consolidated financial

[2]JFMIP was a joint and cooperative undertaking of the Department of the Treasury, GAO, the Office of Management and Budget (OMB), and the Office of Personnel Management working in cooperation with each other and other federal agencies to improve financial management practices in the federal government. Leadership and program guidance were provided by the four Principals of the JFMIP—the Comptroller General of the United States, the Secretary of the Treasury, and the Directors of OMB and the Office of Personnel Management. Although JFMIP ceased to exist as a stand-alone organization as of December 1, 2004, the JFMIP Principals will continue to meet at their discretion.

[3]Eight of these 10 agencies received an unqualified opinion on their originally issued fiscal year 2003 financial statements. Of these 8, the auditors for the Department of Justice withdrew the unqualified opinion that had been previously rendered on the department's fiscal year 2003 financial statements and issued a disclaimer of opinion on these restated financial statements, and the auditors for the Nuclear Regulatory Commission withdrew the unqualified opinion on the commission's fiscal year 2003 financial statements and issued a qualified opinion on these restated financial statements.

statements. Further, there will need to be ongoing and sustained top management attention to business systems transformation at the Department of Defense to address what are some of the most difficult financial management challenges in the federal government. These issues are discussed in detail in our auditor's report.

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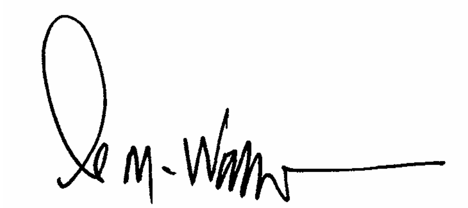
Once again, we appreciate the cooperation and assistance of Department of the Treasury and OMB officials, as well as the chief financial officers and inspectors general, in carrying out our statutory responsibility to report on the U.S. government's consolidated financial statements. We look forward to continuing to work with these officials and the Congress to achieve the goals and objectives of financial management reform.

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

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, 2004 and 2003,[2] and our associated reports on internal control and compliance with 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) are met;[3] and (3) complying with applicable laws and regulations. Also, the 23 Chief Financial Officers (CFO) Act agencies[4] are responsible for implementing and maintaining financial management systems that substantially comply with Federal Financial Management Improvement Act of 1996 (FFMIA)[5] requirements. Our objective

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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, 2004 and 2003, consist of the Statements of Operations and Changes in Net Position, Statements of Net Cost, Reconciliations of Net Operating Cost and Unified Budget Deficit, Statements of Changes in Cash Balance from Unified Budget and Other Activities, and Balance Sheets, including the related notes to these financial statements.
[3]31 U.S.C. 3512 (c), (d) (commonly referred to as FMFIA). This act requires agency heads to evaluate and report annually to the President on the adequacy of their internal control and accounting systems and on actions to correct significant problems.
[4]31 U.S.C. 901 (b). The Federal Emergency Management Agency (FEMA) was transferred to the new Department of Homeland Security (DHS) effective March 1, 2003. With this transfer, FEMA is no longer required to prepare and have audited stand-alone financial statements under the CFO Act, leaving 23 CFO Act agencies for fiscal year 2004. DHS, along with most other executive branch agencies, is required to prepare and have audited financial statements under the Accountability of Tax Dollars Act of 2002, Pub. L. No. 107-289, 116 Stat. 2049 (Nov. 7, 2002). The DHS Financial Accountability Act, Pub. L. No. 108-330, 118 Stat.1275 (Oct. 16, 2004), added DHS to the list of CFO Act agencies and deleted FEMA, increasing the number of CFO Act agencies again to 24 for fiscal year 2005. With this designation, DHS is required to implement and maintain financial management systems that comply with FFMIA and its auditors will be required to report on DHS's financial management systems' compliance with FFMIA beginning with fiscal year 2005. Also beginning in fiscal year 2005, the law requires that the Secretary of DHS include in its performance and accountability report an assertion on the internal control over financial reporting. DHS's auditors will be required to opine on such internal control beginning in fiscal year 2006.
[5]31 U.S.C. 3512 note (Federal Financial Management Improvement).

was to audit the consolidated financial statements for the fiscal years ended September 30, 2004 and 2003. Appendix I discusses the scope and methodology of our work.

A significant number of material weaknesses[6] 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; (3) impair the federal government's ability to adequately safeguard significant assets and properly record various transactions; and (4) prevent the federal government from having reliable financial information to operate in an economical, efficient, and effective manner. We found the following:

- Material deficiencies in financial reporting (which also represent material weaknesses) and other limitations on the scope of our work resulted in conditions that continued to prevent us from forming and expressing an opinion on the accompanying consolidated financial statements for the fiscal years ended September 30, 2004 and 2003.[7]

- The federal government did not maintain effective internal control over financial reporting (including safeguarding assets) and compliance with laws and regulations as of September 30, 2004.

- Our work to determine compliance with selected provisions of applicable laws and regulations in fiscal year 2004 was limited by the material weaknesses 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 2004 and 2003, principally resulting from the material deficiencies, 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 the material deficiencies in the federal government's systems, recordkeeping, documentation, and financial reporting and scope limitations, readers are cautioned that amounts reported in the consolidated financial statements and related notes may not be reliable. These material deficiencies and scope limitations also affect the

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[6]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.

[7]We previously reported that material deficiencies prevented us from expressing an opinion on the consolidated financial statements of the U.S. government for fiscal years 1997 through 2003.

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.

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 2004 *Financial Report of the United States Government*.

As disclosed in Note 17 to the consolidated financial statements, the fiscal year 2003 financial statements, on which we disclaimed an opinion, were restated to reflect certain Department of Defense (DOD) prior-period adjustments. Also as disclosed in Note 17, the federal government changed its method of accounting for national defense property, plant, and equipment effective October 1, 2002, to conform to Statement of Federal Financial Accounting Standards No. 23, *Eliminating the Category National Defense Property, Plant, and Equipment*.

Significant Matters of Emphasis

Before discussing the additional limitations on the scope of our work and the material deficiencies we identified, two significant matters require emphasis—the nation's fiscal imbalance and restatements of certain agencies' prior-year audited financial statements.

The Nation's Fiscal Imbalance

While we are unable to express an opinion on the U.S. government's consolidated financial statements, several 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 *Financial Report of the United States Government* into context. First, the federal government reported a $412.3 billion unified budget deficit and a $568 billion on-budget deficit in fiscal year 2004, representing approximately 3.6 percent and 4.9 percent of gross domestic product (GDP), respectively.[8] Importantly, a significant majority of this deficit was unrelated to the conflicts in Iraq and Afghanistan and additional homeland security costs. Second, the U.S. government's reported liabilities and unfunded social insurance and other obligations grew by over $13 trillion in fiscal year 2004, primarily due to enactment of the new Medicare prescription drug benefit, and now are over $43 trillion, representing close to four times current GDP.[9] In addition, while the size of the

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[8]The transactions of the Postal Service and the Social Security trust funds are classified as off-budget. As such, their reported surpluses—$4 billion for the Postal Service and $151 billion for the Social Security trust funds—are excluded from the on-budget deficit but included in the unified budget deficit.
[9]These amounts use social insurance obligations computed on an open group basis.

nation's long-term fiscal imbalance grew significantly during the fiscal year, the retirement of the "baby boom" generation is closer to becoming a reality. 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 will be necessary in order to address the nation's large and growing fiscal imbalance.

Potential Impact of Restatements

A trend during fiscal year 2004 that bears concern and close scrutiny is the growing number of CFO Act agencies that restated certain of their financial statements for fiscal year 2003 to correct errors. At least 10[10] of the 23 CFO Act agencies fell into this category as compared with at least 4 CFO Act agencies that had restatements in fiscal year 2003 covering their fiscal year 2002 financial statements. At least 2 CFO Act agencies had restatements in both years. Frequent restatements to correct errors can undermine public trust and confidence in both the entity and all responsible parties. The material internal control weaknesses discussed in this report serve to increase the risk that additional errors may occur and not be identified on a timely basis by management or the auditors, resulting in further restatements. We plan to perform a more detailed review as to the nature and causes of the restatements during our audit of the fiscal year 2005 consolidated financial statements.

Limitations on the Scope of Our Work

For fiscal year 2004, there were additional limitations on the scope of our work that were similar to limitations we reported for fiscal year 2003. As agreed with OMB and the Department of the Treasury (Treasury), we accelerated the time frame to issue our report on the audit of the consolidated financial statements for fiscal year 2004 to meet the federal government's December 15, 2004, accelerated reporting date. We stressed to OMB, Treasury, and significant federal agencies' CFOs and the respective inspectors general the importance of receiving requested key documents and information and a complete draft of the consolidated financial statements by certain predetermined time frames to enable us to perform the necessary audit procedures to meet this accelerated reporting date. However, primarily due to incomplete and inaccurate submissions to Treasury by several federal agencies of certain key information used by Treasury to prepare the consolidated financial statements, along with some of the challenges and problems encountered with implementing a new compilation process and other weaknesses in financial statement preparation, as discussed below, Treasury's ability to timely provide us with complete and properly supported drafts of the consolidated financial statements was significantly impaired. As a result, we did not receive the U.S. government's consolidated financial statements in time to complete all of our planned

[10]Eight of these 10 agencies received an unqualified opinion on their originally issued fiscal year 2003 financial statements. Of these 8, the auditors for the Department of Justice withdrew the unqualified opinion that had been previously rendered on the department's fiscal year 2003 financial statements and issued a disclaimer of opinion on these restated financial statements, and the auditors for the Nuclear Regulatory Commission withdrew the unqualified opinion on the commission's fiscal year 2003 financial statements and issued a qualified opinion on these restated financial statements.

auditing procedures related to the compilation of these financial statements by the reporting date. In addition, certain audit documentation for several federal agencies were not made available to us in time to complete certain of our planned audit procedures in key areas, including planned audit procedures related to the Department of Health and Human Services (HHS).[11]

We also continued to identify concerns with the adequacy of certain federal agencies' management and legal representations on which Treasury and OMB depend to provide their representations to us regarding the U.S. government's consolidated financial statements. Further, due to the lack of timely submission of HHS's legal representations to the Department of Justice, we did not receive the final legal representation letter for the consolidated financial statements as of the date of the completion of our fieldwork and as such could not complete our planned auditing procedures by the accelerated reporting date.

Material Deficiencies

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 largest and most challenging impediment to rendering any opinion on the U.S. government's consolidated financial statements continues to be serious financial management problems at DOD. These material deficiencies (which also represent material weaknesses), which generally have existed for years, contributed to our disclaimer of opinion and also constitute material weaknesses in internal control. Appendix II describes the material deficiencies 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. These material deficiencies 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;

[11]The auditor's report for HHS's financial statements for fiscal year 2004 was dated December 6, 2004.

- ensure that the federal government's consolidated financial statements were consistent with the underlying audited agency financial statements, balanced, and in conformity with GAAP;

- adequately account for and reconcile intragovernmental activity and balances between federal agencies; and

- resolve material differences that exist between the total net outlays reported in federal agencies' Statements of Budgetary Resources and the records used by Treasury to prepare the Statements of Changes in Cash Balance.

Due to the additional limitations on the scope of our work and the material deficiencies 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, 2004, 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 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. 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 matters 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.

In addition to the material weaknesses that represented material deficiencies, which were discussed above, we found the following four other material weaknesses in internal control as of September 30, 2004. 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

[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.

government operations. These material weaknesses were the federal government's inability to

- implement effective processes and procedures for properly estimating the cost of certain lending programs, related loan guarantee liabilities, and value of direct loans;
- determine the 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.

COMPLIANCE WITH APPLICABLE LAWS AND REGULATIONS

Our work to determine compliance with selected provisions of applicable laws and regulations related to financial reporting was limited by the material weaknesses and scope limitations discussed above. U.S. generally accepted government auditing standards and OMB guidance require auditors to report on the agency's compliance with 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 applicable laws and regulations.

AGENCY FINANCIAL MANAGEMENT SYSTEMS

To achieve the financial management improvements envisioned by the CFO Act, FFMIA, and, more recently, 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 as well as 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. 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 2004, auditors for 16 of 23 CFO Act agencies reported that the agencies financial management systems did not comply substantially with one or more of these three FFMIA requirements. A 24th agency, DHS, was not subject to the requirements of the CFO Act for fiscal year 2004, and, consequently, was not required to comply with FFMIA. Accordingly, DHS's auditor did not report on DHS's compliance with FFMIA for fiscal year 2004. However, the auditor identified and reported deficiencies that related to the requirements of FFMIA noted above.

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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 problems this report outlines.

David M. Walker
Comptroller General
of the United States

December 6, 2004

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[13] 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.[14] 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 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 to achieve our joint audit objectives. Our audit approach focused primarily on determining the current status of the material deficiencies and the other material weaknesses affecting internal control that we had previously reported in our report on the consolidated financial statements for fiscal year 2003.[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 2004 and 2003 financial statements, which included approximately $2 trillion of tax revenue for both fiscal years; $278 billion and $300 billion of tax refunds for fiscal years 2004 and 2003, respectively; and $20 billion of net federal taxes receivable each year.[18] In fiscal year 2004, we continued to report numerous material internal control weaknesses, which resulted in ineffective internal control. Our tests of compliance with selected provisions of laws and regulations disclosed two areas 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, 2004 and 2003.[19] The schedules reported for these 2 fiscal years (1) approximately $4.3 trillion (2004) and $3.9 trillion (2003) of federal debt held by the

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[13]31 U.S.C. 901(b), 3521(e), but see footnote 4.
[14]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).
[15]Pub. L. No. 107-289, 116 Stat. 2049 (Nov. 7, 2002).
[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 2003, see U.S. Department of the Treasury, *Financial Report of the United States Government* (Washington, D.C. February 2004), pp. 37-52, which can be found on GAO's Internet site at www.gao.gov.
[18]GAO, *Financial Audit: IRS's Fiscal Years 2004 and 2003 Financial Statements,* GAO-05-103 (Washington, D.C.: Nov. 10, 2004).
[19]GAO, *Financial Audit: Bureau of the Public Debt's Fiscal Years 2004 and 2003 Schedules of Federal Debt,* GAO-05-116 (Washington, D.C.: Nov. 5, 2004).

public;[20] (2) about $3.1 trillion (2004) and $2.9 trillion (2003) of intragovernmental debt holdings;[21] and (3) nearly $158 billion (2004) and $157 billion (2003) of interest on federal debt held by the public.[22] We reported that as of September 30, 2004, BPD had effective internal control over financial reporting and compliance with applicable laws and regulations relevant to the Schedule of Federal Debt. Further, we reported that there was no reportable noncompliance in fiscal year 2004 with a law we tested.

- We audited and expressed unqualified opinions on the December 31, 2003 and 2002, 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.[23] We reported that as of December 31, 2003, FDIC had effective internal control over financial reporting and compliance with 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, 2004.

We considered the CFO Act agencies' and certain other federal agencies' fiscal years 2004 and 2003 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 provided to the DOD Inspector General 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 2004 financial statements were not completely reliable. DOD cited deficiencies in several areas affecting its financial statements, including among others (1) property, plant, and equipment; (2) inventory and operating material and supplies; (3) environmental liabilities; (4) intragovernmental eliminations and related accounting adjustments; and (5) disbursement activity.

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 applicable 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.

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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]On November 19, 2004, legislation was enacted to raise the statutory debt limit by $800 billion to $8.184 trillion. Pub. L. No. 108-415, 118 Stat. 2337 (Nov. 19, 2004).
[23]GAO, *Financial Audit: Federal Deposit Insurance Corporation Funds' 2003 and 2002 Financial Statements,* GAO-04-429 (Washington, D.C.: Feb. 13, 2004).
[24]Pub. L. No. 107-107, §1008,115 Stat. 1012, 1204 (Dec. 28, 2001).

APPENDIX II

Material Deficiencies

The continuing material deficiencies discussed below contributed to our disclaimer 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 deficiencies in reporting assets and liabilities, material deficiencies 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 2004 and 2003, there was unreconciled disbursement activity, including unreconciled differences between federal agencies' and the Department of the Treasury's (Treasury) 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 President's budget concerning obligations and outlays.

Preparation of Consolidated Financial Statements

During fiscal year 2004, Treasury made progress in laying the foundation to address certain long-standing material deficiencies in preparing the consolidated financial statements. Foremost is the ongoing development of a new system, the Governmentwide Financial Reporting System (GFRS), to collect agency financial statement information directly from federal agencies' audited financial statements rather than using federal agencies' Standard General Ledger data as Treasury had done in previous years to compile the consolidated financial statements. The goal of the new system is to be able to directly link information from federal agencies' audited financial statements to amounts reported in the consolidated financial statements, a concept that we strongly support. Once Treasury is able to achieve this, it would eliminate a major impediment to our being able to audit the consolidated financial statements.

For the fiscal year 2004 reporting process, Treasury's GFRS was able to capture certain agency financial information from agencies' audited financial statements, which is an important first step. The automated system, though, was not yet at the stage of development that it could be used to compile the consolidated financial statements from the information that was captured. Therefore, for fiscal year 2004, Treasury had to rely primarily on Excel spreadsheets and extensive manual procedures to prepare the consolidated financial statements. As discussed in our scope limitation section of this report, the federal government could not produce the fiscal year 2004 consolidated financial statements in time for us to complete all of our planned auditing procedures. In addition, for fiscal year 2004, 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). Specifically, during our fiscal year 2004 audit, we found the following:[25]

- Treasury's process for compiling the consolidated financial statements did not ensure that the information in these statements was fully consistent with the underlying information in federal agencies' audited financial statements and other financial data.

- Treasury's ability to timely prepare a complete set of consolidated financial statements was greatly impaired because in some cases the financial information provided by federal agencies to Treasury did not agree to the agencies' audited financial statements, causing Treasury to have to resort to last-minute, alternative methods to gather the needed information. These problems were compounded by Treasury's reliance on internal controls that were dependent on procedures that would attempt to identify any errors after they were made by an agency (detective controls) rather than implementation of internal controls that may have prevented or minimized the errors from occurring (preventive controls).

- Other internal control weaknesses existed in Treasury's process for preparing the consolidated financial statements, involving a lack of (1) segregation of duties, (2) appropriate documentation of certain policies and procedures for preparing the consolidated financial statements, (3) adequate support for adjustments made to the consolidated financial statements, and (4) required management reviews.

- Information system weaknesses existed within the segments of GFRS that were used during the fiscal year 2004 reporting process. We found that inappropriate access to GFRS was granted to certain Treasury personnel and that the GFRS database was not configured to prevent the alteration of data submitted by federal agencies and was used for both production and testing during the fiscal year 2004 reporting process.

- Treasury did not have the infrastructure to address the magnitude of the fiscal year 2004 financial reporting challenges it was faced with, such as an incomplete financial reporting system, compressed time frames for compiling the financial information,

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[25]Most of the issues we identified in fiscal year 2004 existed in fiscal year 2003, and some have existed for a number of years. In September 2004, we reported in greater detail on the issues we identified, in GAO, *Financial Audit: Process for Preparing the Consolidated Financial Statements of the U.S. Government Needs Further Improvement*, GAO-04-866 (Washington, D.C.: Sept. 10, 2004). This report includes about 140 recommendations to the federal government.

and inaccurate and incomplete information provided by certain federal agencies. 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 ensure accurate and reliable financial reporting by the accelerated reporting date. Nevertheless, a foundation for the future was put into place and a number of lessons were learned.

- To make the fiscal years 2004 and 2003 consolidated financial statements balance, Treasury recorded a net $3.4 billion increase and a net $24.5 billion decrease, respectively, to net operating cost on the Statements of Operations and Changes in Net Position, which it labeled "Unreconciled Transactions Affecting the Change in Net Position."[26] An additional net $1.2 billion and $11.3 billion of unreconciled transactions were recorded in the Statement of Net Cost for fiscal years 2004 and 2003, respectively. Treasury is unable to fully identify and quantify all components of these unreconciled activities.

- Treasury eliminated many intragovernmental activity and balances through accounting entries for fiscal year 2004 rather than "dropping" or "offsetting" the amounts as it has done in the past, which is a positive step. However, as discussed below, amounts reported for federal agency trading partners[27] for certain intragovernmental accounts were significantly out of balance, resulting in the need for unsupported intragovernmental elimination entries in order to force the Statement of Operations and Changes in Net Position into balance. Treasury's ability to eliminate certain intragovernmental activity and balances continues to be impaired by the federal agencies' problems in handling their intragovernmental transactions, which are noted below. In addition, significant differences in other intragovernmental accounts, primarily related to appropriations, have not been reconciled and still remain unresolved. Therefore, the federal government continues to be unable to determine the impact of unreconciled intragovernmental activity and balances to the consolidated financial statements.

- The federal government did not have an adequate process to identify and report items needed to reconcile the operating results, which for fiscal year 2004 showed a net operating cost of $615.6 billion, to the budget results, which for the same period showed a unified budget deficit of $412.3 billion. In addition, a net $23.2 billion "net amount of all other differences" was needed to force this statement into balance.

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[26]Although Treasury was unable to determine how much of the unreconciled transactions, if any, relate to operations, it reported unreconciled transactions as a component of net operating cost in the accompanying consolidated financial statements.
[27]Trading partners are U.S. government agencies, departments, or other components included in the consolidated financial statements that do business with each other.

- The consolidated financial statements include certain financial information for the executive, legislative, and judicial branches, to the extent that federal agencies within those branches have provided Treasury such information. However, there are 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 such excluded financial information was immaterial.

- Treasury did not have an adequate process to ensure that the financial statements, related notes, Stewardship Information, and Supplemental Information are presented in conformity with GAAP. For example, we found that certain financial information required by GAAP was not disclosed in the consolidated financial statements. Treasury did not provide us with documentation of its rationale for excluding this information. As a result of this and certain of the material deficiencies noted above, we were unable to determine if the missing information was material to the consolidated financial statements. In an effort to begin addressing this issue, we found that Treasury collected certain additional financial information required by GAAP in its new process for fiscal year 2004. However, due to the compressed time frames to compile the consolidated financial statements and because GFRS is still being developed, Treasury plans to analyze this information in fiscal year 2005 and determine how or whether to disclose this information in future years' consolidated financial statements.

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 fully perform the required reconciliations for fiscal years 2004 and 2003. For fiscal year 2004, based on trading partner information provided in 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. After analysis of the material differences, a significant number of CFOs cited differing accounting methodologies, accounting errors, and timing differences for their material differences with their trading partners. Many CFOs simply indicated that they were unable to explain the differences with their trading partners. For both fiscal years 2004 and 2003, amounts reported by federal agency trading partners for certain intragovernmental accounts were significantly out of balance. As a result, the federal government's ability to determine the impact of these differences on the amounts reported in the consolidated financial statements is impaired. Resolving the intragovernmental transactions problem remains a difficult challenge and will require a commitment by federal agencies and strong leadership and oversight by OMB.

Net Outlays—A Component of the Budget Deficit

OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements*, states that outlays in federal agencies' Statement of Budgetary Resources (SBR) should agree with the net outlays reported in the budget of the U.S. government. In addition, Statement of Federal Financial Accounting Standards No. 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, requires explanation of any material differences between the information required to be disclosed (including net outlays) in the financial statements and the amounts described as "actual" in the budget of the U.S. government.

The federal government reported in the Statement of Changes in Cash Balance from Unified Budget and Other Activities (Statement of Changes in Cash Balance) a budget deficit for fiscal year 2004 of $412.3 billion. The budget deficit is calculated by subtracting actual budget outlays from actual budget receipts.[28] In previous years, the Statement of Changes in Cash Balance reported actual budget outlays and actual budget receipts; however, for fiscal year 2004, the federal government chose not to disclose budget outlays and budget receipts in this financial statement and only included the budget deficit. As we reported for fiscal year 2003, we found $140 billion in differences between the total net outlays reported in selected federal agencies' audited SBRs and Treasury's central accounting records, which it uses to prepare the Statement of Changes in Cash Balance. Treasury again chose for fiscal year 2004 to use its central accounting records to prepare the Statement of Changes in Cash Balance without a process for identifying and resolving the differences between its central accounting records and net outlay amounts reported in the agencies' audited SBRs. For fiscal year 2004, while Treasury no longer disclosed this information in the Statement of Changes in Cash Balance, we again found material differences between the total net outlays reported in certain federal agencies' audited SBRs and the records Treasury used to prepare the Statement of Changes in Cash Balance totaling about $69 billion. In addition, we also noted reported internal control weaknesses regarding certain agencies' SBRs.

OMB's efforts in working with the agencies resulted in some notable improvements in reducing the approximately $140 billion of differences that we reported in fiscal year 2003 between the total net outlays reported in the federal agencies' SBRs and the Statement of Changes in Cash Balance. As we reported, two agencies, Treasury and the Department of Health and Human Services (HHS), accounted for about 83 percent of these differences. We found that the major cause of the differences for the two agencies

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[28]Receipts and net outlays (unified budget amounts) are also reported in governmentwide reports-specifically, in the President's Budget (annually); Treasury's Final Monthly Treasury Statement, as part of leading economic indicators on federal finances (quarterly); and Treasury's Annual Combined Statement of Receipts, Outlays, and Balances of the United States Government.

for fiscal year 2003 was the treatment of offsetting receipts.[29] Some offsetting receipts for these two agencies had not been included in the agencies' SBRs, which would have reduced the agencies' net outlays and made the amounts more consistent with Treasury's records used to prepare the Statement of Changes in Cash Balance. In fiscal year 2004, a major component of HHS restated its fiscal year 2003 net outlays in its SBR, and Treasury obtained a waiver from OMB exempting it from reporting certain offsetting receipts in its SBR totaling about $16.9 billion until further research is performed. However, about $75 billion of differences we found for fiscal year 2003 still remained unreconciled as of September 30, 2004.

Until the material differences between the total net outlays reported in the federal agencies' SBRs and the records used to prepare the Statement of Changes in Cash Balance are timely reconciled, the effect of these differences on the U.S. government's consolidated financial statements will be unknown.

[29]Offsetting receipts are collections that are credited to general fund, special fund, or trust fund receipt accounts and that offset gross outlays at the agency or governmentwide level.

APPENDIX III

Other Material Weaknesses

The federal government did not maintain effective internal control over financial reporting (including safeguarding assets) and compliance with laws and regulations as of September 30, 2004. In addition to the material deficiencies discussed in appendix II, we found the following four other material weaknesses in internal control.

Loans Receivable and Loan Guarantee Liabilities

Federal agencies continue to have material weaknesses and reportable conditions related to their lending activities. In fiscal year 2004, significant deficiencies in the processes and procedures used to estimate the costs of certain lending programs and value of loans receivable increased. While the Small Business Administration (SBA) made noteworthy progress to improve its cost estimation processes, additional improvements are still needed at SBA to fully resolve the deficiencies in the area so that reasonable estimates can be produced and audited in a timely manner. Further, this year at the Department of Housing and Urban Development (HUD), a new material weakness was reported. HUD lacked adequate management reviews of underlying data and cost estimation methodologies that resulted in material errors being undetected, and significant adjustments were needed. These material weaknesses at SBA and HUD, plus deficiencies at the Department of Agriculture and the Department of Education relating to the processes and procedures for estimating credit program costs, 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. Further, these weaknesses and the complexities associated with estimating the costs of lending activities greatly increase the risk that significant errors in agency and governmentwide financial statements could occur and go undetected.

Improper Payments

Across the federal government, improper payments occur in a variety of programs and activities, including those related to health care, contract management, federal financial assistance, and tax refunds.[30] Many improper payments occur in federal programs that are administered by entities other than the federal government, such as states and municipalities. Generally, improper payments result from a lack of or an inadequate system of internal control, but some result from program design issues. Federal agencies' estimates of improper payments based on available information for fiscal year 2004 exceeded $45 billion. This estimate could increase significantly over the next several years as agencies become more effective at estimating and reporting improper payment

[30]Improper payments include inadvertent errors, such as duplicate payments and miscalculations, payments for unsupported or inadequately supported claims, payments for services not rendered, payments to ineligible beneficiaries, and payments resulting from fraud and abuse by program participants and/or federal employees.

amounts for programs and activities that are susceptible to significant improper payments.[31]

Fiscal year 2004 represents the first full year that federal agencies were required to include the reports required by the Improper Payments Information Act of 2002 (IPIA)[32] in their Performance and Accountability Reports (PAR). IPIA raised improper payments to a new level of importance by requiring federal agencies to annually review all programs and activities and identify those that may be susceptible to significant improper payments. Federal agencies are to then estimate the annual amount of improper payments for those programs and activities identified as susceptible to significant improper payments. The law further requires federal agencies to report to the Congress the improper payment estimates and information on the actions the agency is taking to reduce the improper payments. The Office of Management and Budget (OMB) implementation guidance required that estimates and, if applicable, the corrective action report, be included in federal agencies' PARs beginning with fiscal year 2004.[33]

The OMB guidance also required 44 programs of 14 CFO Act agencies to report improper payment information in their fiscal year 2003 PARs. Last year, we reported that those 14 CFO Act agencies reported the required improper payment amounts for 29 of the 44 programs,[34] suggesting that despite the enhanced emphasis on improper payments and legislative reporting requirements, those agencies appeared to be struggling with estimating improper payment amounts for about one-third of their programs.

Our preliminary reviews of 29 federal agencies' fiscal year 2004 PARs further suggest that a number of agencies were not well positioned to meet the reporting requirements of IPIA. For example, while most agencies acknowledged the IPIA reporting requirements in their PARs, 8 of the 44 programs with previous reporting requirements as noted above indicated that they would be able to estimate and report on improper payments sometime within the next 4 years but could not do so now. Another 5 programs in 2 agencies with previous reporting requirements determined that improper payment amounts were insignificant for their programs. Further, 4 additional programs in 4 agencies with prior reporting requirements did not estimate improper payment amounts for their programs and were silent as to whether they would report estimates in future reports. Therefore, 32 of the 44 programs with previous reporting requirements reported estimates or reported that their improper payment amounts were insignificant in their fiscal year 2004 PARs.

Until all agencies develop and implement a systematic measurement of the extent of improper payments, the federal government cannot determine (1) the extent to which

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[31]OMB defines the term "significant improper payments" as "annual erroneous payments in the program exceeding both 2.5 percent of program payments and $10 million."
[32]Pub. L. No. 107-300, 116 Stat. 2350 (Nov. 26, 2002).
[33]OMB Memorandum M-03-13, *Improper Payments Information Act of 2002 (Public Law 107-300)* (Washington, D.C.: May 21, 2003).
[34]GAO, *Financial Management: Fiscal Year 2003 Performance and Accountability Reports Provide Limited Information on Governmentwide Improper Payments*, GAO-04-631T (Washington, D.C.: Apr. 15, 2004).

improper payments exist, (2) mitigation strategies and the appropriate amount of investments to reduce them, and (3) the success of efforts implemented to reduce improper payments.

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 information security and enactment of the Federal Information Security Management Act of 2002[35] and the Cyber Security Research and Development Act.[36] In addition, the administration has taken important actions to improve information security, such as integrating information security into the Executive Branch Management Scorecard.[37]

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,[38] an issue that has been reported in our financial statement audit reports for the past 7 years. Due to errors and delays in recording activity in taxpayer accounts, 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

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[35]Title III of the E-Government Act of 2002, Pub. L. No. 107-347, 116 Stat. 2899, 2946 (Dec. 17, 2002).
[36]Pub. L. No. 107-305, 116 Stat. 2367 (Nov. 27, 2002).
[37]The Executive Branch Management Scorecard highlights agencies' progress in achieving management and performance improvements embodied in the President's Management Agenda.
[38]GAO, *Financial Audit: IRS's Fiscal Years 2004 and 2003 Financial Statements*, GAO-05-103 (Washington, D.C.: Nov. 10, 2004).

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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Financial Statements of the United States Government for the Years Ended September 30, 2004, and September 30, 2003

Statements of Net Cost

These statements present the net cost of fiscal years 2004 and 2003 Government operations. 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 presented by department on an accrual basis, while the budget presents costs and revenues by obligations and outlays based on functions (for example, national defense or health) 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.

Because of their specific functions, most of the costs originally associated with the General Services Administration (GSA) and the Office of Personnel Management (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. $112.9 billion has been allocated out of OPM to the agencies. This represents health and pension benefits that are not reported in the individual agency statements. The interest on Treasury securities held by the public is part of the Department of the Treasury's (Treasury) responsibilities, but because of its importance, and the dollar amounts, it is reported separately in these statements. Net cost for Governmentwide reporting purposes includes GSA and 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.

Statements of Operations and Changes in Net Position

These statements report the results of Government 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 includes Federal Insurance Contributions Act (FICA)/Self-Employment Contributions Act (SECA) taxes and other taxes including payroll taxes collected from other agencies.

Excise taxes consist of taxes collected for various items, such as airline tickets, gasoline products, distilled spirits and imported liquor, tobacco, firearms, and others.

Miscellaneous earned revenues consist of earned revenues received from the public with virtually no associated cost. This category includes revenues generated by the Federal Communications Commission from the sale of spectrum licenses to promote open-air communication services to the public (spectrum auctions). It also includes rents and royalties on the Outer Continental Shelf Lands resulting from the leasing and development of mineral resources on public lands.

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.

Unreconciled Transactions Affecting the Change in Net Position

Unreconciled transactions are adjustments needed to bring the change in net position into balance due to unreconciled and unaccounted for differences in the consolidated financial statements. Refer to Note 16—Unreconciled Transactions Affecting the Change in Net Position 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.

Prior Period Adjustments

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—Change in Accounting Principle and Prior Period Adjustments 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.

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 basis 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. Reconciling items to (1) operating revenues include net accrual related to taxes receivable and (2) net cost of Government operations include items such as changes in liabilities for military, veteran and civilian benefits, as well as depreciation expenses on fixed assets and changes in environmental liabilities.

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 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.

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 2004 and 2003) are financed. A budget deficit is the result of 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 2004 and 2003, 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 issuance of student loans, required cash payments and contributed to the use of the surplus or deficit. 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.

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 (see Stewardship Information section), and the Government's sovereign powers to tax, regulate commerce, and set monetary policy.

Selected assets are highlighted in the Stewardship Information section of this report to demonstrate the Government's accountability for these assets. Stewardship assets include stewardship land and heritage assets.

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 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 disclosed in the Statements of Social Insurance in the Stewardship Information 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. The Stewardship Responsibilities section 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 taxes collected for specific use are 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 collections are 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—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.

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United States Government
Statements of Net Cost
for the Years Ended September 30, 2004, and September 30, 2003

(In billions of dollars)	Gross Cost 2004	Earned Revenue 2004	Net Cost 2004	Gross Cost 2003	Earned Revenue 2003	Net Cost 2003
Department of Defense[1,2]	672.1	22.3	649.8	562.2	12.5	549.7
Department of Health & Human Services[1,2]	583.9	33.4	550.5	542.3	29.7	512.6
Social Security Administration	534.9	2.6	532.3	512.6	0.3	512.3
Interest on Treasury Securities held by the public	158.3	-	158.3	156.8	-	156.8
Department of Agriculture[1,2]	84.1	7.6	76.5	95.0	10.7	84.3
Department of the Treasury[1,2]	79.2	4.0	75.2	79.0	2.6	76.4
Department of Education	63.9	4.8	59.1	59.0	5.0	54.0
Department of Labor	58.6	-	58.6	68.1	-	68.1
Department of Transportation[1,2]	56.7	0.6	56.1	63.3	1.2	62.1
Department of Veterans Affairs	51.1	3.2	47.9	175.7	2.1	173.6
Department of Housing and Urban Development	41.8	1.3	40.5	44.1	2.0	42.1
Department of Homeland Security	45.7	5.7	40.0	27.5	2.6	24.9
Department of Justice[1]	35.4	0.8	34.6	30.7	1.3	29.4
Department of Energy[1]	27.3	4.9	22.4	2.0	5.3	(3.3)
National Aeronautics and Space Administration	17.3	0.1	17.2	12.9	0.1	12.8
Department of the Interior	18.8	2.2	16.6	16.0	4.7	11.3
Pension Benefit Guaranty Corporation	16.9	3.9	13.0	12.3	1.2	11.1
Department of State	13.9	1.3	12.6	12.7	1.4	11.3
Agency for International Development	10.7	0.1	10.6	10.3	0.1	10.2
Railroad Retirement Board	9.3	-	9.3	9.6	-	9.6
Environmental Protection Agency	9.5	0.3	9.2	9.5	0.4	9.1
Office of Personnel Management	22.3	13.9	8.4	0.3	-	0.3
Department of Commerce[1]	9.1	1.4	7.7	8.8	1.3	7.5
Federal Communications Commission	7.6	0.8	6.8	7.1	1.2	5.9
National Science Foundation	5.2	-	5.2	4.8	-	4.8
Small Business Administration[2]	2.1	0.5	1.6	5.0	0.7	4.3
Federal Deposit Insurance Corporation	0.8	0.2	0.6	(0.2)	0.2	(0.4)
Nuclear Regulatory Commission	0.8	0.5	0.3	0.7	0.5	0.2
Tennessee Valley Authority[2]	8.6	8.3	0.3	8.0	7.0	1.0
National Credit Union Administration	0.2	0.1	0.1	0.2	0.5	(0.3)
General Services Administration[1]	-	0.5	(0.5)	0.8	0.3	0.5
Export-Import Bank of the United States[2]	1.3	2.7	(1.4)	(0.3)	0.3	(0.6)
U.S. Postal Service	54.0	68.0	(14.0)	81.5	67.6	13.9
All other entities	30.6	11.1	19.5	34.6	2.0	32.6
Total	2,732.0	207.1	2,524.9	2,652.9	164.8	2,488.1

[1] These agencies reorganized and transferred various programs and operations to the newly created Department of Homeland Security. The majority of the assets and expenses transferred were in fiscal year 2003, immaterial transfers have taken place in fiscal year 2004.
[2] 2003 numbers have been restated to reflect a change in presentation for immaterial prior period adjustments previously published as adjustments to net position.

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, 2004, and September 30, 2003

(In billions of dollars)	2004	2003
Revenue:		
Individual income tax and tax withholdings	1,512.3	1,481.3
Corporation income taxes	183.8	128.2
Unemployment taxes	36.8	31.2
Excise taxes	72.5	67.6
Estate and gift taxes	24.8	21.9
Customs duties	21.0	19.0
Other taxes and receipts	47.7	39.8
Miscellaneous earned revenues	13.8	7.0
Total revenue	1,912.7	1,796.0
Less net cost of Government operations[1]	2,524.9	2,488.1
Unreconciled transactions affecting the change in net position (Note 16)	(3.4)	24.5
Net operating cost	(615.6)	(667.6)
Net position, beginning of period	(7,094.2)	(6,820.2)
Change in accounting principle (Note 17)	-	383.1
Prior period adjustments (Note 17)	-	10.5
Net operating cost	(615.6)	(667.6)
Net position, end of period	(7,709.8)	(7,094.2)[1]

[1] 2003 numbers have been restated to reflect a change in presentation for immaterial prior period adjustments previously published as adjustments to net position.

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, 2004, and September 30, 2003

(In billions of dollars)	2004	2003
Net operating cost[1]	(615.6)	(667.6)
Components of Net Operating Cost Not Part of the Budget Deficit:		
Increase in Liability for Military Employee Benefits (Note 11):		
Increase in military pension liabilities	98.7	9.0
Increase in military health liabilities	42.3	91.0
Increase in other military benefits	2.4	1.1
Increase in liability for military employee benefits	143.4	101.1
Increase in Liability for Veterans Compensation and Burial Benefits (Note 11):		
(Decrease)/increase in liability for veterans	(39.7)	93.3
Increase in liability for survivors	9.6	12.5
Increase/(decrease) in liability for burial benefits	0.1	(0.2)
(Decrease)/increase in liability for veterans compensation	(30.0)	105.6
Increase in Liability for Civilian Employee Benefits (Note 11):		
Increase in civilian pension liabilities	39.8	60.6
Increase in civilian health liabilities	21.7	23.0
Increase in other civilian benefits	7.2	0.3
Increase in liability for civilian employee benefits	68.7	83.9
Decrease in Environmental Liabilities (Note 12):		
Decrease in energy's environmental liabilities	(1.7)	(26.2)
Increase in all others' environmental liabilities	1.0	3.1
Decrease in environmental liabilities	(0.7)	(23.1)
Depreciation expense	89.9	71.2
Property, plant, and equipment disposals and revaluations	0.2	13.0
Increase in benefits due and payable (Note 13)	2.9	4.7
(Decrease)/increase in taxes receivable (Note 5)	1.6	(1.5)
Increase in other liabilities (Note 14)	32.3	25.1
Seigniorage and sale of gold	(0.7)	(0.6)
(Decrease)/increase in accounts payable (Note 9)	(2.1)	6.4
Components of the Budget Deficit Not Part of Net Operating Cost:		
Capitalized Fixed Assets:		
Department of Defense	(83.2)	(67.5)
Civilian agencies	(28.9)	(34.5)
Total capitalized fixed assets	(112.1)	(102.0)
Increase in accounts receivable (Note 3)	(1.3)	(1.8)
Increase/decrease in inventory (Note 6)	(8.8)	17.5
Increase in other assets (Note 8)	(11.7)	(12.3)
Principal repayments of precredit reform loans	8.5	9.1
Net amount of all other differences	23.2	(3.5)
Unified budget deficit	(412.3)	(374.8)

[1] 2003 numbers have been restated to reflect a change in presentation for immaterial prior period adjustments previously published as adjustments to net position.

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, 2004, and September 30, 2003

(In billions of dollars)	2004			2003		
Unified budget deficit			(412.3)			(374.8)
Adjustments for Noncash Outlays Included in the Budget:						
Interest accrued by Treasury on debt held by the public		(145.6)			(143.3)	
Subsidy expense (Note 4)		6.6			11.8	
Items Affecting the Cash Balance Not Included in the Budget:						
Net Transactions from Financing Activity:						
Repayment of debt held by the public	4,379.5			3,914.7		
Borrowings from the public	(4,759.2)			(4,289.1)		
Total		(379.7)			(374.4)	
Net Transactions from Monetary Activity:						
Increase in special drawing rights	0.7			0.4		
Increase/(decrease) in other monetary assets	(1.3)			(26.5)		
Increase in loans to the IMF	(4.6)			3.2		
Total		(5.2)			(22.9)	
Net Transactions from Other Activities:						
Net direct loan activity	5.5			1.3		
Interest paid by Treasury on debt held by the public	144.7			144.4		
Net guaranteed loan activity	(16.7)			(5.8)		
Decrease in miscellaneous assets	0.5			(0.4)		
Increase in allocations of special drawing rights	(0.2)			(0.5)		
Increase in deposit fund balances	(2.9)			(2.8)		
(Increase)/Decrease in miscellaneous liabilities	(1.2)			7.1		
Seigniorage and other equity	(0.7)			(0.6)		
Reclassification of aged unreconciled accounts	-			0.1		
NRRIT non-Federal securities[1]	2.4			21.3		
Total		131.4			164.1	
Disposition of Deficit			(392.5)			(364.7)
Decrease in operating cash balance			(19.8)			(10.1)
Operating Cash: (Note 2)						
Operating cash balance beginning of period			50.8			60.9
Operating cash balance end of period			31.0			50.8

[1] For more information, see Railroad Retirement in the Stewardship Information section (page 90).

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

United States Government Balance Sheets as of September 30, 2004, and September 30, 2003

(In billions of dollars)	2004	2003
Assets:		
Cash and other monetary assets (Note 2)	97.0	119.6
Accounts receivable, net (Note 3)	35.1	33.8
Loans receivable, net (Note 4)	220.9	221.1
Taxes receivable, net (Note 5)	21.3	22.9
Inventories and related property, net (Note 6)	261.5	252.7[1]
Property, plant, and equipment, net (Note 7)	652.7	658.2
Other assets (Note 8)	108.8	97.1
Total assets	1,397.3	1,405.4
Liabilities:		
Accounts payable (Note 9)	60.1	62.2
Federal debt securities held by the public and accrued interest (Note 10)	4,329.4	3,944.9
Federal employee and veteran benefits payable (Note 11)	4,062.1	3,880.0
Environmental and disposal liabilities (Note 12)	249.2	249.9
Benefits due and payable (Note 13)	102.9	100.0
Loan guarantee liabilities (Note 4)	43.1	34.6
Other liabilities (Note 14)	260.3	228.0[1]
Total liabilities	9,107.1	8,499.6
Contingencies (Note 18) and Commitments (Note 19)		
Net position	(7,709.8)	(7,094.2)[1]
Total liabilities and net position	1,397.3	1,405.4

[1] Restated – See Note 17.

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

United States Government Stewardship Information (Unaudited) for the Years Ended September 30, 2004, and September 30, 2003

Stewardship Responsibilities

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, stewardship 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 and Medicare 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.

Statements of Social Insurance

These statements present estimates for several key indicators of the status of the Social Security, Medicare, Railroad Retirement, and Black Lung programs. The estimates are actuarial present values of cashflow projections as set forth in the relevant Trustees' reports and in the relevant agency performance and accountability reports for Railroad Retirement and Black Lung.[1] For example, for the OASDI program as of January 1, 2004, the present value of costs is projected to exceed the present value of cash income by $5,229 billion over the next 75-years. That is the amount that, if invested at the beginning of the period, together with interest earnings, would be just enough to cover excess costs over 75 years. The cashflow projections are analyzed in more detail in later sections. The estimates in the statements below 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. Refer to the footnotes at the bottom of these statements for the projection valuation date.

[1] Present values recognize that a dollar 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. The resulting present value is the amount that would have to be put in the bank today at the assumed interest rate to fund the future cashflows.

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

(In billions of dollars)	2004	2003	2002	2001	2000
Federal Old-Age, Survivors and Disability Insurance (Social Security):					
Contributions and Earmarked Taxes from:					
Participants who have attained age 62	411	359	348	309	266
Participants ages 15-61	14,388	13,576	13,048	12,349	11,335
Future participants (under age 15 and births during period)	12,900	12,213	11,893	11,035	10,088
All current and future participants	27,699	26,147	25,289	23,693	21,689
Expenditures for Scheduled Future Benefits for:					
Participants who have attained age 62	4,933	4,662	4,401	4,256	4,020
Participants ages 15-61	22,418	21,015	20,210	18,944	17,217
Future participants (under age 15 and births during period)	5,578	5,398	5,240	4,700	4,297
All current and future participants	32,928	31,075	29,851	27,900	25,534
Present value of future expenditures less future revenue	5,229[1]	4,927[2]	4,562[3]	4,207[4]	3,845[5]
Federal Hospital Insurance (Medicare Part A):					
Contributions and Earmarked Taxes from:					
Participants who have attained eligibility age	148	128	125	113	97
Participants who have not attained eligibility age	4,820	4,510	4,408	4,136	3,757
Future participants	4,009	3,773	3,753	3,507	3,179
All current and future participants	8,976	8,411	8,286	7,756	7,033
Expenditures for Scheduled Future Benefits for:					
Participants who have attained eligibility age	2,168	1,897	1,747	1,693	1,681
Participants who have not attained eligibility age	12,054	10,028	9,195	8,568	6,702
Future participants	3,246	2,653	2,470	2,225	1,349
All current and future participants	17,468	14,577	13,412	12,487	9,732
Present value of future expenditures less future revenue	8,492[1]	6,166[2]	5,126[3]	4,730[4]	2,699[5]
Federal Supplementary Medical Insurance (Medicare Part B):					
Premiums:					
Participants who have attained eligibility age	332	284	252	258	234
Participants who have not attained eligibility age	2,665	2,148	1,856	1,845	1,527
Future participants	891	688	600	593	404
All current and future participants	3,889	3,120	2,708	2,696	2,165
Expenditures for Scheduled Future Benefits for:					
Participants who have attained eligibility age	1,475	1,306	1,132	1,159	1,051
Participants who have not attained eligibility age	10,577	8,845	7,463	7,415	6,094
Future participants	3,277	2,622	2,238	2,206	1,514
All current and future participants	15,329	12,773	10,833	10,780	8,659
Present value of future expenditures less future revenue[6]	11,440[1]	9,653[2]	8,125[3]	8,084[4]	6,494[5]
Federal Supplementary Medical Insurance (Medicare Part D):					
Premiums:					
Participants who have attained eligibility age	176				
Participants who have not attained eligibility age	1,857				
Future participants	618				
All current and future participants	2,651				
Expenditures for Scheduled Future Benefits for:					
Participants who have attained eligibility age	773				
Participants who have not attained eligibility age	7,566				
Future participants	2,431				
All current and future participants	10,770				
Present value of future expenditures less future revenue[6]	8,119[1]				

	2004	2003	2002	2001	2000
Railroad Retirement:					
Contributions and Earmarked Taxes from:					
Participants who have attained eligibility	4	4	3	3	N/A
Participants who have not attained eligibility	37	40	40	41	N/A
Future participants	39	41	41	41	N/A
All current and future participants	80	85	83	84	N/A
Expenditures for Scheduled Future Benefits for:					
Participants who have attained eligibility	81	80	74	73	N/A
Participants who have not attained eligibility	72	73	76	74	N/A
Future participants	14	14	13	13	N/A
All current and future participants	167	167	162	161	N/A
Present value of future expenditures less future revenues[7]	87[1]	83[2]	79[3]	77[4]	N/A
Black Lung (Part C) *present value of future expenditures less future revenue*	(4)[8]	(4)[9]	(5)[10]	(4)[11]	(4)[12]

[1] The projection period is 1/1/2004 - 12/31/2078 and the valuation date is 1/1/2004.
[2] The projection period is 1/1/2003 - 12/31/2077 and the valuation date is 1/1/2003.
[3] The projection period is 1/1/2002 - 12/31/2076 and the valuation date is 1/1/2002.
[4] The projection period is 1/1/2001 - 12/31/2075 and the valuation date is 1/1/2001.
[5] The projection period is 1/1/2000 - 12/31/2074 and the valuation date is 1/1/2000.
[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 intragovernmental transfers are included as income in the 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 SSEB Account (see later discussion of Railroad Retirement program). They are included as income in the Railroad Retirement Financial Report but are not income from the Governmentwide perspective of this report.
[8] The projection period is 9/30/2004 - 9/30/2040 and the valuation date is 6/30/2004.
[9] The projection period is 9/30/2003 - 9/30/2040 and the valuation date is 6/30/2003.
[10] The projection period is 9/30/2002 - 9/30/2040 and the valuation date is 6/30/2002.
[11] The projection period is 9/30/2001 - 9/30/2040 and the valuation date is 6/30/2001.
[12] The projection period is 9/30/2000 - 9/30/2040 and the valuation date is 6/30/2000.
The "N/A" (not available) entries have not been calculated by the Railroad Retirement Board.

Note: Details may not add to totals due to rounding.

The following notes are an integral part of this statement.

Notes to the Statements of Social Insurance

Actuarial present values of the projections are computed based on the economic and demographic assumptions believed most likely to occur (the intermediate assumptions) as set forth in the relevant Trustees' reports and in the relevant agency performance and accountability reports for Railroad Retirement and Black Lung. The projections are based on the continuation of program provisions contained in current Social Security law.

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 participants in Medicare. Income for all programs is presented from a consolidated perspective. Interest payments and other intragovernmental transfers have been eliminated. For example, the Centers for Medicare & Medicaid Services' (CMS) 2004 Financial Report presents income from the trust fund's perspective, not a Governmentwide perspective. Therefore, CMS' Financial Report includes $11,440 billion for the present value of future transfers from the general fund of the Treasury to the Medicare Part B Account and $8,119 billion for the Medicare Part D Account that have been eliminated in this *Financial Report*. Expenditures include scheduled benefit payments and administrative expenses. The term "scheduled" is used to signify that projected benefits are 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 include births during the projection period and individuals below age 15 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 beginning-of-year trust fund balances in billions of dollars for the respective programs are shown in the following table.

Program	**2004**	**2003**	**2002**	**2001**	**2000**
Social Security	$1,531	$1,378	$1,213	$1,049	$896
Medicare					
Part A	$256	$235	$209	$178	$141
Part B	$24	$34	$41	$44	$45
Part D	N/A	N/A	N/A	N/A	N/A
Railroad Retirement	$26	$22	$21	$19	$17
Black Lung	($8)	($8)	($8)	($7)	($7)

The projection period for future participants covers the next 75 years for the Social Security and Medicare programs. The projection period for current participants (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.

For Social Security and Medicare, further information can be obtained from the Social Security Administration (SSA) (*The 2004 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds)* and from the Department of Health and Human Services (HHS) (*The 2004 Annual Report of the Boards of the Trustees of the Federal Hospital Insurance and the Federal Supplementary Medical Insurance Trust Funds)*.

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. 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 receipts 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 ($87,900 in 2004) that increases each year with economy-wide wages.

Since 1984, up to one-half of OASDI benefits has 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 50 percent of benefits is allocated to the OASDI Trust Funds and the rest is allocated to the Hospital Insurance (HI) Trust Fund.

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 Government 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.[2] 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 will pay for prescription drugs through the Part D account. Though the events that trigger benefit payments are quite similar, HI and SMI have very different earmarked financing structures. Like 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 income. 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.

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 about 25 percent of costs. As with HI, interest due on Treasury securities held in the SMI Trust Fund is credited to the fund, although in the case of SMI, this is quite small.

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.[3] 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.[4] 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 transfers make up roughly three-fourths of SMI program expenses. While the transfers currently support the Part B account, beginning in 2006 additional transfers will be made to the Part D account and are expected to comprise 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

[2] 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 will begin in 2006. As in the case of Medicare Part B, approximately three-quarters of revenues to the Part D account will come from general revenues. 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.

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

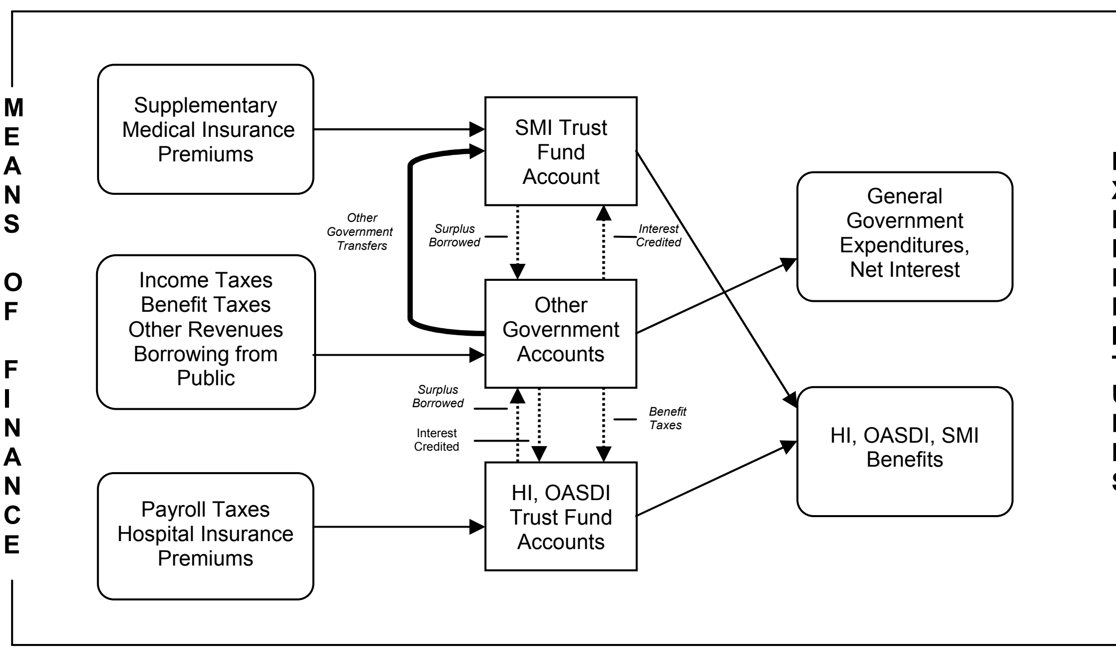
[4] Other programs also have dedicated revenues in the form of taxes and fees (and other forms of receipt) and there are a large number of earmarked trust funds in the Federal budget. Total trust fund receipts account for about 40 percent of total Government receipts with the Social Security and Medicare 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.

revenue comes into the Treasury. If general fund revenues become insufficient 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 that 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 2004. 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 ($81.4) and interest credits ($100.8) 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 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 such revenues ($165.2 billion) and total expenditures made to the public ($167 billion) was -$1.8 billion in 2004, indicating that HI had a relatively small negative 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 2004. The difference, -$104.2 billion, resulted in a net draw on the overall budget balance in that year. For OASDI, the difference between revenues from the public ($560.4 billion) and total expenditures was $64.9 billion in 2004, 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 that contain data from the respective trustees' reports. For HI, total revenues exceeded total expenditures by $13.8 billion in 2004, 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 $126.8 billion ($30.3 + $96.5), including $94.5 billion transferred from other Government accounts (the general fund), fell short of total expenditures by $7.7 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 $646.6 billion ($560.4 + $86.2), including interest and a small amount of other Government transfers, exceeded total expenditures of $495.5 billion by $151.1 billion.

Table 1
Annual Revenues and Expenditures for Medicare and Social Security Trust Funds and the Total Federal Budget, Fiscal Year 2004

(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	162.2	-	560.4	722.6	-	722.6
Premiums	3.0	30.3	-	33.3	-	33.3
Other taxes and fees	-	-	-	-	1,124.1	1,124.1
Total	165.2	30.3	560.4	755.9	1,124.1	1,880.0
Total expenditures to the public[2]	167.0	134.5	495.5	797.0	1,495.0	2,292.0
Net results for budget perspective	(1.8)	(104.2)	64.9	(41.1)	(370.9)	(412.0)
Revenues from Other Government Accounts:						
Transfers	0.6	94.5	-	95.1	(95.1)	-
Interest credits	15.0	1.9	86.2	103.1	(103.1)	-
Total	15.6	96.5	86.2	198.3	(198.3)	-
Net results for trust fund perspective	13.8	(7.7)	151.1	157.2	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 $412 was the total Federal deficit in fiscal year 2004.
[2] The OASDI figure includes $3.8 billion transferred to the Railroad Retirement Board for benefit payments.
Note: “N/A” indicates not applicable.

Cashflow Projections

Background

Economic and Demographic Assumptions. The Boards of Trustees[5] 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 Table 2 are generally referred to as the "intermediate assumptions," and reflect the Trustees' best estimate of expected future experience.

Table 2
Social Security and Medicare Demographic and Economic Assumptions

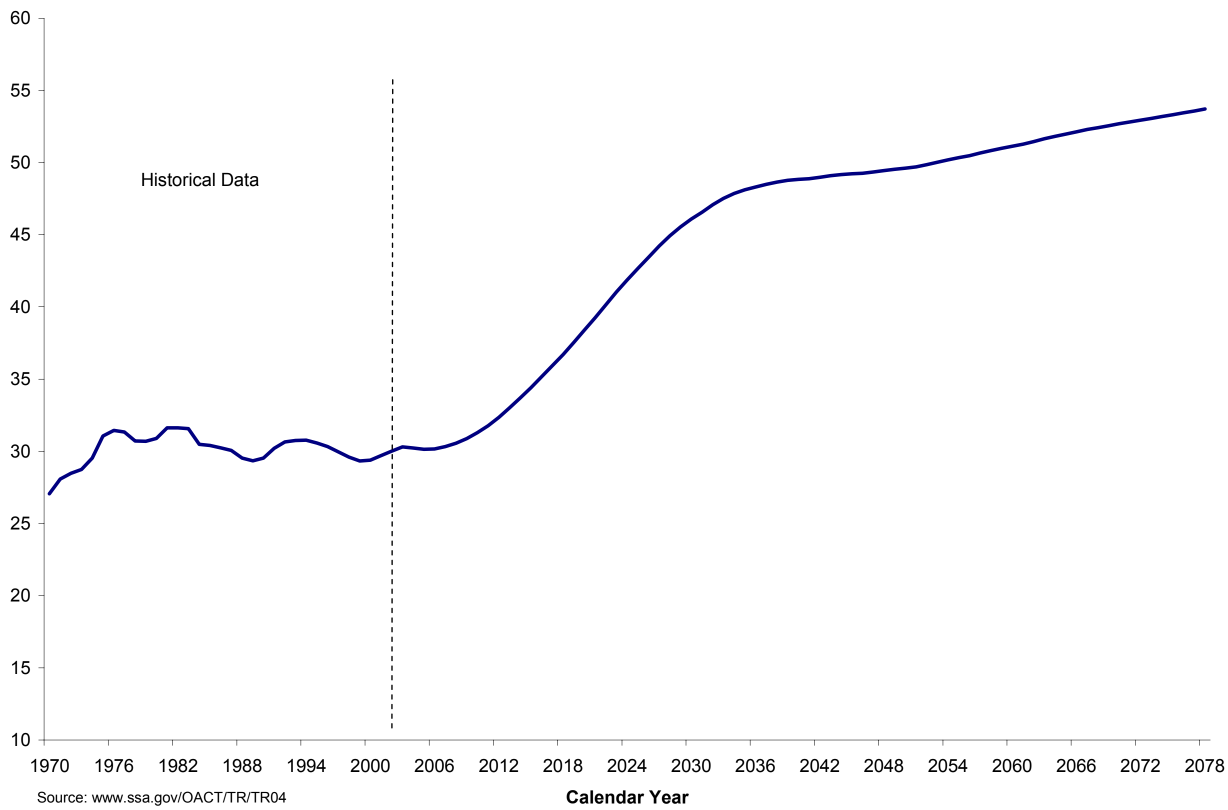
	Demographic Assumptions					Economic Assumptions			
Year	Total Fertility Rate[1]	Age-Sex Adjusted Death Rate[2]	Life Expectancy At Birth Male[3]	Life Expectancy At Birth Female[3]	Net Immi-Gration[4] (persons)	Productivity, total economy (percent change)	Real Wage Differential[5] (percent)	CPI[6] (percent change)	Average Annual Interest Rate[7] (percent)
2004	2.02	862.6	74.5	79.6	1,175,000	2.7	2.4	1.2	4.4
2005	2.01	858.4	74.7	79.6	1,150,000	1.8	2.8	1.5	4.8
2010	2.00	831.0	75.3	80.0	1,025,000	1.7	1.3	2.8	5.9
2020	1.97	766.8	76.3	80.8	950,000	1.6	1.1	2.8	5.8
2030+	1.95	706.9	77.4	81.7	900,000	1.6	1.0	2.8	5.8

[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 1.95 is assumed to be reached in 2028.
[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. Note that after 2030, the death rate continues to fall, to 497.2 by 2080.
[3] 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. Life expectancy continues to increase, to 81.6 for males and 85.3 for females by 2080.
[4] 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.
[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. The ultimate real wage differential eventually trends upwards to an ultimate value of 1.1.
[6] The CPI is the annual average value for the calendar year of the CPI for urban wage earners and clerical workers.
[7] 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.

[5] 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. The two current public trustees are John Palmer, Syracuse University, and Thomas Saving, Texas A&M University. Palmer and Saving began their term on 10/28/2000.

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 2003, 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 2003; 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—Beneficiaries per 100 Covered Workers 1970-2078

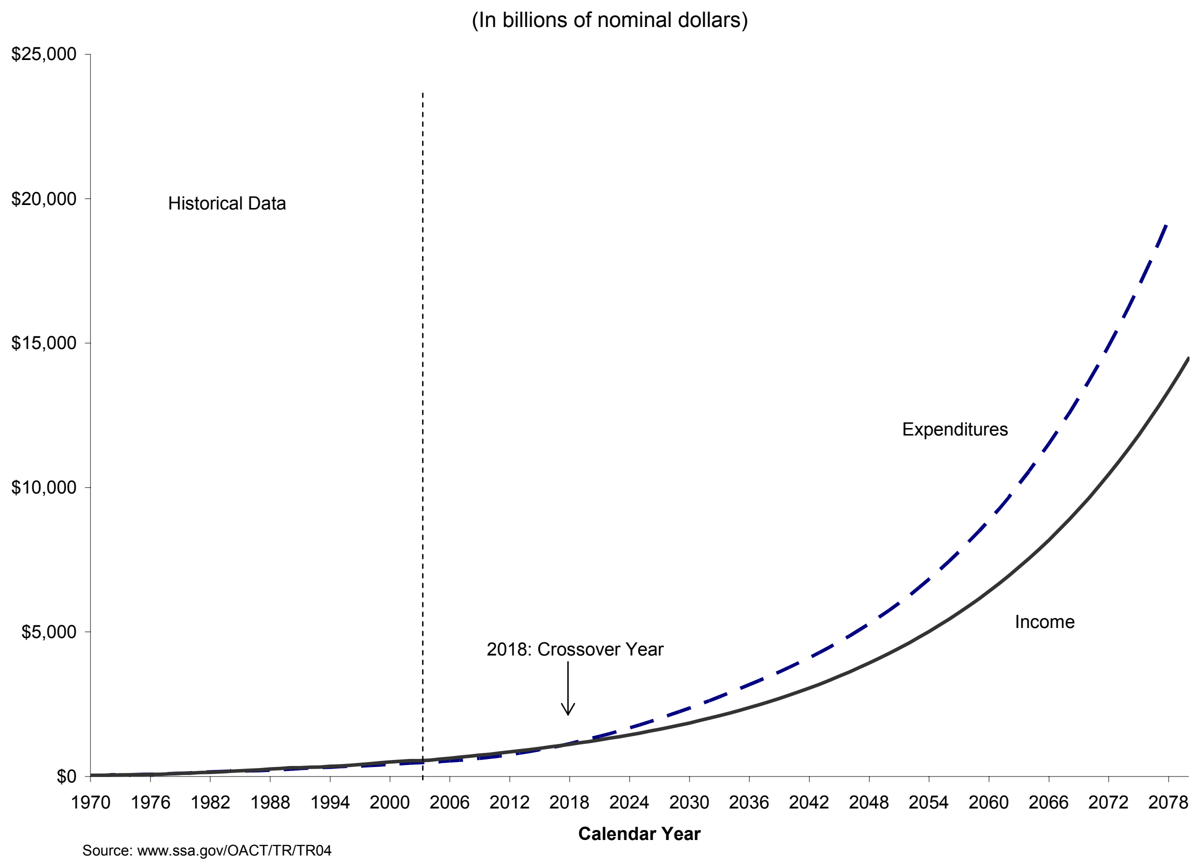


Source: www.ssa.gov/OACT/TR/TR04

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 1970-2078 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 1970-2078

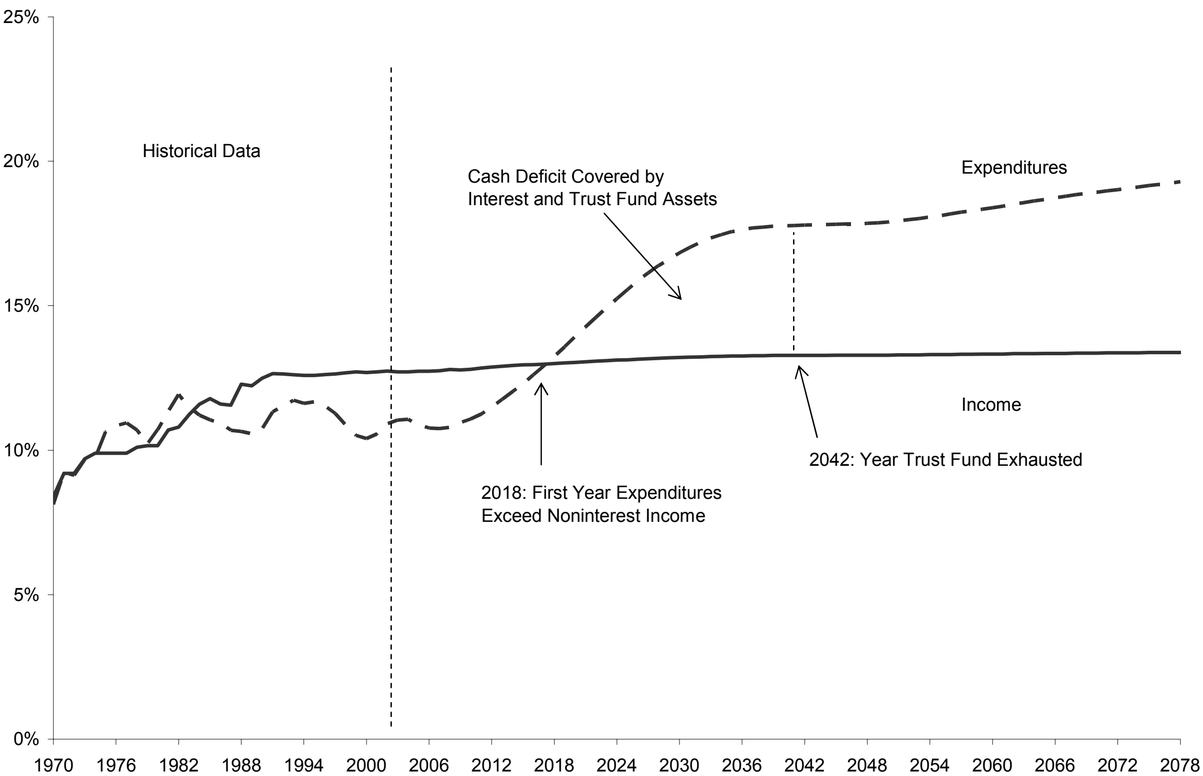


Currently, Social Security tax revenues exceed benefit payments and will continue to do so until 2018, when revenues are projected to fall below benefit payments, after which the gap between expenditures and revenues continues to widen.

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 2018, producing cashflow deficits thereafter. As described above, surpluses that occur prior to 2018 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 2018, 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 2042, 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 73 percent of scheduled benefits after trust fund exhaustion in 2042 and 68 percent of scheduled benefits in 2078.

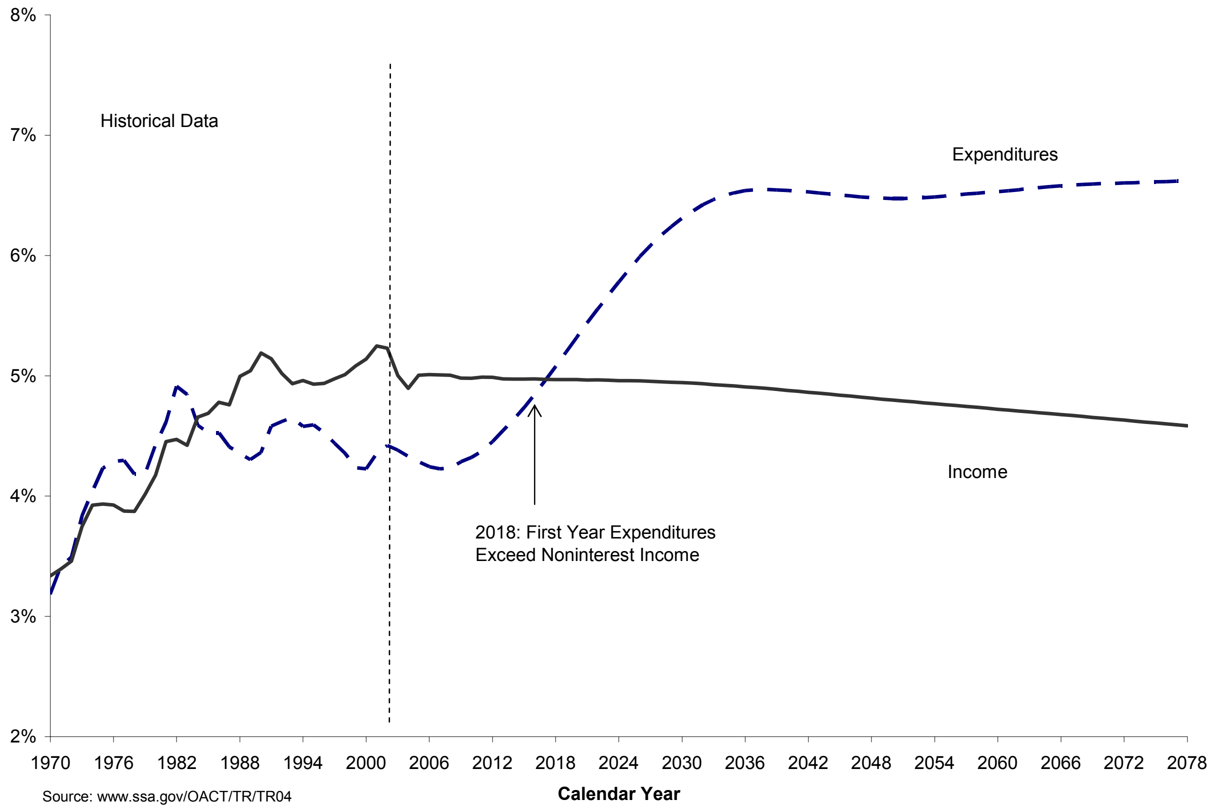
Chart 3—OASDI Income (Excluding Interest) and Expenditures as a Percent of Taxable Payroll 1970-2078



Source: www.ssa.gov/OACT/TR/TR04

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 growing as a share of GDP and income declining slightly relative to GDP. Social Security's expenditures are projected to grow from 4.4 percent of GDP in 2003 to 6.5 percent by 2033 and to 6.6 percent by 2078. In 2078, expenditures are projected to exceed income by 2 percent of GDP.

Chart 4—OASDI Income (Excluding Interest) and Expenditures as a Percent of GDP 1970-2078



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 sensitivy with respect to variation in real wages, income and expenditures are projected using the intermediate assumptions and comparing the outcome when projections are done by changing only the real wage asssumption 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 3 shows the effects of changing various 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 $5,229 billion to $3,983 billion, a 24 percent smaller shortfall. The high cost death rate assumption (1.28 percent) results in an increase in the shortfall, from $5,229 billion to $6,738 billion, a 29 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 1.95 to 2.2 results in a 10 percent smaller shortfall (i.e., expenditures less income), from $5,229 billion to $4,707 billion.

Higher real wage growth results in faster income growth relative to expenditure growth. Table 3 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 $5,229 billion to $4,429 billion, a 15 percent decline.

The CPI change assumption operates in a somewhat counterintuitive manner, as seen in Table 3. 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 $5,229 billion to $5,612 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 an 8 percent drop in the shortfall, from $5,229 billion to $4,813 billion, relative to the intermediate case; and the high-cost assumption results in a 6 percent higher shortfall.

Finally, Table 3 shows the sensitivity of the shortfall to variations in the real interest rate or, in present value terminology, the sensitivity to alternative discount rates. A higher discount rate reduces future values relative to a lower rate. As seen in the table, the shortfall is $1,404 billion lower (27 percent lower) if the real interest rate is 3.7 percent rather than 3 percent and $2,280 billion higher (44 percent higher) if the real interest rate is 2.2 percent rather than 3 percent.

Table 3
Present Values of Estimated OASDI Expenditures in Excess of Income Under Various Assumptions, 2004-2078

(In billions of dollars)

Assumption	Low Cost (Alternative I)	Intermediate (Alternative II)	High Cost (Alternative III)
Average annual reduction in death rates ..	3,983 (0.30)	5,229 (0.72)	6,738 (1.28)
Total fertility rate	4,707 (2.2)	5,229 (1.95)	5,757 (1.7)
Real wage differential	4,429 (1.6)	5,229 (1.1)	5,795 (0.6)
CPI change	5,612 (1.8)	5,229 (2.8)	4,839 (3.8)
Net immigration	4,813 (1,300,000)	5,229 (900,000)	5,526 (672,500)
Real interest rate	3,825 (3.7)	5,229 (3.0)	7,509 (2.2)

Source: 2004 OASDI Trustees Report and SSA. Numbers in parentheses are the values of the assumptions used in the respective scenario.

Medicare Projections

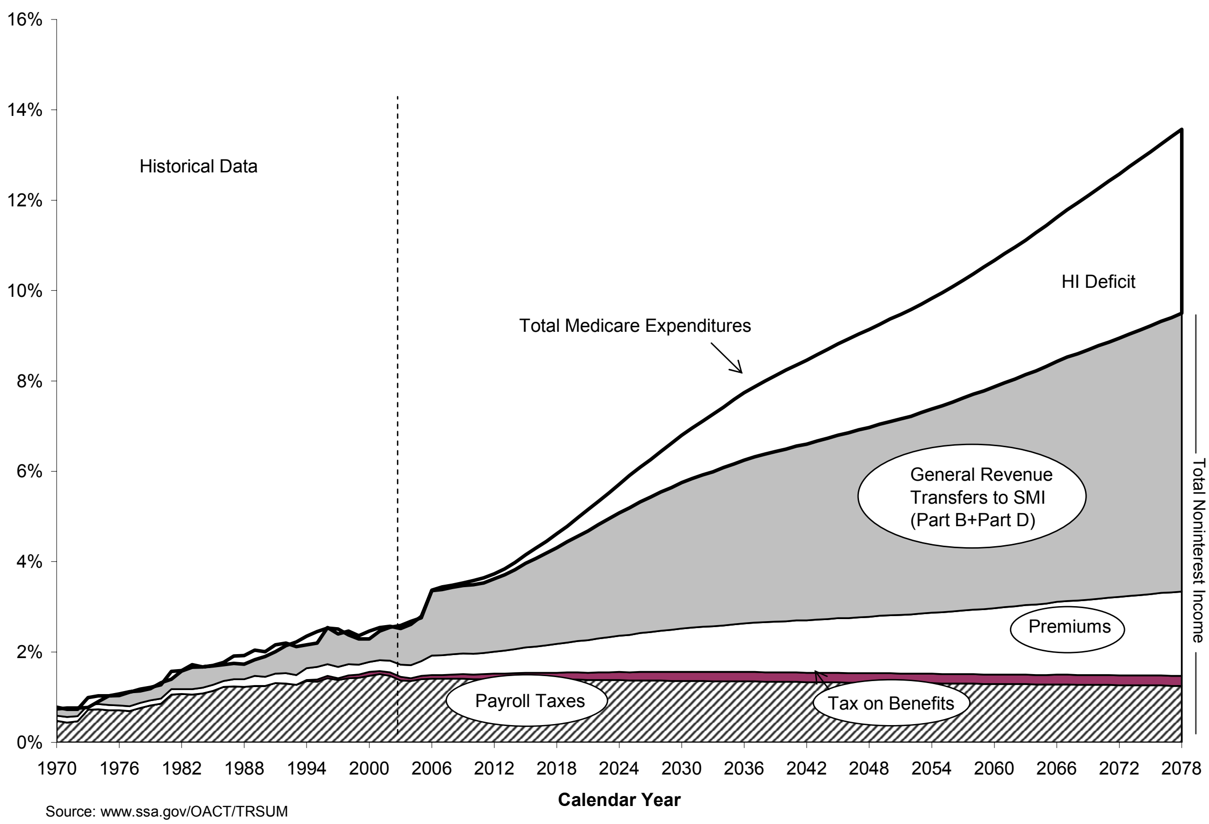
Recent Medicare Legislation. On December 8, 2003, President Bush signed into law the Medicare Prescription Drug, Improvement, and Modernization Act of 2003. The 2003 law will have a major impact on the operations and finances of Medicare. The law adds a prescription drug benefit to Medicare beginning 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 will be 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 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 almost 14 percent of GDP by 2078. Revenues from taxes and premiums (i. e., revenue from the public) are expected to increase from 1.7 percent of GDP in 2003 to only 3.3 percent of GDP in 2078. Payroll tax income declines gradually as a percent of GDP as growth in the number of workers paying such taxes slows, 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 0.8 percent to 6.2 percent over the same period. Thus, revenues from taxes and premiums will fall substantially as a share of total noninterest Medicare income (from 68 percent in 2003 to 34 percent in 2078) while general revenues will rise (from 32 percent to 63 percent). The gap between total noninterest Medicare income (including general revenue contributions) and expenditures begins around 2006 and then steadily continues to widen, reaching 4.1 percent of GDP by 2078.

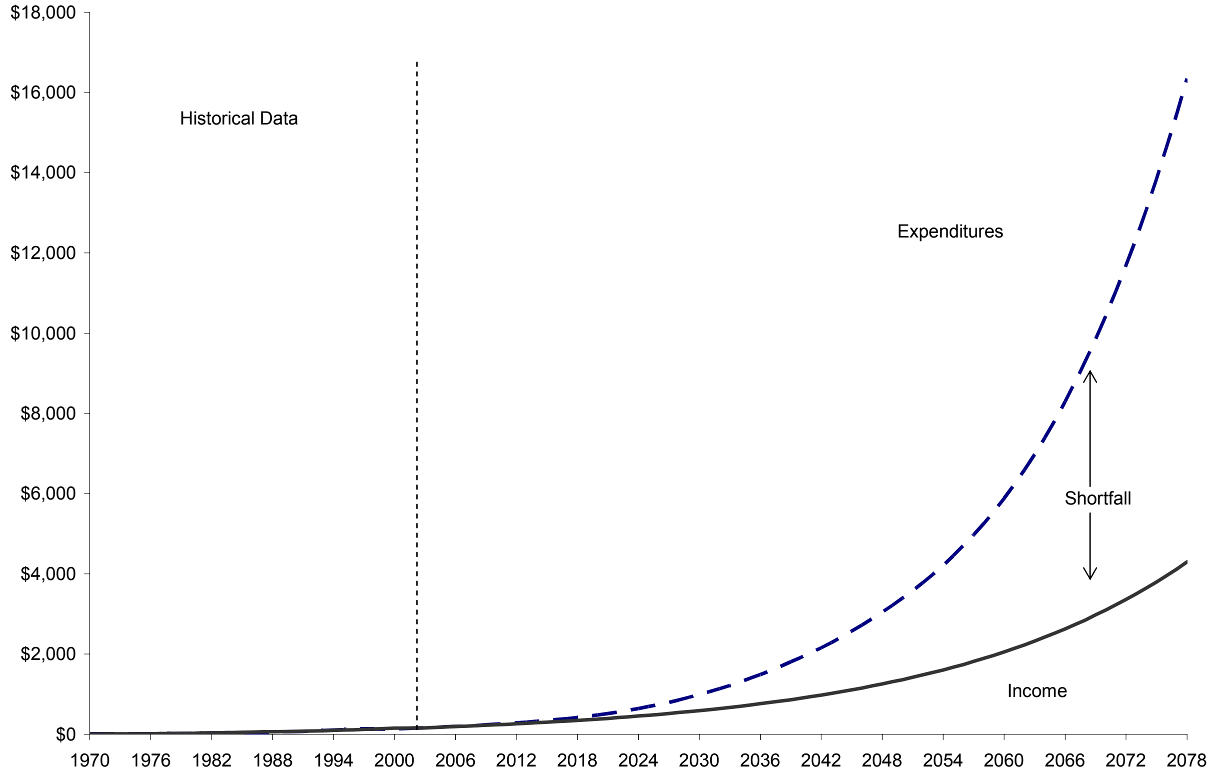
Chart 5—Total Medicare (HI and SMI) Expenditures and Noninterest Income as a Percent of GDP 1970-2078



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 1970-2078 in nominal dollars. The estimates are for the open-group population. The figure reveals a widening gap between income and expenditures after 2004.

Chart 6—Medicare Part A Income (Excluding Interest) and Expenditures 1970-2078

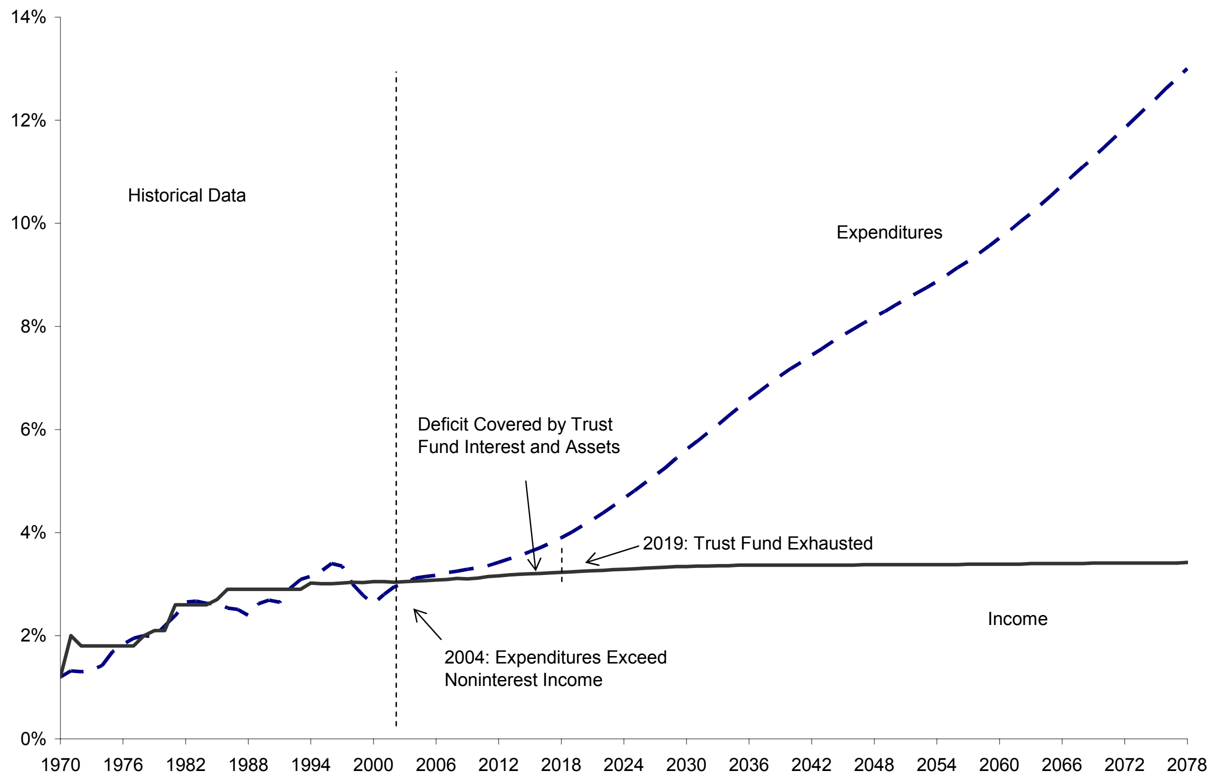
(In billions of nominal dollars)



Source: www.cms.hhs.gov/publications/trusteesreport/2004

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 income rate exceeds the expenditure rate beginning in 2004, and cash deficits continue thereafter. Trust fund interest earnings and assets provide enough resources to pay full benefit payments until 2019 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 2019. Present tax rates would be sufficient to pay 73 percent of scheduled benefits after trust fund exhaustion in 2019 and 30 percent of scheduled benefits in 2078.

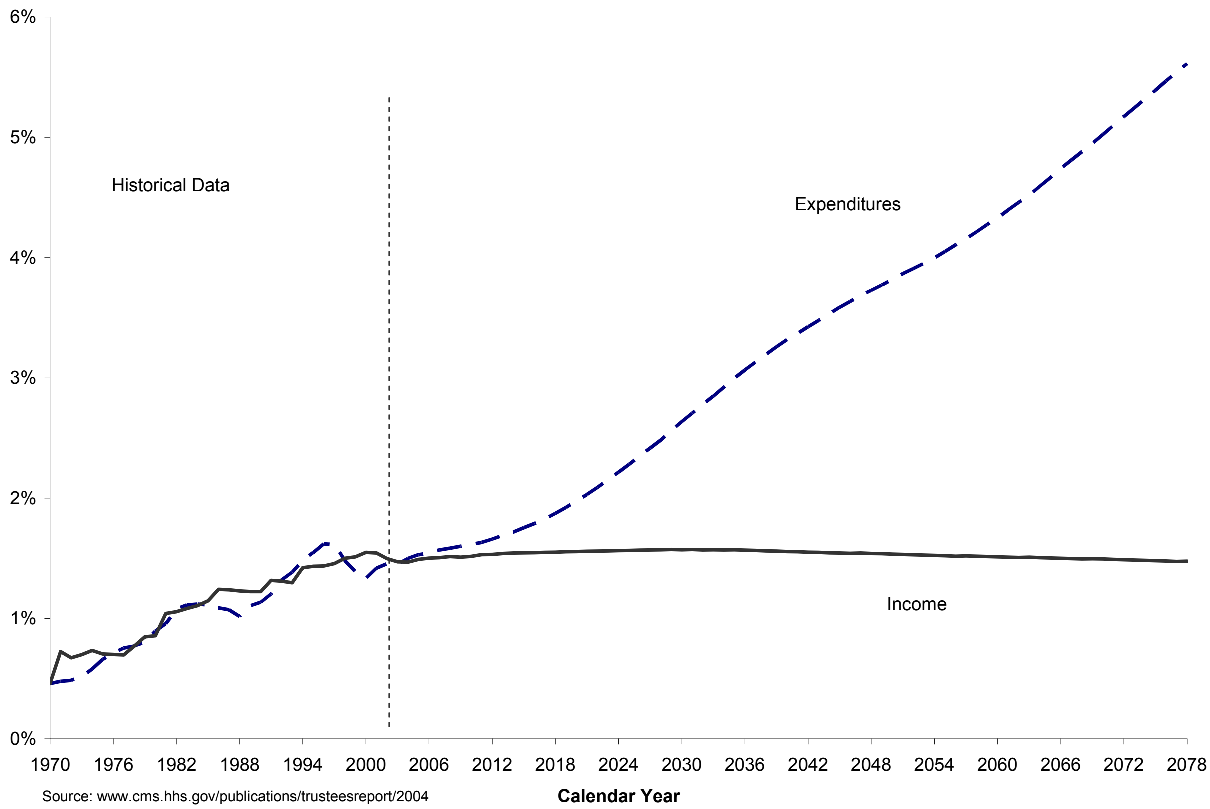
Chart 7—Medicare Part A Income (Excluding Interest) and Expenditures as a Percent of Taxable Payroll 1970-2078



Source: www.cms.hhs.gov/publications/trusteesreport/2004

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 2003 to 2.9 percent in 2033 and to 5.6 percent by 2078. The gap between expenditures and income widens continuously with expenditures growing as a share of GDP and income declining slightly relative to GDP. By 2078, expenditures are projected to exceed income by 4.1 percent of GDP.

Chart 8—Medicare Part A Income (Excluding Interest) and Expenditures as a Percent of GDP 1970-2078

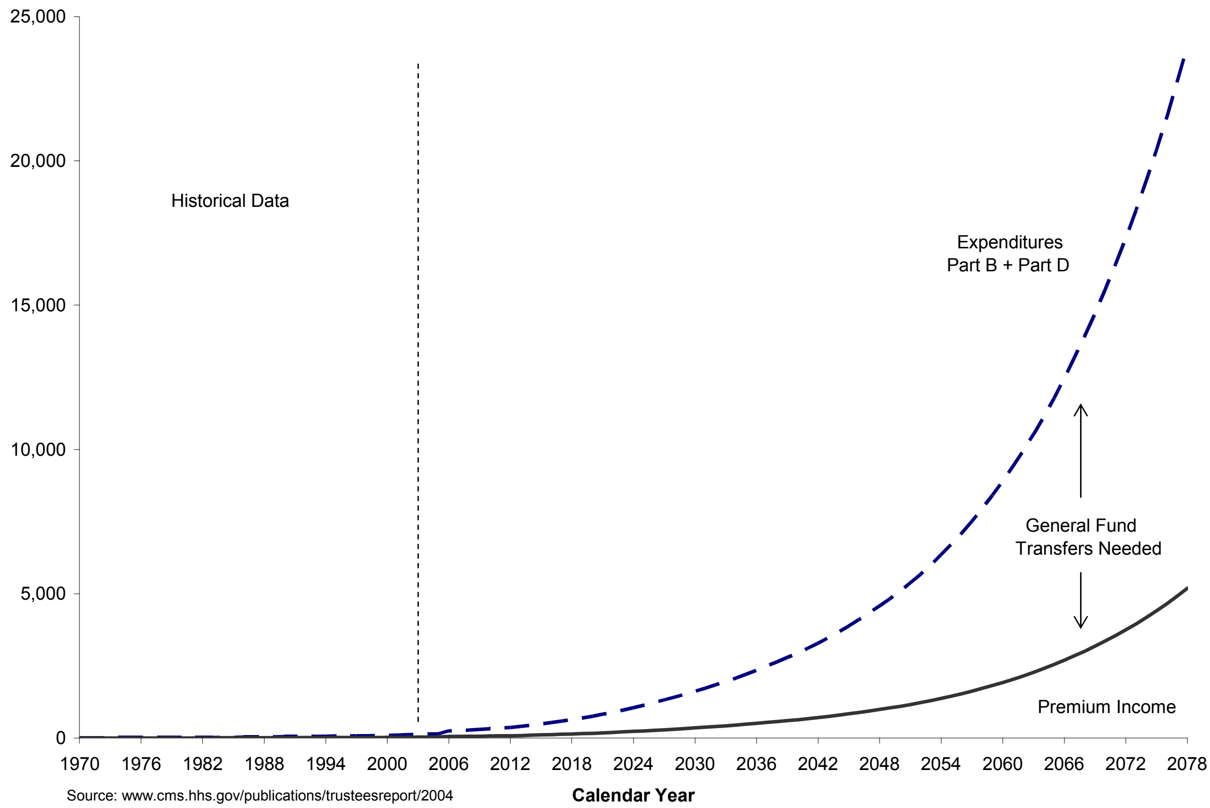


Source: www.cms.hhs.gov/publications/trusteesreport/2004

Medicare, Parts B and D (Supplementary Medical Insurance). Chart 9 shows historical and actuarial estimates of Medicare Part B and Part D premiums and expenditures for each of the next 75 years, in nominal dollars. The gap between premiums and 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 Income and Expenditures 1970-2078

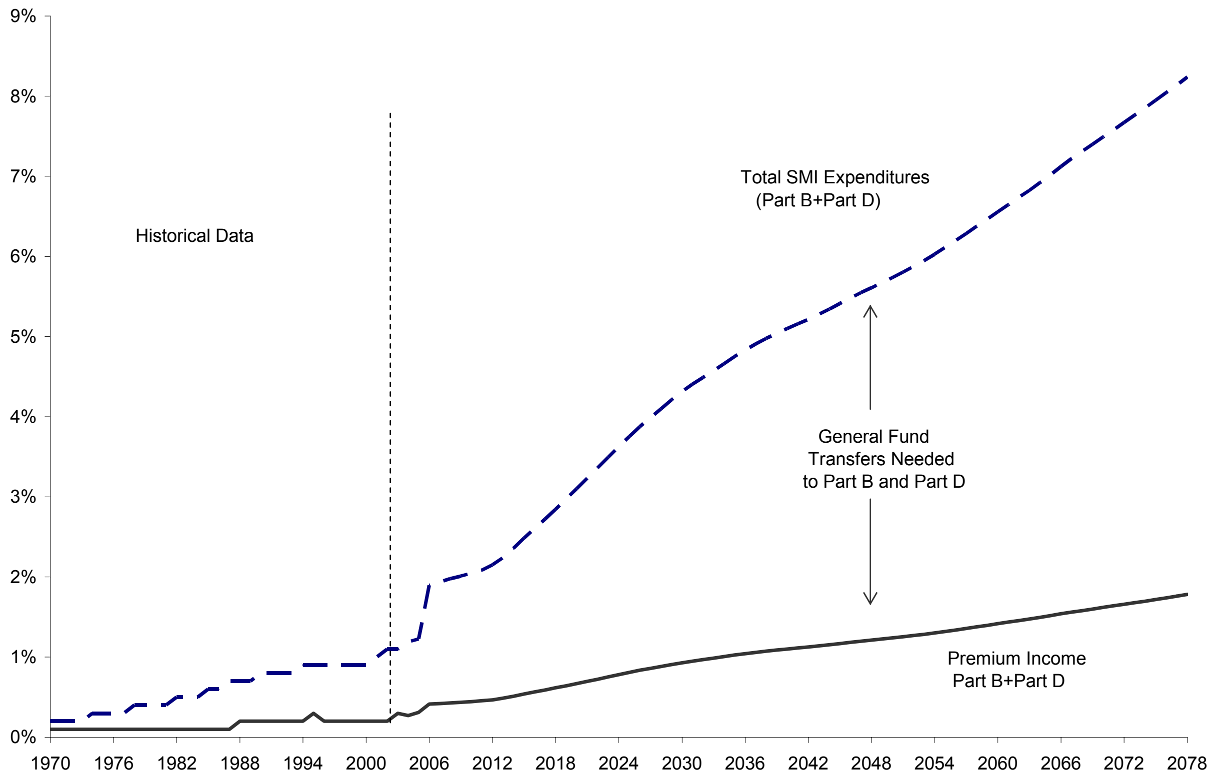
(In billions of nominal dollars)



Source: www.cms.hhs.gov/publications/trusteesreport/2004

Medicare Part B and Part D Premium 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 2003, SMI expenditures were $120 billion, which was 1.1 percent of GDP. After 2005, this percentage is projected to increase steadily reaching 8.2 percent in 2078. 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 income grows from under 0.3 percent in 2003 to 1.8 percent of GDP in 2078, so the portion financed by general fund transfers to SMI is projected to be about 78 percent throughout the projection period.

Chart 10—Medicare Part B and Part D Premium Income and Expenditures as a Percent of GDP 1970-2078



Source: www.cms.hhs.gov/publications/trusteesreport/2004

Medicare Sensitivity Analysis. This section presents estimates that illustrate the sensitivity of long-range cost and income long-range 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 4 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 $8,492 billion to $2,990 billion, a 65 percent smaller shortfall. The high cost assumption results in a more than doubling of the shortfall, from $8,492 billion to $17,531 billion.

Variations in the next four assumptions in Table 4 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. Higher (lower) real wage growth results in about an 8 percent (6 percent) change in the expenditure shortfall and CPI changes have very little effect on net HI expenditures. Similarly, net immigration has very little impact (the data for the low-cost alternatives for CPI and net immigration are the same by coincidence). Higher immigration increases the net shortfall modestly as higher payroll tax revenue is more than offset by higher medical care expenditures.

Table 4 also shows that net HI expenditures are 29 percent lower if the real interest rate is 3.7 percent rather than 3 percent and 44 percent higher if the real interest rate is 2.1 percent rather than 3 percent.

Table 4
Present Values of Estimated Medicare Part A Expenditures in Excess of Income Under Various Assumptions, 2004-2078

(In billions of dollars)

Assumption[1]	Low Cost	Intermediate	High Cost
Average annual growth in health costs[2]	2,990 (note 2)	8,492 (note 2)	17,531 (note 2)
Total fertility rate[3]	8,350 (2.2)	8,492 (1.95)	8,639 (1.7)
Real wage differential	7,974 (1.6)	8,492 (1.1)	9,155 (0.6)
CPI change	8,316 (3.8)	8,492 (2.8)	8,525 (1.8)
Net immigration	8,299 (672,500)	8,492 (900,000)	8,525 (1,300,000)
Real interest rate	6,054 (3.7)	8,492 (3.0)	12,231 (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 in 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 5 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.[6] 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 growth in health costs causes the shortfall in Part B to drop from $11,440 billion to $7,921 billion and in Part D from $8,119 to $5,703, about a 30 percent difference in each case. The high cost assumption results in a shortfall of $16,959 billion for Part B and $11,924 billion for Part D, just under a 50 percent increase in each case.

Table 5
Present Values of Estimated Medicare Parts B and D Future Expenditures Less Premium Income Under Various Health Care Cost Growth Assumptions, 2004-2078

(In billions of dollars)

Medicare Program[1]	Low Cost (Alternative I)	Intermediate (Alternative II)	High Cost (Alternative III)
Part B	7,921	11,440	16,959
Part D	5,703	8,119	11,924

[1] 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 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 2004 Medicare Trustees Report, the HI Trust Fund is projected to remain solvent until 2019 and, according to the 2004 Social Security Trustees Report, the OASDI Trust Funds are projected to remain solvent until 2042. 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 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 6 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 Statement of Social Insurance. For HI, revenues from the public are projected to fall short of total expenditures by $8,492 billion in present value terms.[7] From the budget or Governmentwide perspective, that is the additional amount needed in order to pay scheduled benefits over the next 75 years. From the trust fund perspective, the amount needed is smaller by 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 are $11,440 billion less than total expenditures for the Part B account and $8,119 billion less for the Part D account, amounts that, from a budget perspective, will be needed to keep the program solvent for the next 75 years. From the trust fund perspective,

[6] The SMI sensitivity analysis should cover the same set of assumptions as the HI sensitivity analysis. Next year's report is expected to satisfy this requirement.
[7] Interest income is not a factor in this table as dollar amounts are in present value terms.

however, the present values of total revenues and total expenditures for the SMI program are equal.[8] For OASDI, revenues from the public fall short of total expenditures by $5,229 billion in present value dollars and, from the trust fund perspective, by $3,699 billion.

From the Governmentwide perspective, the present value of the total resources needed for the Social Security and Medicare programs equals $33,280 billion. These resources needed from the budget are in addition to payroll taxes, benefit taxes, and premium payments. From the trust fund perspective, which counts the trust funds and the general revenue transfers to the SMI program as dedicated funding sources, in order to meet projected costs for the next 75 years the three programs will require additional resources of $11,910 billion in present value terms, beyond the $19,559 billion in present value of required general revenue transfers to the SMI program and $1,811 billion to honor the trust fund investments in Treasury securities.

Table 6
Present Values of Revenue and Cost Components of 75-Year Open Group Obligations HI, SMI, and OASDI

(In billions of dollars, as of January 1, 2004)

		SMI			
	HI	**Part B**	**Part D**	**OASDI**	**Total**
Revenues from the Public:					
Taxes	8,976	-	-	27,699	36,675
Premiums, State transfers	-	3,889	2,651	-	6,540
Total	8,976	3,889	2,651	27,699	43,215
Total costs to the public	17,468	15,329	10,770	32,928	76,495
Net results for Government-wide (budget) perspective	(8,492)	(11,440)	(8,119)	(5,229)	(33,280)
Revenues from other Government accounts	-	11,440	8,119	-	19,559
Trust fund in 1/1/2004	256	24	-	1,531	1,811
Net results for trust fund perspective	(8,236)	24	-	(3,699)	(11,910)

Source: 2004 OASDI and Medicare Trustees' Reports.

Infinite Horizon

The 75-year horizon represented in Table 6 is consistent with the primary focus of the Social Security and Medicare Trustees' Reports. For the OASDI program, for example, an additional $5.2 trillion in present value will be needed above currently scheduled taxes to pay for scheduled benefits ($3.7 trillion from the trust fund perspective). Yet, a 75-year projection is incomplete. 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 complete estimate of the long-run unfunded obligations of the programs, estimates should 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 7 for the three trust funds represented in Table 6.

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

From the budget or Governmentwide perspective, the values in line 1 plus the values in line 4 of Table 7 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 needed for all the programs sums to nearly $74 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 2004. 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 $21.8 trillion and $10.4 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 expenditures in the SMI program ($23.2 trillion + $16.5 trillion) represents future general revenue obligations of the Federal budget.

In comparison to the analogous 75-year number in Table 6, extending the calculations beyond 2078 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 7
Present Values of Expenditures Less Tax and Premium Revenue through the Infinite Horizon, HI, SMI, OASDI

		SMI			
(In trillions of dollars)	**HI**	**Part B**	**Part D**	**OASDI**	**Total**
Present value of future expenditures less future taxes and premiums for current participants	14.2	9.1	6.2	12.7	42.2
Less current trust fund	0.3	-	-	1.5	1.8
Equals net obligations for past and current participants	14.0	9.1	6.2	11.2	40.5
Plus net obligations for future participants	7.8	14.1	10.3	(0.8)	31.4
Equals net obligations through the infinite future for all participants	21.8	23.2	16.5	10.4	71.9
Present value of future expenditures less the present value of future income over the infinite horizon (line 2 + line 5)	22.1	23.2	16.5	11.9	73.7

Source: 2004 OASDI and Medicare Trustees' Reports.

Railroad Retirement, Black Lung, and Unemployment Insurance

Railroad Retirement

Railroad retirement pays full retirement annuities at age 60 to 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 Social Security beneficiaries. The Railroad Retirement and Survivors Improvement Act of 2001 (RRSIA), enacted into law on December 21, 2001, 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 Railroad Retirement Board (RRB) and 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 provide 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 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). The financial interchange is a significant source of income from a trust fund perspective. This transaction between railroad'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 is intended to put the three trust funds in the same position they would have been had railroad employment been covered under the Social Security Act. From a Governmentwide (budget) perspective, the financial interchange is an intragovernmental transfer.

Investments are also an important source of income for the Railroad Retirement and Survivors Benefit program. Provisions in RRSIA modified the manner in which this income is generated. Amounts in the Railroad Retirement Account and the SSEB Account not needed to pay current benefits and administrative expenses are transferred to the National Railroad Retirement Investment Trust (NRRIT). NRRIT's Board[9] of seven 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.

The sole purpose of the NRRIT is to manage and invest railroad retirement assets. Since its inception, NRRIT has received $21.3 billion from RRB (including $19.2 billion in fiscal year 2003, pursuant to RRSIA) and returned $1.9 billion. During fiscal year 2004, the NRRIT made net transfers of $1.564 billion to the RRB to pay retirement benefits. Administrative expenses of the trust are paid out of trust assets.

Cashflow Projections

Economic and Demographic Assumptions. The economic assumptions include a cost-of-living increase of 3 percent, an interest rate of 8 percent, and a wage increase of 4 percent. The demographic assumptions include rates of mortality and total termination rates, remarriage rates for widows, retirement rates, and withdrawal rates. For details on the demographic assumptions and other assumptions, refer to the Railroad Retirement System Annual Report, June 2004 and the 22nd Actuarial Valuation of the Assets and Liabilities under the Railroad Retirement Acts as of December 31, 2001, with Technical Supplement.

The average railroad employment is assumed to be 218,000 in 2004. The employment assumption, based on a model developed by the Association of American Railroads, assumes that (1) passenger employment will remain at

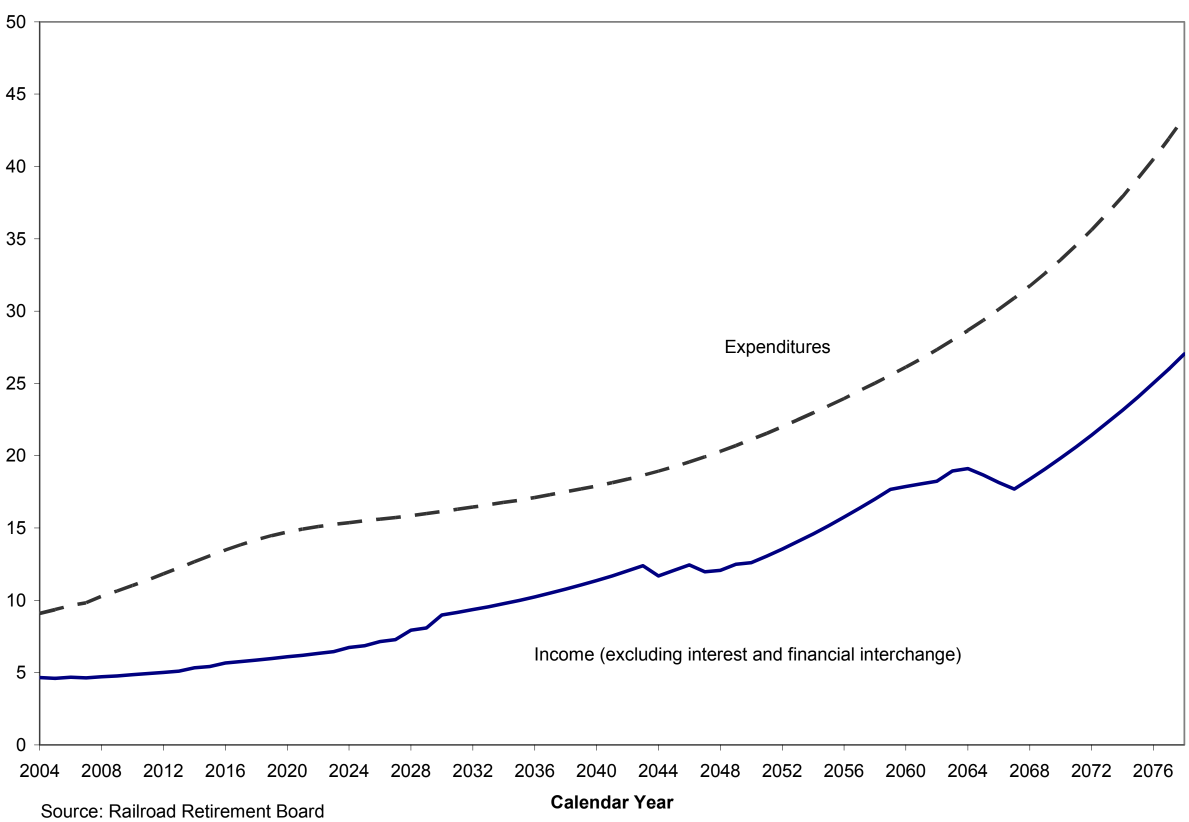
[9] The Board of Trustees is comprised of seven trustees, three selected by railroad labor unions and three by railroad companies. The seventh trustee is an independent trustee selected by the other six trustees. The trustees' terms are for 3 years and are staggered. RRSIA provides that on the initial Board, one each of the Labor and Management members would be selected for 3-year terms, one each for 2-year terms, and one each for a 1-year term. Thereafter, all terms are 3 years. The independent trustees' initial and succeeding terms are 3 years.

the level of 42,000 and (2) the employment base, excluding passenger employment, will decline at a constant 3 percent annual rate for 25 years, at a falling rate over the next 25 years, and remain level thereafter.

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 2004-2078 based on the intermediate set of assumptions used in the Railroad Retirement Board'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 will 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 2004-2078

(In billions of nominal dollars)

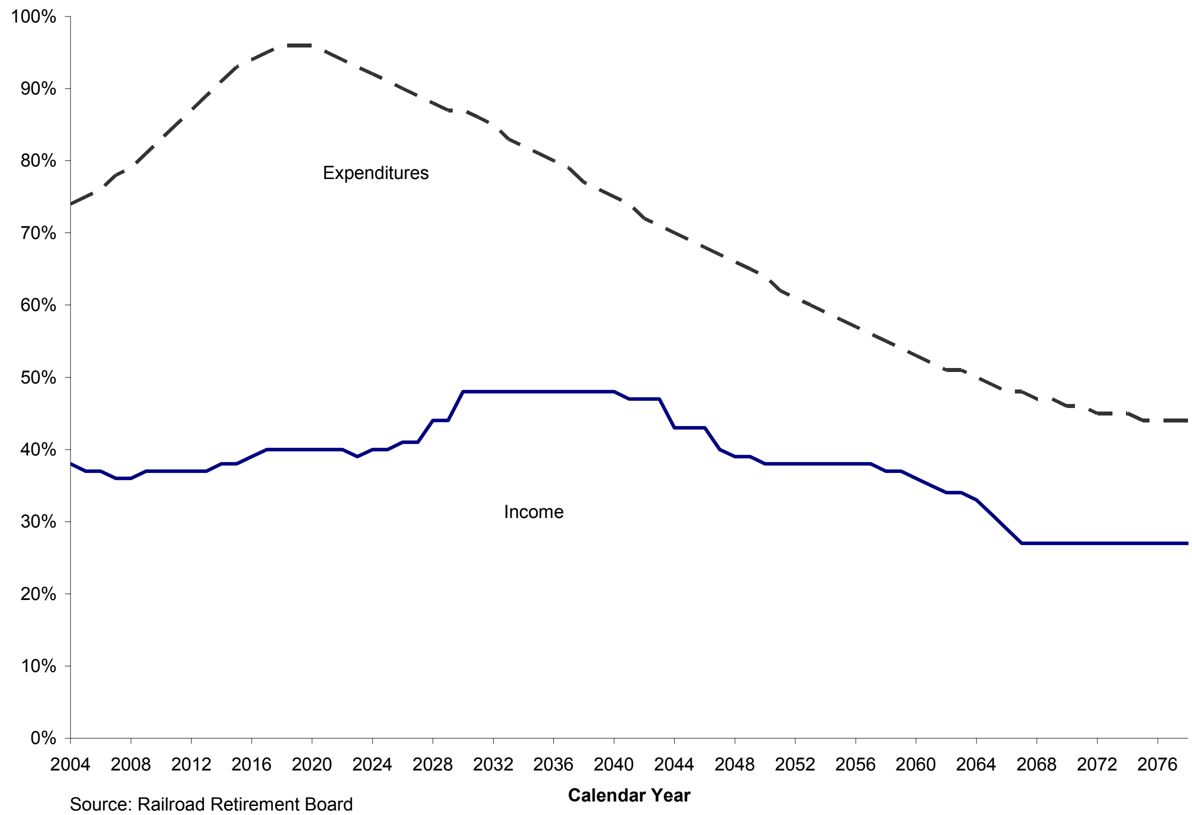


Source: Railroad Retirement Board

As Chart 11 shows, expenditures are expected to exceed tax income for the entire projection period. The imbalances continue to widen for the next 18 years (until 2022) but then begin to narrow for the subsequent 20 years due, in part, to increases in the tier II tax rate in 2028 and 2030. The imbalances widen after 2040 and again after 2050 due to reductions in tax rates.

Income and Expenditures as a Percent of Taxable Payroll. Chart 12 shows estimated expenditures and income as a percent of tier II taxable payroll. Tax rate changes are seen more clearly in this chart. The imbalances grow until about 2020 but then begin to decease steadily as expenditures fall and tax rates increase in 2028 and 2030. Tax rate reductions occur in 2044, 2047, 2048, and in several years after 2060.

Chart 12—Estimated Railroad Retirement Income (Excluding Interest and Financial Interchange Income) and Expenditures as a Percent of Tier II Taxable Payroll 2004-2078



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 8 shows the sensitivity of the shortfall in the railroad retirement program to variations in these two assumptions. The low-cost employment scenario has a 3.9 percent smaller shortfall of income to expenditures, and the high-cost scenario has a 6.1 percent higher shortfall. A higher discount rate reduces future values relative to a lower rate. As seen in the table, the shortfall is 29.6 percent lower if the interest rate is 12 percent rather than 8 percent and 75.9 percent higher when the interest rate is 4 percent rather than 8 percent.

Table 8
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]	83,588 (1.5%)	86,974 (3.0%)	92,244 (4.5%)
Interest rate...................	61,223 (12%)	86,974 (8%)	153,014 (4%)

[1] The low and middle employment scenarios have passenger employment remaining at 42,000 and the remaining employment base declining at 1.5 percent and 3 percent, respectively, for the next 25 years. The high cost scenario has passenger employment declining by 500 per year until a level of 35,000 is reached with the remaining employment base declining by 4.5 percent per year.

Source: Railroad Retirement Board.

Sustainability of Railroad Retirement

Table 9 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, 2004. The data are consistent with the Statement of Social Insurances.

From a Governmentwide (budget) perspective, revenues are expected to fall short of expenditures by $87 billion. That is the present value of resources needed from the budget for the Railroad Retirement program. From a trust fund perspective, when the trust fund balance and the financial interchange are included, the combined balance of the NRRIT, the Railroad Retirement Account, and the SSEB Account show a slight surplus.

Table 9
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, 2004)

Estimated Future Income (Excluding Interest)[3] Received from or on Behalf of:	
Current participants who have attained retirement age	3.9
Current participants not yet having attained retirement age	36.9
Those expected to become participants	39.1
All participants	79.9
Estimated Future Expenditures:[4]	
Current participants who have attained retirement age	81.1
Current participants not yet having attained retirement age	71.8
Those expected to become participants	13.9
All participants	166.8
Net obligations from budget perspective (expenditures less income)	87.0
Railroad Retirement program assets (mostly investments stated at market)[5]	26.3
Financial Interchange from Social Security Trust	61.1
Net Obligations from Trust Fund Perspective	(0.4)

[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 8 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 1/1/2003, whereas present values are as of 1/1/2004.

Black Lung

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 U.S. Department of Labor (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. 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.

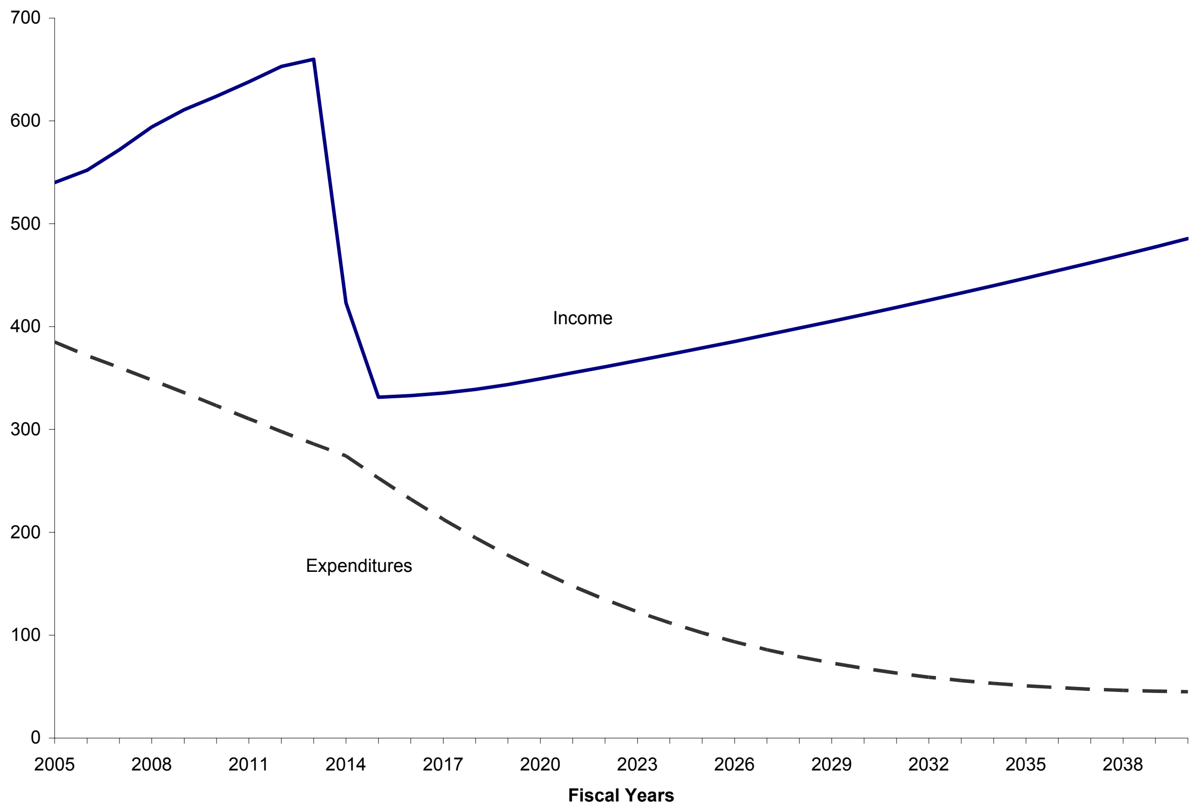
Excise taxes on coal mine operators, based on the sale of coal, is the primary source of financing black lung disability payments and related administrative costs. Though excise tax revenues currently exceed costs (and are expected to in the future), that was not always the case. The Black Lung Benefits 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 Disability Trust Fund financial statements continue to report a balance payable and interest paid to the general fund.

On September 30, 2004, total liabilities of the BLDTF exceeded assets by $8.7 billion. This deficit fund balance represented the accumulated shortfall of excise taxes necessary to meet benefit payment and interest expenses. This shortfall was financed by repayable advances (with interest) to the BLDTF. Outstanding advances on September 30, 2004, were $8.7 billion, bearing interest rates ranging from 5.375 to 13.875 percent. Excise tax revenues of $566 million, benefit payment expense of $344.3 million, and interest expense of $650.6 million were recognized for the year ended September 30, 2004.

Chart 13 shows projected black lung expenditures (excluding interest payments) and excise tax collections for the period 2005-2040. The significant assumptions used in the projections are coal production estimates, the tax rate structure, the number of beneficiaries, life expectancy, and medical costs. Analysts project that a scheduled reduction in taxes on coal sales will decrease cash inflows by 50 percent between the years 2013 to 2015. After 2015, cash surpluses continue to widen due to a declining beneficiary population and increasing revenues.

Chart 13—Estimated Black Lung Total Income and Expenditures (Excluding Interest) 2005-2040

(In millions of nominal dollars)



Source: Department of Labor

Table 10 shows present values of 36-year projections of expenditures and revenues for the Black Lung program computed as of September 30, 2004, using a discount rate of 5.25 percent. From a Governmentwide (budget) perspective, the present value of expenditures is expected to be less than the present value of income by $4.1 billion (a surplus). From a trust fund perspective, a large balance ($8.7 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 $4.6 billion in present value dollars.

Table 10
Present Values of 36-Year Projections of Revenues and Expenditures for the Black Lung Program

(In billions of present value dollars, as of September 30, 2004)

Estimated future tax income	7.7
Estimated future expenditures	3.6
Net obligations from budget perspective (expenditures less income)	(4.1)
Accumulated balance due general fund	8.7
Net obligations from trust fund perspective	4.6

Source: Department of Labor. The projections were based on data from the 2004 Mid-Session Review.

Unemployment Insurance

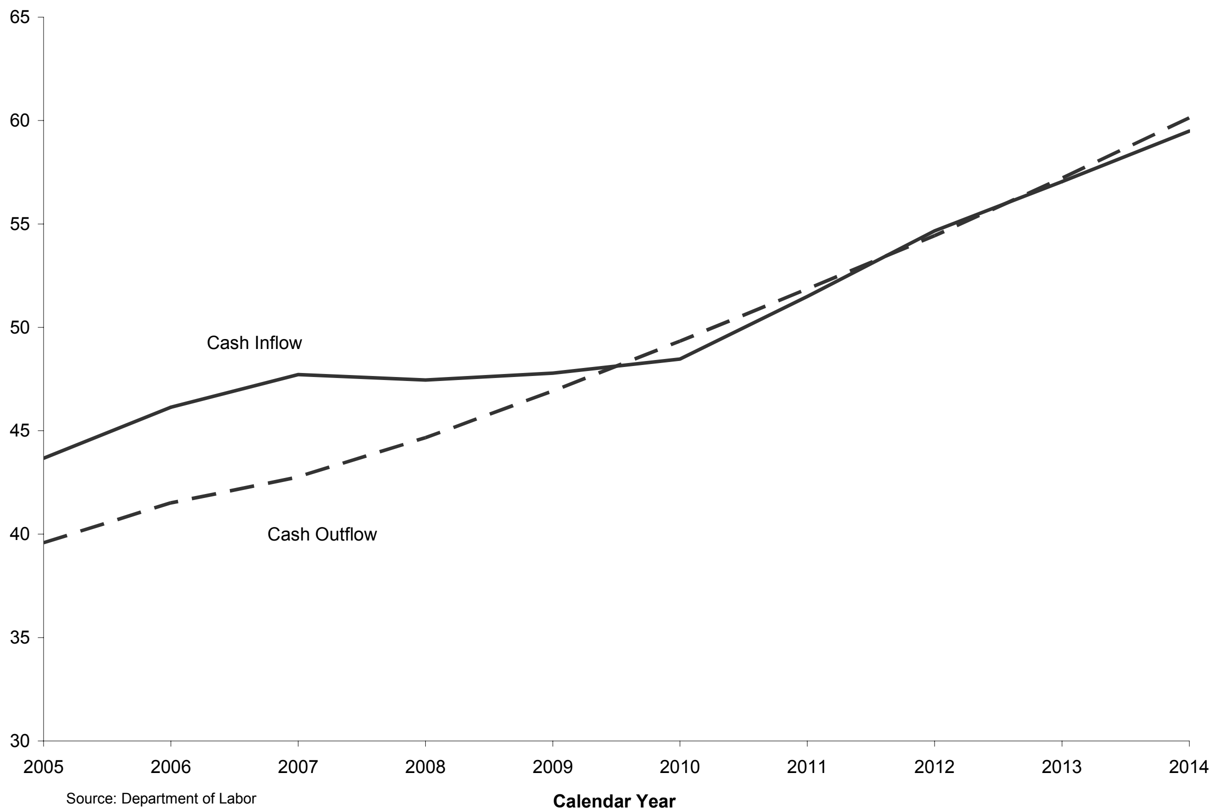
The Unemployment Insurance Program was created in 1935 to provide temporary partial wage replacement to unemployed workers who lose their jobs. The program is administered through a unique system of Federal and State partnerships established in Federal law but administered through conforming State laws 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 14 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 net cash inflows for the next 5 years. There is a crossover back to small net outflows in fiscal year 2010. From a trust fund perspective, the Unemployment Fund will have to rely on interest earnings to keep growing.

Chart 14—Estimated Unemployment Fund Cashflow Using Expected Economic Conditions 2005-2014

(In billions of nominal dollars)



Source: Department of Labor

Table 11 shows present values of 10-year projections of revenues and expenditures for the Unemployment Insurance program using a discount rate of 5.03 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 5.35 percent during fiscal year 2005, decreasing to 5.10 percent in fiscal year 2008 and thereafter. Under the mild recessionary scenario, the unemployment rate peaks at 7.43 percent in fiscal year 2007 and declines gradually until reaching 5.1 percent in 2013. Finally, under the deep recession scenario, the unemployment rate is assumed to peak at 10.15 percent in 2008 and gradually fall to 6.4 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 11 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 $14 billion. From the same perspective, under a deep recession scenario, the present value of expenditures exceeds the present value of income by $37 billion. From a trust fund perspective, the program has more than $45 billion in assets. When combined with the present value of net cash income under expected economic conditions, the program has a surplus of $59 billion.

Table 11
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 January 1, 2005)

	Economic Conditions		
	Expected	Mild Recession	Deep Recession
Future cash income	383.6	423.9	470.9
Future expenditures	369.5	416.6	507.6
Net obligations from budget perspective (expenditures less income)	(14.1)	(7.3)	36.7
Trust fund assets	45.2	45.2	45.2
Net obligations from trust fund perspective	(59.3)	(52.5)	8.5

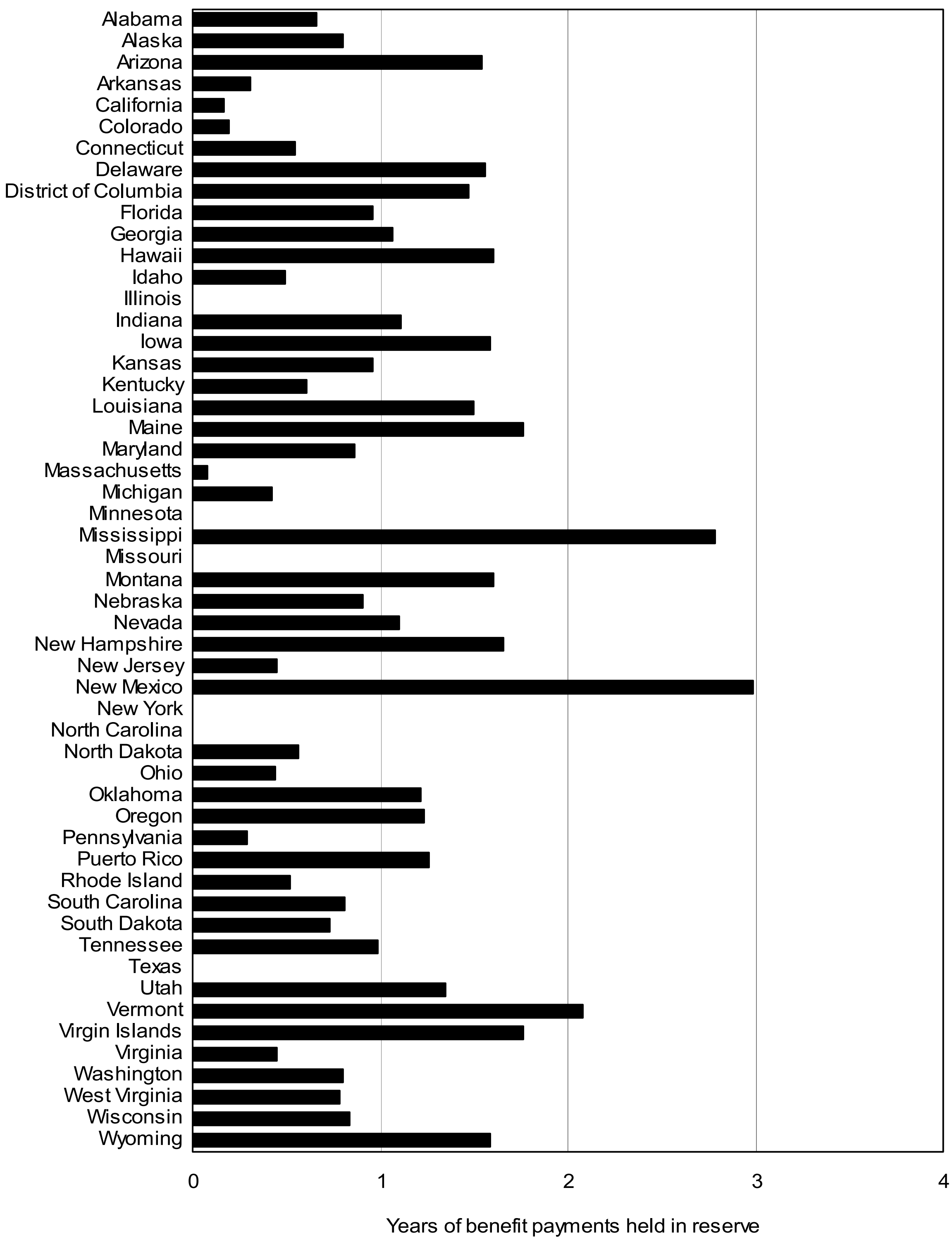
Source: Data for the present value calculations are from the Department of Labor; the calculations were done by the Department of the Treasury.

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, New York, and Minnesota State accounts had loans payable to FUA at the end of fiscal year 2004. In addition, Texas, Illinois, and North Carolina 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 15 presents the State by State results of this analysis as of September 30, 2004. As the table illustrates, 32 State funds were below the minimal solvency ratio on September 30, 2004.

Chart 15—Unemployment Trust Fund Solvency as of September 30, 2004



Stewardship Assets

The Government holds stewardship assets for the benefit of the Nation. Because the Government has been entrusted with, and made accountable for, these resources and responsibilities, they are recognized in this *Financial Report*.

When acquired, stewardship assets are generally treated as expenses in the financial statements. This section provides more detailed stewardship information on these resources to highlight their long-term benefit and to demonstrate accountability. This information facilitates the understanding of the operations and financial condition of the Government.

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 nonfinancial units such as acres of land and lakes, miles of parkways, and miles of wild and scenic rivers. 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. Stewardship land acquired totaled $312.5 million and $329.6 million for the years ended September 30, 2004, and 2003, respectively. Table 10 depicts the stewardship land owned by the Government and administered by the Department of the Interior (DOI), the Department of Defense (DOD), and the Department of Agriculture (USDA). Detailed information concerning stewardship land can be obtained in the financial statements of DOI, DOD, and USDA.

Table 10
United States Government Stewardship Land as of September 30

Agency	Predominate Use	Millions of Acres		Percentage	
		2004	2003	2004	2003
Bureau of Land Management	Public land	261.8	262.0	40.5	39.9
U.S. Forest Service	National forest system	192.9	192.5	29.8	29.3
U.S. Fish and Wildlife Service	National wildlife refuge system	90.3	95.9	14.0	14.6
National Park Service	National park system	79.0	84.2	12.2	12.8
Department of Defense	Defense facilities	16.7	16.7	2.6	2.5
Bureau of Reclamation	Water, power, and recreation	5.7	5.9	0.9	0.9
Total acres		646.4	657.2	100.0	100.0

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, Yosemite National Park, and museum objects on display at the Smithsonian Institution. 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.

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 following 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 three broad categories:

- Collection-type.
- Natural.
- Cultural.

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

Collection-Type Heritage Assets

The Smithsonian Institution holds some of the most prominent Federal museum collections. The Smithsonian acquires, protects, and preserves approximately 142 million individual objects for public exhibition, education, and research.

Similarly, the Library of Congress holds the world’s largest library collection, comprising more than 130.2 million items. The Library of Congress receives two copies of every book, pamphlet, map, print, photograph, and piece of music registered for copyright in the United States.

The National Archives holds about 3.1 million cubic feet of records. These records ensure ready access to essential information documenting the rights of citizens, the actions of Federal officials, and the effects of those actions on the national experience. These records include text and legislative records; cartographic and architectural records; motion picture, sound, and video records; and still pictures and graphics. The National Archives also maintains historically important documents such as the U.S. Constitution and the Louisiana Purchase Treaty.

Collection-type heritage assets acquired totaled $19 million and $21.2 million for the years ended September 30, 2004, and 2003, respectively.

Natural Heritage Assets

Congress has designated several wilderness areas to preserve their natural conditions. DOI manages approximately 70.7 million acres of these wilderness areas comprised of almost 67 percent of the Nation’s more than 105 million wilderness acres. The Cebolla Wilderness in New Mexico is one such area.

The national wild and scenic rivers system includes protected free-flowing rivers. The Government protects these areas because of their fish and wildlife, or for their scenic, recreational, geologic, historic, or cultural value. DOI manages 52 percent of these 11,314 river miles, including the Bluestone National Scenic River in West Virginia.

The Government also sets aside natural landmarks that exemplify a region's natural characteristics. The U.S. Fish and Wildlife Service manages 9 national historic landmarks, the Bureau of Land Management manages 21 natural historic landmarks, and the National Park Service manages 177 national natural landmarks, such as the Grand Coulee Gorge in Washington State.

The U.S. Forest Service manages 155 national forests and 20 national grasslands on more than 192 million acres of public land. These areas encompass significant heritage resources. Examples include the White Mountain National Forest in New Hampshire and the Thunder Basin National Grassland in Wyoming.

Natural heritage assets acquired totaled $199.5 million and $263.1 million for the years ended September 30, 2004, and 2003, respectively.

Any acreage cited above for natural heritage assets, such as wilderness areas, are also included in the acreage cited in the Stewardship Land section.

Cultural Heritage Assets

The National Register of Historic Places lists historic sites and structures. This is America's official list of cultural resources worthy of preservation. Official properties include districts, sites, buildings, structures, and objects significant to American history. It also includes significant architectural, archaeological engineering, and cultural properties. Forest Service land encompasses 2,834 such properties.

The Nation's monuments and memorials include the Washington Monument, the Vietnam Veterans Memorial, the World War II Memorial (new), and the Jefferson Memorial in Washington, D.C. The National Park Service manages these. In addition, the American Battle Monuments Commission administers, operates, and maintains 24 permanent American Military Cemeteries on foreign soil and 29 stand-alone memorials, monuments, and markers around the world. This includes the Belleau Wood Marine Monument in France.

Archeological and historical sites contain the remains of human activity. DOI manages numerous archaeological sites. The National Park Service manages approximately 60,855 archeological and historical sites; the Bureau of Land Management, the U.S. Fish and Wildlife Service and the Bureau of Reclamation manage approximately 285,183 archaeological and historical properties. The ancient earthen mounds at the Hopewell Culture National Historic Site in Ohio are a notable example.

National cemeteries include the Arlington National Cemetery in Virginia and the Fort Logan National Cemetery in Colorado. The Department of the Army (Army) manages the Arlington National Cemetery. The Department of Veterans Affairs (VA) manages Fort Logan National Cemetery and other cemeteries.

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.

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. The amounts reported in fiscal year 2003 for investments in prior years (fiscal years 2003-2000) have been restated because agencies are continuously reviewing, correcting, and updating this data.

Table 11
Stewardship Investments
for the Years Ended September 30

(In billions of dollars)	Fiscal Year 2004	Restated Fiscal Year 2003	Restated Fiscal Year 2002	Restated Fiscal Year 2001	Restated Fiscal Year 2000
Investments in non-Federal physical property	45.3	46.8	47.6	37.9	38.9
Investments in human capital	77.1	71.3	54.7	44.3	36.8
Research and development:					
Investments in basic research	32.9	24.6	22.8	18.9	18.2
Investments in applied research	23.9	21.5	21.6	17.5	16.3
Investments in development	60.2	48.3	44.4	39.4	38.1
Total investments	239.4	212.5	191.1	158.0	148.3

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.

Research and Development

Federal investments in research and development 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.

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United States Government Notes to the Financial Statements for the Years Ended September 30, 2004, and September 30, 2003

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 Fannie Mae, 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, etc.

Material intragovernmental transactions are eliminated in consolidation, except as described in Note 16—Unreconciled Transactions Affecting the Change in Net Position. The financial reporting period ends September 30 and is the same as used for the annual budget.

On November 25, 2002, the DHS Reorganization Plan was enacted. The Reorganization Plan was submitted pursuant to Section 1502 of the Department of Homeland Security Act of 2002. The majority of the assets and expenses transfers occurred in fiscal year 2003, and only small immaterial transfers have taken place in fiscal year 2004.

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 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.

This 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. See the Reconciliations of Net Operating Cost and Unified Budget Deficit in the Financial Statements section.

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.

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 6—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 cost. 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 is recognized using the straight-line method over the estimated useful lives of the assets.

G. Federal Employee and Veteran Benefits Payable

Federal employee and veteran benefits payable are recorded during the time employee services are rendered. The related liabilities for defined benefit pension plans and post-retirement health benefits are recorded at estimated present value of future benefits, less the estimated present value of future normal cost contributions.

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 due as of the reporting date. No liability is recognized for future benefit payments not yet due. For further information, see the Stewardship Information section on Stewardship Responsibilities, and Note 20—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 $698 billion and $654 billion of Treasury securities held by the public as of September 30, 2004, and 2003, 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 $19.7 billion and $21.9 billion for the years ended September 30, 2004, and 2003, respectively. The primary source of these earnings is from interest earned on Treasury securities held by the FRBs. Also, as described in Note 14—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.

Note 2. Cash and Other Monetary Assets

Cash and Other Monetary Assets as of September 30

(In billions of dollars)	2004	2003
Operating cash	31.0	50.8
Other cash	13.3	11.3
Total cash	44.3	62.1
International monetary assets	41.5	46.3
Gold	10.9	10.9
Domestic monetary assets	0.3	0.3
Total cash and other monetary assets	97.0	119.6

Cash

Total cash consists of:

- Operating cash of the Government representing balances from tax collections, customs duties, other revenues, Federal debt receipts, other various receipts, net of checks outstanding, and time deposits which are held in the Federal Reserve banks, foreign and domestic financial institutions, and in Treasury tax and loan accounts.
- Other cash representing the balances of petty cash and other funds held in agencies' books, such as deposits in transit, imprest funds, undeposited collections and amounts held in trust.

Throughout fiscal year 2003, the Government maintained formal arrangements with numerous financial institutions for holding time deposits known as compensating balances and depositary compensation securities. On January 23, 2004, with the passage of the "Consolidated Appropriations Act, 2004," Treasury received a permanent and indefinite appropriation to compensate the banks for services rendered. As a result, the compensating balances and depositary compensation securities established for this purpose did not exist on September 30, 2004. The September 30, 2003, balance of $22.2 billion is included in other cash.

Operating cash and the other cash of the Government are either insured (for balances up to $100,000) by the Federal Deposit Insurance Corporation (FDIC), or collateralized by securities pledged by financial institutions.

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 $35 billion and $28.9 billion for the years ended September 30, 2004, and 2003, respectively. The U.S. reserve position in the IMF has a U.S. dollar equivalent of $19.4 billion and $24.1 billion for the years ended September 30, 2004, and 2003, 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 $12.8 billion and $12.1 billion equivalent for the years ended September 30, 2004, and 2003, 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, 2004, and 2003, and are included in Note 14—Other Liabilities.

As of September 30, 2004, and 2003, other liabilities included $7.2 billion and $7 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 258,713,310 as of September 30, 2004, and 2003. The market value of gold on the London Fixing as of the reporting date was $416 and $388 per fine troy ounce for the years ended September 30, 2004, and 2003, respectively. Gold totaling $10.9 billion for the years ending September 30, 2004, and 2003, 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 14—Other Liabilities.

Domestic Monetary Assets

Domestic monetary assets consist of liquid assets, other than cash, that are based on the U.S. dollar, including coins, silver bullion, and other coinage metals.

Note 3. Accounts Receivable, Net

Accounts receivable includes related interest receivable of $6.2 billion and $4.6 billion for the years ended September 30, 2004, and 2003, respectively, 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 $16.7 billion and $16.1 billion for the years ended September 30, 2004, and 2003, respectively.

Accounts Receivable as of September 30

(In billions of dollars)	2004	2003
Department of Defense	7.5	7.3
Social Security Administration	6.2	5.8
Department of Energy	4.0	4.4
Pension Benefit Guaranty Corporation	2.5	0.5
Department of Agriculture	2.5	1.9
Department of Health and Human Services	2.1	2.8
Department of the Interior	1.3	1.2
Department of Labor	1.1	0.8
Tennessee Valley Authority	1.0	1.0
Department of Veterans Affairs	0.9	0.9
All other departments	6.0	7.2
Total accounts receivable, net	35.1	33.8

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		Long-term Cost of Loans and Guarantees Outstanding		Net Loans Receivable		Amount Guaranteed by the Government		Subsidy Expense for the Fiscal Year Ended September 30	
	2004	2003	2004	2003	2004	2003	2004	2003	2004	2003
Direct Loan Programs:										
Federal Direct Student Loans	92.1	84.5	(1.6)	(2.1)	93.7	86.6			(0.6)	4.7
Rural Utilities Service	32.4	40.1	2.7	4.1	29.7	36.0			(0.1)	0.6
Rural Housing Service	27.1	27.3	7.4	7.5	19.7	19.8			0.2	-
Federal Family Education Loans	20.0	17.7	9.3	6.9	10.7	10.8			-	-
Housing and Urban Development	13.2	7.5	3.1	-	10.1	7.5			-	-
Export-Import Bank Loans	13.2	7.8	5.5	1.2	7.7	6.6			-	-
Community Loans	7.9	9.8	1.0	5.3	6.9	4.5			-	0.2
Agricultural Credit Insurance Fund	7.3	4.6	0.6	0.7	6.7	3.9			(0.1)	(0.6)
U.S. Agency for International Development	8.8	8.5	2.7	3.2	6.1	5.3			-	-
Other Foreign Loans	9.5	3.0	4.6	0.4	4.9	2.6			(0.1)	0.3
Export Credit Guarantees	6.5	6.7	3.0	3.2	3.5	3.5			-	-
Direct Loans for Spectrum Auction Sales	6.5	5.1	3.8	0.7	2.7	4.4			-	0.4
All other programs	21.4	28.7	2.9	(0.9)	18.5	29.6			0.1	(0.3)
Total	265.9	251.3	45.0	30.2	220.9	221.1			(0.6)	5.3
Guaranteed Loan Programs:										
Federal Family Education Loans	245.3	213.0	23.3	15.4			240.5	209.0	9.0	2.5
Veterans Housing Benefit Program	207.4	213.2	4.7	4.8			64.7	67.6	0.2	(1.5)
Unsubsidized Federal Housing Administration Loans, HUD	412.4	434.0	4.0	2.1			383.6	404.4	(2.5)	2.5
Export-Import Bank Guarantees	47.5	32.9	3.1	1.8			47.5	32.9	0.3	0.3
Small Business Loans	67.5	53.6	2.5	2.5			56.4	43.4	0.1	2.2
Subsidized Federal Housing Administration Loans, HUD	97.3	101.2	1.2	4.1			87.8	85.6	(0.4)	0.1
Israeli Loan Guarantee Program, AID	12.3	10.8	0.8	0.7			12.3	10.8	-	-
Overseas Private Investment Corporation Credit Program	3.7	3.0	0.7	0.6			3.7	3.0	-	-
Rural Housing Service	13.6	13.8	0.4	0.4			12.2	12.4	0.1	0.1
Business and Industry Loans	4.2	4.1	0.3	0.3			3.1	3.0	-	-
Agriculture Credit Insurance Fund	10.4	10.3	0.2	0.2			9.3	9.2	0.1	-
Export Credit Guarantee Programs	5.0	4.8	0.2	-			4.8	4.7	0.1	(0.1)
Health Education Assistance Loans	2.1	2.5	0.2	0.4			2.1	2.5	0.1	0.2
All other programs	8.4	10.6	1.5	1.3			8.4	9.9	0.5	0.2
Total	1,137.1	1,107.8	43.1	34.6			936.4	898.4	7.6	6.5

Net loans receivable includes related interest and foreclosed property, and is included in the assets section of the balance sheets.

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 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, has guaranteed loan programs. Like the Federal Direct Student Loan Program, it offers four types of loans: Stafford, Unsubsidized Stafford, PLUS for parents, and consolidation loans.

USDA, Rural Utilities Service loans are for the construction and operation of electric generating plants, transmission and distribution lines, telecommunication lines, and related systems. These loans carry an average maturity of greater than 20 years and are usually secured.

The major Federal rural housing programs are funded through the Rural Housing Insurance Fund Program account. 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.

Loan programs are limited to rural areas that include towns, villages, and other places not part of an urban area. The majority of these loans mature in excess of 25 years and are secured by the property of the borrower.

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 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.

Repayment terms for these loans are usually 1 to 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 (SBA) 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.

Note 5. Taxes Receivable, Net

Taxes receivable are the gross tax receivables net of allowance for doubtful accounts. The allowance for doubtful accounts is based on projections of collectibility from a statistical sample of taxes receivable.

Taxes Receivable as of September 30

(In billions of dollars)	2004	2003
Gross taxes receivable	91.4	94.4
Allowance for doubtful accounts	(70.1)	(71.5)
Taxes receivable, net	21.3	22.9

Note 6. Inventories and Related Property, Net

Inventories and Related Property as of September 30

	Defense	All Others	Total	Defense	All Others	Total
(In billions of dollars)	2004			2003		
Inventory purchased for resale	76.0	0.7	76.7	70.2	0.5	70.7
Inventory held in reserve for future sale	-	0.1	0.1	-	-	-
Inventory and operating material and supplies held for repair	48.1	0.3	48.4	45.9	0.4	46.3
Inventory—excess, obsolete and unserviceable	5.4	0.1	5.5	3.8	-	3.8
Operating materials and supplies held for use	127.8	4.8	132.6	117.8	4.8	122.6
Operating materials and supplies held in reserve for future use	-	0.2	0.2	5.1	0.1	5.2
Operating materials and supplies—excess, obsolete and unserviceable	3.1	-	3.1	3.7	0.1	3.8
Stockpile materials	1.5	41.2	42.7	1.8	40.0	41.8
Other related property	1.1	1.8	2.9	1.9	3.0	4.9
Total allowance for inventories and related property	(49.8)	(0.9)	(50.7)	(44.5)[1]	(1.9)	(46.4)
Total inventories and related property, net	213.2	48.3	261.5	205.7	47.0	252.7

[1] Restated – See Note 17.

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 and future sale in the Government, generally uses the Latest Acquisition Cost (LAC) method, which is revalued for holding gains and losses.

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.

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.

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 amount reported by the DOD is stockpile materials held for sale, and the amount reported in all others is stockpile materials held in reserve, and is reported by the Department of Energy (DOE).

Other related property:

- Commodities include items of commerce or trade that have an exchange value used to stabilize or support market prices.
- 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.
- 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.
- Other property not classified above.

Note 7. 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.

Property, Plant, and Equipment as of September 30, 2004

(In billions of dollars)	Cost		Accumulated Depreciation/ Amortization		Net	
	Defense	All Others	Defense	All Others	Defense	All Others
Buildings, structures, and facilities	159.4	162.6	91.5	78.1	67.9	84.5
Furniture, fixtures, and equipment	1,192.4	153.2	852.1	89.3	340.3	63.9
Construction in progress	19.6	40.0	N/A	N/A	19.6	40.0
Land	10.1	16.7	N/A	N/A	10.1	16.7
Automated data processing software	6.1	5.8	3.6	2.0	2.5	3.8
Assets under capital lease	0.6	1.7	0.4	0.5	0.2	1.2
Leasehold improvements	0.1	3.7	0.1	2.0	-	1.7
Other property, plant, and equipment	0.1	8.5	-	8.3	0.1	0.2
Subtotal	1,388.4	392.2	947.7	180.2	440.7	212.0
Total property, plant, and equipment, net		1,780.6		(1,127.9)		652.7

Property, Plant, and Equipment as of September 30, 2003

(In billions of dollars)	Cost		Accumulated Depreciation/ Amortization		Net	
	Defense	All Others	Defense	All Others	Defense	All Others
Buildings, structures, and facilities	159.5	168.0	83.1	80.3	76.4	87.7
Furniture, fixtures, and equipment	1,163.1	152.3	825.2	82.6	337.9	69.7
Construction in progress	19.4	37.5	N/A	N/A	19.4	37.5
Land	9.7	10.1	N/A	N/A	9.7	10.1
Automated data processing software	5.0	5.2	2.6	1.5	2.4	3.7
Assets under capital lease	0.6	1.4	0.3	0.4	0.3	1.0
Leasehold improvements	0.2	3.4	0.1	1.7	0.1	1.7
Other property, plant, and equipment	0.1	0.5	-	-	0.1	0.5
Subtotal	1,357.6	378.4	911.3	166.5	446.3	211.9
Total property, plant, and equipment, net		1,736.0		(1,077.8)		658.2

Note 8. Other Assets

Other Assets as of September 30

(In billions of dollars)	2004	2003
Securities and investments:		
All other	32.5	37.7
NRRIT[1]	24.6	19.4
Advances and prepayments	27.0	26.1
Other	24.7	13.9
Total other assets	108.8	97.1

[1] For more information, see Railroad Retirement in the Stewardship Information section (page 90).

Securities and investments are presented at cost, net of unamortized premiums and discounts.

As discussed in the Stewardship Information section of this report, 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.

Note 9. Accounts Payable

Accounts Payable as of September 30

(In billions of dollars)	2004	2003
Department of Defense	28.4	28.4
Department of Agriculture	3.4	3.6
Department of Veterans Affairs	3.0	3.0
Department of Homeland Security	2.8	2.0
United States Postal Service	2.5	3.3
General Services Administration	2.3	2.2
Department of Justice	2.1	2.1
National Aeronautics and Space Administration	2.0	2.2
Agency for International Development	2.0	1.8
Department of Energy	1.3	3.1
Department of State	1.2	1.0
Pension Benefit Guaranty Corporation	1.2	0.4
Department of Labor	1.0	0.7
Tennessee Valley Authority	0.9	1.0
Department of Housing and Urban Development	0.8	1.5
All other departments	5.2	5.9
Total accounts payable	60.1	62.2

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, 2003	Net Change During Fiscal Year 2004	Balance September 30, 2004	Average Interest Rate 2004	Average Interest Rate 2003
Treasury Securities (Public):					
Marketable securities:					
Treasury bills	918.2	43.3	961.5	1.6%	1.0%
Treasury notes	1,919.5	354.6	2,274.1	3.5%	3.8%
Treasury bonds	622.7	(12.3)	610.4	8.0%	7.8%
Total marketable Treasury securities	3,460.4	385.6	3,846.0		
Nonmarketable securities	463.7	(2.2)	461.5	5.1%	5.3%
Net unamortized premium/ (discounts)	(36.8)	2.0	(34.8)		
Total Treasury securities, net (public)	3,887.3	385.4	4,272.7		
Agency Securities:					
Tennessee Valley Authority	24.6	(1.3)	23.3		
All other agencies	1.2	(0.5)	0.7		
Total agency securities, net of unamortized premiums and discounts	25.8	(1.8)	24.0		
Accrued interest payable	31.8	0.9	32.7		
Total Federal debt securities held by the public and accrued interest	3,944.9	384.5	4,329.4		

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.

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, and bonds).
- Interest-bearing nonmarketable securities (foreign series, State and local government series, domestic series, depositary compensation securities, and savings bonds).
- Non interest-bearing marketable and nonmarketable securities (matured and other).

Section 3111 of Title 31, 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 2004 and 2003.

As of September 30, 2004, and 2003, respectively, $7,333.3 billion and $6,737.6 billion of debt were subject to a statutory limit (31 U.S.C. § 3101). That limit was $7,384 billion as of September 30, 2004, and 2003, respectively. Public Law No. 108-415, November 19, 2004, amended Title 31 of the United States Code to increase the statutory debt limit to $8,184 billion. As of this date $7,437.6 billion of debt were subject to the statutory limit. 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 major trust funds. For more information on trust funds, see Note 20─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 2003	Net Change During Fiscal Year 2004	Balance 2004
Social Security Administration, Federal Old-Age and Survivors Insurance	1,313.4	139.2	1,452.6
Office of Personnel Management, civil service retirement and disability	601.7	30.2	631.9
Department of Health and Human Services, Federal Hospital Insurance	251.3	13.1	264.4
Social Security Administration, Federal Disability Insurance	170.8	12.0	182.8
Department of Defense, military retirement	172.4	4.9	177.3
Federal Deposit Insurance Corporation funds	45.4	1.6	47.0
Department of Labor, unemployment	48.2	(3.0)	45.2
Department of Defense, Medicare retirement fund	18.4	17.5	35.9
Department of Energy, nuclear waste disposal	25.9	4.6	30.5
Office of Personnel Management, Employees' Life Insurance	26.8	1.3	28.1
Housing and Urban Development, Federal Housing	23.8	(0.5)	23.3
Department of Health and Human Services, Federal Supplementary Medical Insurance	24.9	(7.5)	17.4
Department of Veterans Affairs	13.7	(0.5)	13.2
Pension Benefit Guaranty Corporation Fund	12.9	0.3	13.2
Department of State, Foreign service and retirement & disability fund	12.3	0.6	12.9
Office of Personnel Management, Employees health benefits	9.0	1.7	10.7
Department of the Treasury, Exchange stabilization fund	10.5	(0.2)	10.3
Department of Transportation, Highway Trust Fund	13.6	(3.4)	10.2
Department of Transportation, Airport and Airway Trust Fund	10.5	(0.6)	9.9
All other programs and funds	53.7	1.2	54.9
Subtotal	2,859.2	212.5	3,071.7
Unamortized net (discounts)/premiums	(0.3)	(0.3)	(0.6)
Total intragovernmental debt holdings, net	2,858.9	212.2	3,071.1

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 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, 2004, and 2003, respectively, are presented below.

Federal Employee and Veteran Benefits Payable as of September 30

	Civilian[1]		Military		Total[1]	
(In billions of dollars)	2004	2003	2004	2003	2004	2003
Pension and accrued benefits	1,230.2	1,190.4	837.7	739.0	2,067.9	1,929.4
Post-retirement health benefits	266.1	244.4	725.3	683.0	991.4	927.4
Veterans compensation and burial benefits	N/A	N/A	924.8	954.8	924.8	954.8
Liability for other benefits	54.4	47.2	23.6	21.2	78.0	68.4
Total Federal employee and veteran benefits payable	1,550.7	1,482.0	2,511.4	2,398.0	4,062.1	3,880.0

[1] Does not include U.S. Tax Court and judicial branch.

Change in Actuarial Accrued Pension Liability and Components of Related Expenses

(In billions of dollars)	Civilian[1]	Military	Total[1]
Actuarial accrued pension liability as of September 30, 2003	1,190.4	739.0	1,929.4
Adjusted accrued pension liability	1,190.4	739.0	1,929.4
Pension Expense:			
Normal costs	25.3	13.0	38.3
Plan amendment and assumption change liability	-	81.0	81.0
Interest on liability	73.1	45.3	118.4
Actuarial (gains)/losses	(3.7)	(4.0)	(7.7)
Total pension expense	94.7	135.3	230.0
Less benefits paid	54.9	36.6	91.5
Actuarial accrued pension liability as of September 30, 2004	1,230.2	837.7	2,067.9

[1] Does not include U.S. Tax Court and judicial branch.

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

(In percentages)	Civilian 2004	Civilian 2003	Military 2004	Military 2003
Rate of interest	6.25%	6.25%	6.25%	6.25%
Rate of inflation	3.25%	3.25%	3.00%	3.00%[1]
Projected salary increases	4.00%	4.00%	3.75%	3.75%[1]

[1] Revised.

Change in Actuarial Accrued Post-Retirement Health Benefits Liability and Components of Related Expenses

(In billions of dollars)	Civilian	Military	Total
Actuarial accrued post-retirement health benefits liability, as of September 30, 2003	244.4	683.0	927.4
Adjusted beginning post-retirement health benefits liability	244.4	683.0	927.4
Post-Retirement Health Benefits Expense:			
Normal costs	19.2	17.6	36.8
Interest on liability	-	42.9	42.9
Actuarial (gains)/losses	12.1	(5.3)	6.8
Total post-retirement health benefits expense	31.3	55.2	86.5
Less claims paid	9.6	12.9	22.5
Actuarial accrued post-retirement health benefits liability, as of September 30, 2004	266.1	725.3	991.4

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

(In percentages)	Civilian 2004	Civilian 2003	Military 2004	Military 2003
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 2004 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 2004 is 7 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—Dedicated Collections.

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. 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. FERS employees may contribute up to 14 percent of base pay to the plan, which the Government matches up to 5 percent. CSRS employees may contribute up to 9 percent of base pay with no Government match.

The G-Fund held $56.4 billion and $51.1 billion in nonmarketable Treasury securities on September 30, 2004, and 2003, 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.

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 National Defense Authorization Act of 2004 (P.S. 108-136) amended the MRF to provide a phase-out of the offset to military pay due to receipt of VA disability compensation for certain DOD retirees who qualify for both retirement and disability pay–referred to as concurrent receipt–and reformed basic pay rates on which retired pay is based. The $81 billion increase in pension liability for military plan amendments is primarily the result of the concurrent receipt provision discussed above.

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 will be 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 15th 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 15th 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.

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, United States Code 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 2000-2004, the average medical cost per year was $22 billion.

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 decreased by $30 billion in fiscal year 2004 and increased by $105.6 billion in fiscal year 2003. The primary factors contributing to this fluctuation were changes in interest rates and other actuarial assumptions.

Veterans Compensation and Burial Benefits as of September 30

(In billions of dollars)	2004	2003
Veterans	775.3	815.0
Survivors	146.2	136.6
Burial benefits	3.3	3.2
Total compensation and burial benefits payable	924.8	954.8

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 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, 2004, and 2003 were $102.2 and $102.7 billion, respectively.

Note 12. Environmental and Disposal Liabilities

Environmental and Disposal Liabilities as of September 30

(In billions of dollars)	2004	2003
Department of Energy:		
Environmental management baseline estimates	112.8	116.6
Active and surplus facilities—other programs	30.4	27.5
Long-term stewardship	17.5	18.2
All other energy environmental liabilities	21.0	21.1
Total Department of Energy	181.7	183.4
Department of Defense:		
Environmental restoration	37.0	34.1
Environmental corrective other	1.0	1.0
Base realignment and closure	4.0	4.5
Disposal of Weapon Systems Program	22.3	21.9
All other Defense environmental liabilities	-	-
Total Department of Defense	64.3	61.5
All other agencies	3.2	5.0
Total environmental and disposal liabilities	249.2	249.9

During World War II and the Cold War, DOE 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 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:

- Nuclear explosion test areas (e.g., Nevada test site).
- Large surface water bodies (e.g., Clinch and Columbia Rivers).
- Most ground water (even with treatment, future use will be restricted).

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 liability estimates are dependent on annual funding levels and achievement of work as scheduled.

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. 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. 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 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 the Army to cleanup 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 and the Department of Navy Cost to Complete module. These two methods of valuation are used in this note's table.

DOD has not identified any unamortized portion of the estimated total cleanup cost associated with general property, plant, and equipment. The department's financial management regulation requires the unamortized cleanup cost associated with property, plant, and equipment to be recognized. The department is working with the military departments to ensure the regulation is properly implemented.

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 Stewardship Responsibilities section under Stewardship Information.

Benefits Due and Payable as of September 30

(In billions of dollars)	2004	2003
Federal Old-Age and Survivors Insurance	37.1	35.9
Grants to States for Medicaid	19.3	17.8
Federal Hospital Insurance (Medicare Part A)	15.0	15.0
Federal Supplementary Medical Insurance (Medicare Part B)	14.8	15.3
Federal Disability Insurance	12.8	12.0
Supplemental security income	1.8	1.5
Unemployment insurance	1.1	1.5
Other benefits	1.0	1.0
Total benefits due and payable	102.9	100.0

Note 14. Other Liabilities

Other Liabilities as of September 30

(In billions of dollars)	2004	2003
Insurance Programs:		
Pension Benefit Guaranty Corporation	60.9	44.5
All other insurance programs	6.8	25.1
Accrued wages and benefits	38.2	44.0
Deferred revenue	25.0	29.2
Gold certificates	10.9	10.9
Other actuarial liabilities	10.4	9.8
Accrued grant liability	10.2	3.7
Exchange stabilization fund	9.4	9.2
Other debt	9.1	8.6
Deposit funds and undeposited collections	8.5	8.2
D.C. pension liability	8.4	8.3
Custodial liabilities	6.5	5.2
Other accrued liability	6.0	5.8
Other miscellaneous liabilities	50.0	15.5[1]
Total other liabilities	260.3	228.0[1]

[1] Restated – See Note 17.

Pension Benefit Guaranty Corporation (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, 2004, PBGC had liabilities of more than $60 billion for pension benefits, and its total liabilities exceeded its total assets by $23.5 billion. In addition, as discussed in Note 18, PBGC reported reasonably possible contingent losses of about $96 billion.

All other insurance programs include bank and savings and loan institutions (thrifts) deposit insurance and life and medical insurance. They also include insurance against damage to property (home, crops, and airplanes) caused by perils such as flooding and other natural disasters, risk of war, and insolvency.

The following are descriptions of some of the other categories (i.e., those over $5 billion) classified as other liabilities:

- Accrued wages and benefits consist of the estimated liability for civilian and military salaries and wages earned but unpaid. They also include annual leave and other employee benefits that have been earned but are unpaid.
- 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.
- Gold certificates include monetized portions of gold and certificates deposited in FRBs.
- Other actuarial liabilities includes the accrual of amounts recorded by the administering agencies for the actuarial liability of future benefit payments.
- Accrued grant liability represents the advances related to grant program funds provided primarily to State and local governments, as well as universities and nonprofit organizations.
- Exchange stabilization fund includes SDR certificates issued to the FRBs and allocations from the IMF.
- Other debt includes Government obligations, whether secured or unsecured, not included in public debt.

- Deposit funds 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.
- Other miscellaneous liabilities include amounts accrued for loss contingencies, mainly from DOL, DOE, DOI and FDIC, and other liabilities from the Department of Transportation (DOT), VA, USDA, and Treasury.

Note 15. Collections and Refunds of Federal Revenue

Collections of Federal Revenue for the Year Ended September 30, 2004

(In billions of dollars)	Federal Revenue Collections	Tax Year to Which Collections Relate			
		2004	2003	2002	Prior Years
Individual income tax and tax withholdings	1,695.3	1,128.1	541.0	13.2	13.0
Corporation income taxes	230.4	150.6	67.3	1.1	11.4
Estate and gift taxes	25.6	0.1	16.9	1.1	7.5
Excise taxes	71.8	52.7	18.6	0.5	-
Customs duties	21.0	21.0	-	-	-
Unemployment taxes	36.9	20.7	9.0	7.2	-
Railroad retirement taxes	4.5	3.4	1.1	-	-
Federal Reserve earnings	19.7	13.1	6.6	-	-
Fines, penalties, interest, and other taxes	3.7	3.6	0.1	-	-
Subtotal	2,108.9	1,393.3	660.6	23.1	31.9
Less: Amounts collected for non-Federal entities	(0.8)				
Total	2,108.1				

Collections of Federal Revenue for the Year Ended September 30, 2003

(In billions of dollars)	Federal Revenue Collections	Tax Year to Which Collections Relate			
		2003	2002	2001	Prior Years
Individual income tax and tax withholdings	1,670.2	1,098.0	547.9	13.1	11.2
Corporation income taxes	194.3	124.3	59.5	0.9	9.6
Estate and gift taxes	22.8	0.1	18.7	1.3	2.7
Excise taxes	69.6	50.9	18.2	0.1	0.4
Customs duties	20.2	20.2	-	-	-
Unemployment taxes	31.4	23.7	7.7	-	-
Railroad retirement taxes	4.4	3.3	1.1	-	-
Federal Reserve earnings	21.9	16.0	5.9	-	-
Fines, penalties, interest, and other taxes	2.2	1.5	0.7	-	-
Subtotal	2,037.0	1,338.0	659.7	15.4	23.9
Less: amounts collected for non-Federal entities	(0.4)				
Total	2,036.6				

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.

Individual income and tax withholdings include refunds and Earned Income Tax Credit (EITC) payments. EITC is a refundable credit for taxpayers who work and whose earnings fall below the established ceiling. A refundable credit is first used to offset any individual taxes owed; any remaining amounts are issued to the taxpayer. In fiscal year 2004, the IRS issued $38.2 billion in EITC refunds; $33 billion were applied to advance EITC, and an additional $5.2 billion of the EITC credits were applied to reduce taxpayer liability. (In fiscal year 2003, the IRS issued $31.8 billion in EITC refunds; $63 million were applied to advance EITC, and an additional $5 billion of the EITC credits were applied to reduce taxpayer liability.) All of these EITC amounts are included in gross cost in the Statements of Net Cost as a component of Treasury. Amounts reported for corporate income taxes in tax year 2004 include corporate taxes of $7 billion for tax year 2004. (Similarly, amounts reported for corporate income taxes collected in fiscal year 2003 include corporate taxes of $5 billion for tax year 2003.) Taxes collected are reported in the Revenue section of the Statements of Operations and Changes in Net Position, and are presented on a modified cash basis. On the other hand, collections reported in the table in Note 15—Collections and Refunds of Federal Revenue are reported on a gross cash basis.

The Statements of Operations and Changes in Net Position reports total revenue of $1,912.7 billion and $1,796 billion for fiscal years 2004 and 2003, respectively. The difference between collections, net of refunds, and total revenue is primarily due to changes in taxes receivable, imputed revenue for the EITC and Child Tax Credit, other collecting entities, and other earned revenue.

Federal Tax Refunds Disbursed for the Year Ended September 30, 2004

(In billions of dollars)	Refunds Disbursed	Tax Year to Which Refunds Relate			
		2004	2003	2002	Prior Years
Individual income tax and tax withholdings	230.1	0.6	210.0	12.6	6.9
Corporation income taxes	46.6	1.5	8.9	6.7	29.5
Unemployment taxes	0.1	-	0.1	-	-
Excise taxes	0.9	0.3	0.3	0.1	0.2
Estate and gift taxes	0.8	-	0.2	0.3	0.3
Custom duties	1.0	1.0	-	-	-
Total	279.5	3.4	219.5	19.7	36.9

Federal Tax Refunds Disbursed for the Year Ended September 30, 2003

(In billions of dollars)	Refunds Disbursed	Tax Year to Which Refunds Relate			
		2003	2002	2001	Prior Years
Individual income tax and tax withholdings	232.4	0.6	211.6	13.1	7.1
Corporation income taxes	66.1	2.0	11.1	10.8	42.2
Unemployment taxes	0.1	-	0.1	-	-
Excise taxes	0.9	0.2	0.3	0.1	0.3
Estate and gift taxes	0.9	-	0.2	0.4	0.3
Custom duties	0.7	0.7	-	-	-
Total	301.1	3.5	223.3	24.4	49.9

Note 16. Unreconciled Transactions Affecting the Change in Net Position

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 unreconciled transactions needed to bring the change in net position into balance amounted to a net value of $3.4 billion and $24.5 billion for the years ended September 30, 2004, and 2003, respectively.

The three primary factors affecting this out-of-balance situation are:

- Improper recording of intragovernmental transactions by agencies.
- Transactions affecting balance sheet assets and liabilities not identified properly by agencies as prior period adjustments.
- Timing differences and errors in reporting transactions.

The Federal financial community considers the identification and accurate reporting of these unreconciled transactions a priority.

Note 17. Change in Accounting Principle and Prior Period Adjustments

Change in Accounting Principle and Prior Period Adjustments to Fiscal Years 2004 and 2003

(In billions of dollars)	Increases to Net Position 2004	Increases to Net Position 2003
Change in Accounting Principle:		
Department of Defense	-	383.1
Prior Period Adjustments:		
Department of Defense	-	10.5

Change in accounting principle for fiscal year 2003 consists of a $383.1 billion net adjustment by DOD, resulting from changes in accounting principle that eliminated the category of national defense property, plant, and equipment in accordance with SFFAS No. 23, and included these assets in property, plant, and equipment for $316.6 billion and inventory for $66.5 billion in the balance sheet.

Prior period adjustments for fiscal 2003 consist of $11.5 billion due to inventory valuation changes and errors and $1 billion of undistributed disbursements from other liabilities to cumulative results of operations by DOD.

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 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 litigation described in the next paragraph.

Numerous litigation cases are pending involving, among many other matters, access to and participation in farm programs, spent nuclear fuel, North American Free Trade Agreement arbitrations, individual Native American money accounts and tribal accounts revenues. It is difficult to predict the outcome of litigation, and therefore, the ultimate total costs cannot be reasonably estimated at this time.

A Federal District Court ruled that DOE's plan to reclassify a portion of its radioactive waste violated provisions of the Nuclear Waste Policy Act of 1982. On November 5, 2004, the 9th U.S. Circuit Court of Appeals dismissed the lawsuit. DOE believes that additional legal challenges are possible; however, cost impacts to the waste program are unlikely.

In addition to litigation, DOD has other contingencies for the chemical demilitarization nonstockpile disposal (cost of destroying buried chemical munitions) and environmental restoration.

[2] For loss contingencies related to litigation, probable is defined as a future confirming event(s) that are likely to occur.

Loss Contingencies as of September 30

(In billions of dollars)	2004	2003
Insurance Contingencies:		
Pension Benefit Guaranty Corporation	96.0	85.6
Federal Deposit Insurance Corporation	0.4	5.9
Other insurance programs	0.8	1.0
Total insurance contingencies	97.2	92.5
Civil Litigation, Claims, and Assessments:		
Department of Homeland Security	-	3.9
Department of Defense	-	3.0
Department of Energy	3.0	-
Department of the Interior	0.4	0.4
Other civil contingencies	0.6	1.5
Total civil litigation, claims, and assessments	4.0	8.8
All Other Contingencies:		
Department of Defense	9.8	10.3
Other contingencies	-	0.8
Total other loss contingencies	9.8	11.1

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 2004	Operating Leases 2004	Capital Leases 2003	Operating Leases 2003
General Services Administration	0.3	22.1	0.3	19.9
U.S. Postal Service	0.6	9.6	1.0	8.7
Department of Justice	-	-	0.1	6.6
Department of Health and Human Services	-	1.0	0.1	1.9
Department of Veterans Affairs	-	0.1	-	1.6
Other long-term leases	1.0	3.8	1.1	5.4
Total long-term leases	1.9	36.6	2.6	44.1

	Undelivered Orders 2004	Undelivered Orders 2003
Department of Defense	185.6	167.1
Department of Housing and Urban Development	71.8	76.8
Department of Transportation	68.0	63.6
Department of Health and Human Services	67.4	68.4
Department of Education	46.4	40.7
Department of the Treasury	39.1	47.2
Department of Homeland Security	16.7	15.9
Department of Agriculture	14.0	24.6
U.S. Agency for International Development	11.4	9.0
Department of Energy	10.1	9.9
Department of Justice	9.9	11.0
Environmental Protection Agency	9.7	10.5
Department of State	7.1	6.0
National Science Foundation	6.9	6.3
General Services Administration	6.7	7.4
Department of Labor	6.0	7.0
Other undeliverable orders	19.5	24.3
Total undelivered orders	596.3	595.7

	Other Commitments 2004	Other Commitments 2003
Callable capital subscriptions for multi-lateral development banks	61.7	61.5
Department of Agriculture	52.0	23.0
Department of Energy	14.5	-
Department of the Treasury	8.5	-
Tennessee Valley Authority	8.0	5.0
National Oceanic and Atmospheric Administration satellites and weather systems	7.7	7.0
Department of Transportation	4.7	4.5
Real property activities	-	3.4
All other programs	-	2.6
Total other commitments	157.1	107.0

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. Dedicated Collections

Dedicated Collections as of September 30*

	Revenue		Expenses		Trust Fund Net Assets		Less Intra-governmental Net Assets		Consolidated Assets	
(In billions of dollars)	2004	2003	2004	2003	2004	2003	2004	2003	2004	2003
Federal Old-Age and Survivors Insurance Trust Fund	551.5	537.3	412.8	397.9	1,474.3	1,334.5	1,472.5	1,332.5	1.8	2.0
Civil Service Retirement and Disability Fund	82.1	76.7	90.5	102.7	641.7	611.5	641.4	611.2	0.3	0.3
Federal Hospital Insurance Trust Fund (Medicare Part A)	179.7	175.3	169.0	154.2	287.8	257.9	287.0	256.4	0.8	1.5
Military Retirement Fund	42.4	41.6	135.7	44.5	188.0	182.6	188.0	182.6	-	-
Federal Disability Insurance Trust Fund	87.9	86.0	75.3	69.9	187.4	175.7	185.3	173.7	2.1	2.0
Unemployment Trust Fund	39.8	34.0	41.7	53.8	47.9	50.4	46.3	49.1	1.6	1.3
Federal Supplementary Medical Insurance Trust Fund (Medicare Part B)	129.7	109.5	134.2	124.3	52.4	30.3	51.1	28.9	1.3	1.4
Medicare-Eligible Retiree Health Care Fund (MERHCF)	22.5	22.8	30.5	68.6	38.6	18.5	38.6	18.5	-	-
Highway Trust Fund	34.7	33.7	37.3	38.6	13.6	16.1	13.6	16.1	-	-
Railroad Retirement Trust Fund	9.2	9.2	9.1	8.9	5.1	4.9	5.0	4.9	0.1	-
Airport and Airway Trust Fund	9.7	9.3	10.8	9.7	10.7	11.2	10.7	10.5	-	0.7
Hazardous Substance Superfund	1.4	0.7	1.5	1.5	2.4	2.5	2.4	2.5	-	-
Black Lung Disability Trust Fund	0.5	0.5	1.0	1.0	0.1	-	-	-	0.1	-

*By law, certain expenses (costs) related to the administration of the above funds are not charged to the funds and are financed by other sources.

The table above depicts selected trust funds that have been chosen based on their financial activity. Additionally, the Federal Government has many other dedicated collections and trust 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.

Trust fund net 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).

Intragovernmental net assets are comprised of investments in Federal debt securities, related accrued interest, and fund balances with Treasury. These amounts were eliminated in preparing these financial statements.

Consolidated assets represent only the net assets from 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 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.

Depicted below is a description of all the funds included in the table Dedicated Collections as of September 30, which also includes the names of the Government agencies that administer each particular fund. For detailed information concerning liabilities, revenues by type, program expenses, other expenses, and other financial sources, as well as other changes in fund balance, please refer to the financial statements of the corresponding administering agencies. For information on the actuarial and other liabilities associated with the funds in this report, see Note 11—Federal Employee and Veteran Benefits Payable and Note 13—Benefits Due and Payable.

Federal Old-Age and Survivors Insurance Trust Fund

This trust fund provides assistance and protection against the loss of earnings due to retirement or death in the form of money payments. SSA administers the Federal Old-Age and Survivors Insurance Trust Fund.

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 Civil Service Retirement and Disability Fund 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 Civil Service Retirement and Disability Fund 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.

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 is set forth in 10 U.S.C. § 1461-1467.

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.

Unemployment Trust Fund

The Unemployment Trust Fund protects 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 primarily fund the Unemployment Trust Fund. 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 Unemployment Trust Fund 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 Part B)

The Federal Supplementary Medical Insurance Trust Fund finances the Supplementary Medical Insurance program (Medicare Part B) that provides supplementary medical insurance for enrolled eligible participants to cover physician and outpatient services not covered by Medicare Part A. HHS administers the program.

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-Eligible Retiree Health Care Fund

The DOD Medicare-Eligible Retiree Health Care Fund, 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.

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.

Railroad Retirement Trust Fund

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.

During fiscal year 2002, RRSIA, enacted on December 21, 2001, provided several changes in benefits and financing provisions for employees and widow(er)s. RRSIA also created NRRIT 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 Stewardship Information section).

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, as well as fuel used in non-commercial aircraft.
- International departure taxes.
- Interest earned on investments in Treasury securities.

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 (EPA) 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:

- Excise taxes collected on petroleum, chemicals, and imported substances (expired in 1995).
- Environmental taxes from corporations with alternative minimum taxable income in excess of $2 million (expired in 1995).
- Fines, penalties, and cost recoveries from responsible parties.
- Appropriations.
- Interest earned on investments in Treasury securities.

Black Lung Disability Trust Fund

The BLDTF provides benefits to coal miners who are totally disabled due to pneumoconiosis (black lung disease). It also covers surviving dependents of miners who died due to pneumoconiosis.

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.

Note 21. Indian Trust Funds

The Indian Trust Funds differ from other dedicated collections reported in Note 20—Dedicated Collections. 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's (OST's) Office of Trust Funds Management, holds trust funds in accounts for Indian tribes. It maintains approximately 1,400 accounts for Tribal and Other Special Trust Funds (including the Alaska Native Escrow Fund).

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 table below depicts the U.S. Government as trustee for Indian Trust Funds Held for Indian Tribes and Other Special Trust Funds. The 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 Changes in Trust Fund Balances as of September 30 (Unaudited)

(In millions of dollars)	2004	2003
Receipts	413.7	378.5
Disbursements	318.5	354.7
Receipts in excess of disbursements	95.2	23.8
Trust fund balances, beginning of year	2,880.1	2,856.3
Trust fund balances, end of year	2,975.3	2,880.1

OST also maintains about 260,000 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 table.

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 (Unaudited)

(In millions of dollars)	2004	2003
Receipts	204.6	194.2
Disbursements	221.0	192.5
Receipts in excess of disbursements	(16.4)	1.7
Trust fund balances, beginning of year	413.1	411.3
Trust fund balances, end of year	396.7	413.0

The amounts presented in the above two tables 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.

United States Government Supplemental Information (Unaudited) for the Years Ended September 30, 2004, and September 30, 2003

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 on the table below have been 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.

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)	2004	2003	2004	2003	2004	2003
Asset Category:						
General property, plant, and equipment	13.4	12.1	25.3	18.3	7.7	3.6
Heritage assets	-	-	0.1	0.1	-	-
Total deferred maintenance	13.4	12.1	25.4	18.4	7.7	3.6

Unexpended Budget Authority

Unexpended budget authority is the sum of the unobligated and obligated, but unliquidated, budget authority.

Unobligated budget authority, including amounts for trust funds, is the cumulative amount of budget authority that is not obligated and that remains 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 authority amount balance for fiscal years 2004 and 2003 are $359.4 billion and $383 billion, respectively.

Obligated budget authority is the cumulative amount of budget authority that has been obligated but not liquidated. This balance can be carried forward for a maximum of 5 years after the appropriation has expired. The total obligated budget authority amount balance for fiscal years 2004 and 2003 are $827 billion and $789.8 billion, respectively.

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 2002

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	38,133	211,417	3,942	5,544	103	1.9%
$15,000 under $30,000.......	29,964	657,946	27,621	21,958	922	4.2%
$30,000 under $50,000.......	24,556	959,677	70,761	39,081	2,882	7.4%
$50,000 under $100,000.....	26,687	1,864,379	196,005	69,862	7,345	10.5%
$100,000 under $200,000...	8,442	1,112,924	175,904	131,834	20,837	15.8%
$200,000 or more................	2,419	1,233,062	323,558	509,695	133,745	26.2%
Total.................................	130,201	6,039,405	797,791	-	-	-

Corporation Income Tax Returns for Tax Year 2001

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	12,101	3,410	28.2%
$1 under $500	9,232	1,662	18.0%
$500 under $1,000	4,624	1,027	22.2%
$1,000 under $5,000	13,786	4,031	29.2%
$5,000 under $10,000	7,091	2,310	32.6%
$10,000 under $25,000	10,330	3,399	32.9%
$25,000 under $50,000	8,945	2,892	32.3%
$50,000 under $100,000	10,711	3,379	31.5%
$100,000 under $250,000	20,613	6,378	30.9%
$250,000 or more	537,824	138,224	25.7%
Total	635,257	166,712	26.2%

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 $1.7 billion and $6.5 billion for fiscal years 2004 and 2003, respectively. For those under appeal, the estimated payout is $6.7 billion and $7.6 billion for fiscal years 2004 and 2003, respectively. 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.

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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 Agriculture (USDA)
www.usda.gov
Department of the Treasury (Treasury)
www.ustreas.gov
Department of Education (ED)
www.ed.gov
Department of Labor (DOL)
www.dol.gov
Department of Transportation (DOT)
www.dot.gov
Department of Veterans Affairs (VA)
www.va.gov
Department of Housing and Urban Development (HUD)
www.hud.gov
Department of Homeland Security (DHS)
www.dhs.gov
Department of Justice (DOJ)
www.usdoj.gov
Department of Energy (DOE)
www.energy.gov
National Aeronautics and Space Administration (NASA)
www.nasa.gov
Department of the Interior (DOI)
www.doi.gov
Pension Benefit Guaranty Corporation (PBGC)
www.pbgc.gov
Department of State (State)
www.state.gov
U.S. Agency for International Development (USAID)
www.usaid.gov
Railroad Retirement Board (RRB)
www.rrb.gov
Environmental Protection Agency (EPA)
www.epa.gov
Office of Personnel Management (OPM)
www.opm.gov
Department of Commerce (DOC)
www.doc.gov
Federal Communications Commission (FCC)
www.fcc.gov
National Science Foundation (NSF)
www.nsf.gov
Small Business Administration (SBA)
www.sba.gov
Federal Deposit Insurance Corporation (FDIC)
www.fdic.gov
Nuclear Regulatory Commission (NRC)
www.nrc.gov
Tennessee Valley Authority (TVA)
www.tva.gov
National Credit Union Administration (NCUA)
www.ncua.gov
General Services Administration (GSA)
www.gsa.gov
Export-Import Bank of the United States (Ex-Im Bank)
www.exim.gov
U.S. Postal Service (USPS)
www.usps.gov
Farm Credit System Insurance Corporation (FCSIC)
www.fcsic.gov
Smithsonian Institution
www.si.edu
U.S. Securities and Exchange Commission (SEC)
www.sec.gov

All Other Entities

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
Office of Management and Budget (OMB)
www.whitehouse.gov/omb

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
U.S.A. Education Inc. (Sallie Mae)