



A MESSAGE FROM THE SECRETARY OF THE TREASURY

I am pleased to present the fiscal year 2000 *Financial Report of the United States Government*. The Report includes audited financial statements that cover the executive branch, as well as parts of the legislative and judicial branches of U.S. Government. This is the fourth report issued pursuant to the Federal Financial Management Act of 1994. Our goal is to present the activities of the U.S. Government in a timely, accurate, and professional manner. Developing the capability for the Government to produce financial reports in accordance with generally accepted accounting principles continues to be an enormous task.

The U.S. Government is again reporting an accrual-based surplus, which this year is \$46 billion. Additionally, this past year the size of the Federal debt held by the public has been reduced by \$223 billion. All 24 major agencies completed their financial statements on time and the quality of their reporting continues to improve. The Joint Financial Management Improvement Program has established a Governmentwide financial software certification process that is beginning to ensure that commercial systems being purchased by the Federal Government meet its requirements.

The Statement of Federal Financial Accounting Standards Number 17 "Accounting for Social Insurance" became effective in fiscal year 2000. Accordingly, for the first time this Financial Report is required to contain comprehensive information regarding Social Security, Medicare, Railroad Retirement benefits, Black Lung benefits, and Unemployment Insurance. The purpose of this statement is to assist users in evaluating the Government's financial condition and the sufficiency of future budgetary resources to sustain program services and meet program obligations as they come due.

I am pleased that the Government has progressed to the point where a comprehensive report such as this can be issued; however, in my experience, reporting financial results 6 months after the end of the year is simply not good enough. Nor does this adequately fulfill our responsibilities to Congress or to the public. This process will improve. Over the next several years this Administration will be implementing a series of improvements to achieve the following goals:

- We will substantially accelerate the timing of the issuance of agency and Governmentwide financial reports.
- A comprehensive review of the processes necessary to produce financial statements will be conducted by management and our auditors, and the results of their recommendations will be implemented.
- The Treasury Department will implement new Governmentwide central accounting systems and processes for reporting budget execution information to improve data access, reduce redundant data entry and reporting, and eliminate time-consuming reconciliations.

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

Paul H. O'Neill

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MANAGEMENT'S DISCUSSION AND ANALYSIS

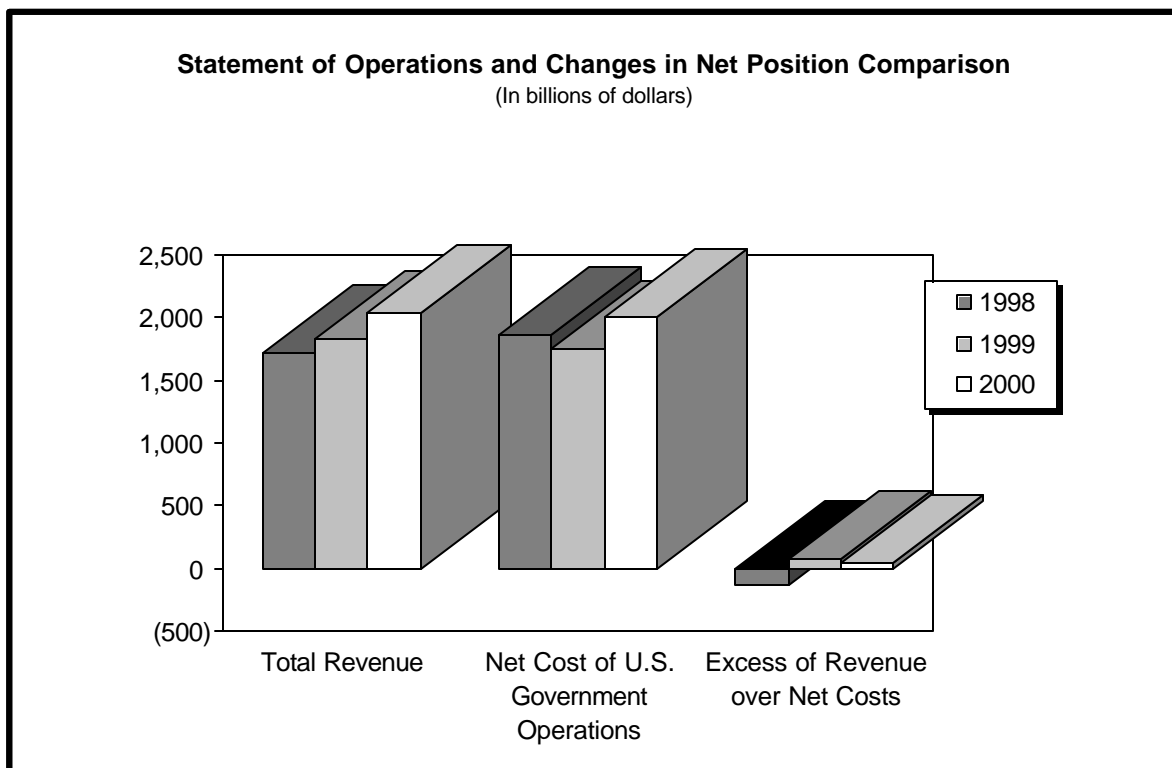
Introduction

We are pleased to be presenting the fourth annual consolidated *Financial Report of the United States Government (Financial Report)*. Although we continue to receive a disclaimer of opinion from our auditors, we have made significant progress in our quest to report the financial activities of the U.S. Government timely, reliably, and in a format that is useful to the readers. All 24 of the largest agencies completed their financial statements on time and 18 received an unqualified or clean opinion this year, which compares to 15 last year. We are committed and will continue to work to improve financial management, modernize the Government's financial management systems, and strengthen financial reporting.

The accompanying *Financial Report* is required by 31 United States Code 331(e)(1) and consists of the Management's Discussion and Analysis (MD&A), Statement of Operations and Changes in Net Position, Statement of Net Cost, Balance Sheet, Stewardship Information, Notes to the Financial Statements, and Supplemental Information. Each section is preceded by a description of its contents.

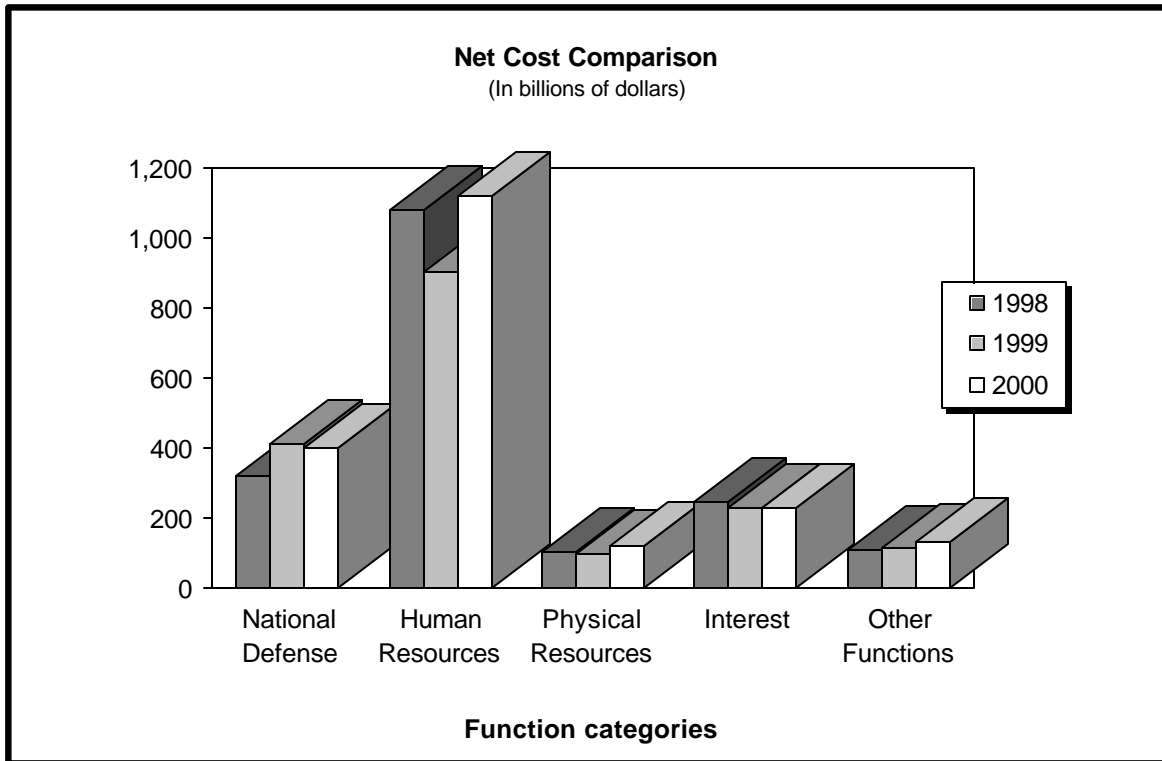
Financial Highlights

The following charts present comparisons in major revenue, cost, asset, and liability amounts between fiscal 1998, 1999, and 2000. Some of these changes are discussed in the following sections.

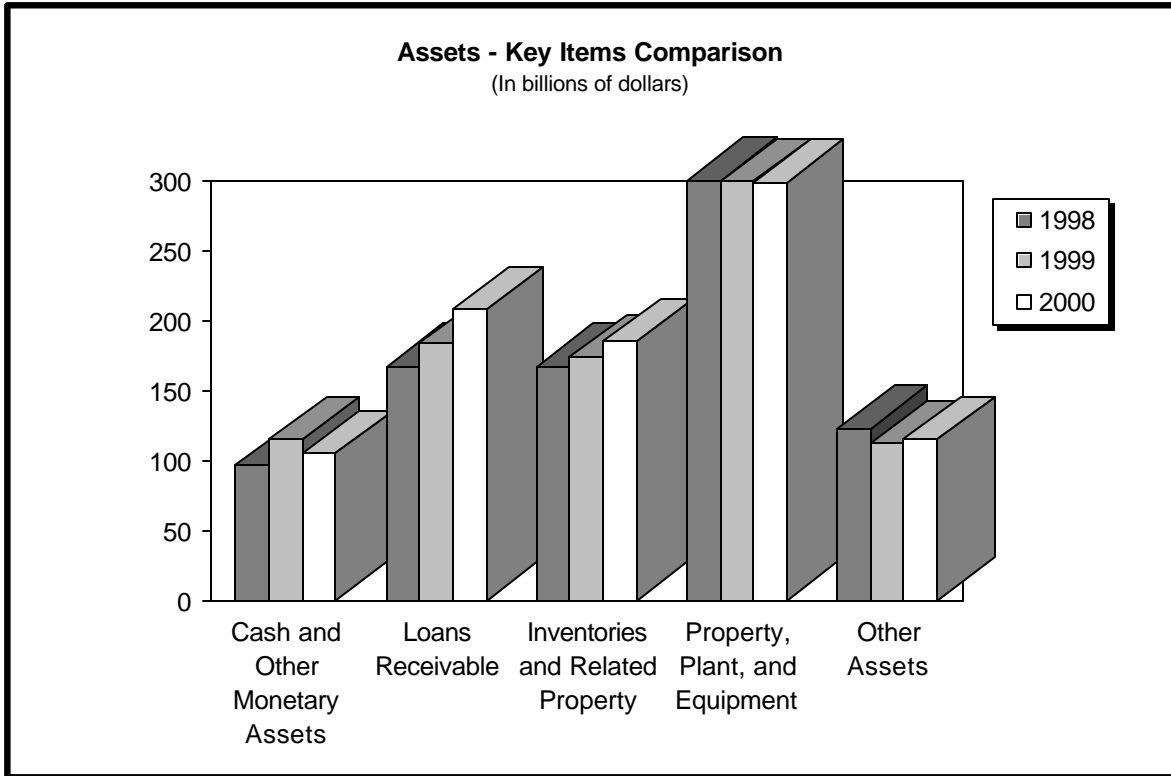


This chart shows that the Government has progressed from an accrual deficit in fiscal 1998 to accrual surpluses in fiscal 1999 and 2000. Revenue has steadily increased each year while Net Cost of U.S. Government Operations

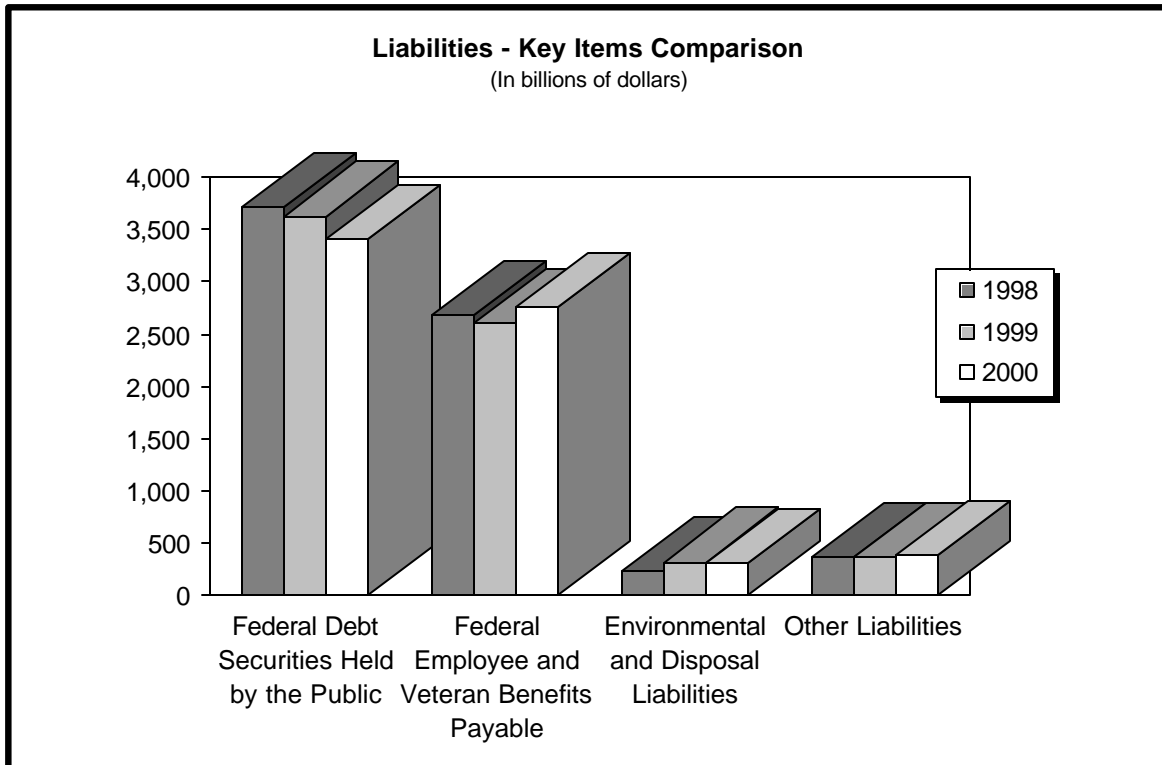
experienced a decrease in fiscal 1999. The largest increase in revenue for fiscal 2000 was for individual income tax and tax withholdings (an increase of \$179.2 billion or 12.3 percent). The decrease in net cost for fiscal 1999 was due primarily to a change in the interest rate assumptions for the veterans compensation and burial benefits payable and its effect on net cost was a decrease of \$204.8 billion. In fiscal 2000, there were further changes in the actuarial and interest rate assumptions resulting in an increase in net cost and accrued liability for veterans benefits and services of \$62.5 billion.



The above chart compares net cost, by fiscal year, in each function category. As noted earlier, the reduction in human resources for fiscal 1999 was due primarily to a change in the interest rate assumptions for the veterans compensation and burial benefits payable. Interest has been declining in relationship to the decrease in the debt held by the public; however, in fiscal 2000, the decrease in interest was offset by a \$5.5 billion premium on buyback purchases.



The above chart compares changes in key balance sheet asset items by fiscal year. In fiscal 1999, cash and other monetary assets increased by 19 percent over the previous year with cash comprising the largest increase of \$18.2 billion. In fiscal 2000, cash and other monetary assets decreased by 9 percent with international monetary assets decreasing by \$6.9 billion and cash decreasing by \$4.2 billion. For fiscal 2000, loans receivable increased by 13 percent with Federal Direct Student Loans comprising the largest dollar increase of \$16.8 billion. Inventories and related property increased by 7 percent in fiscal 2000 with operating materials and supplies increasing by \$25.8 billion and inventory held for sale, principally to Federal agencies, decreasing by \$14.1 billion.



The above chart compares changes in key balance sheet liability items by fiscal year. As clearly shown above, the Federal debt securities held by the public have been significantly decreasing over the past 2 years. The reduction in fiscal 2000 was \$223.1 billion. The reduction in the Federal employee and veteran benefits payable for fiscal 1999 was primarily as a result of a change in the interest rate assumption for computing the liability for veterans compensation and burial benefits payable. In fiscal 2000, the liability for veterans compensation and burial benefits payable increased by \$62.5 billion, mainly due to changes in actuarial and interest rate assumptions. In addition, civilian and military pension liability increased in fiscal 2000 by \$46.7 billion and \$28.6 billion, respectively.

Mission and Organizational Structure

No other entity in the world compares in size, scope, and complexity to the U.S. Government. The Federal Government is the largest landowner in the world. Its budgeted outlays for fiscal 2000 were \$1.8 trillion. A civilian Federal workforce of 2.7 million individuals plus 1.4 million Department of Defense active duty military personnel serves a diverse Nation of more than 275 million Americans.

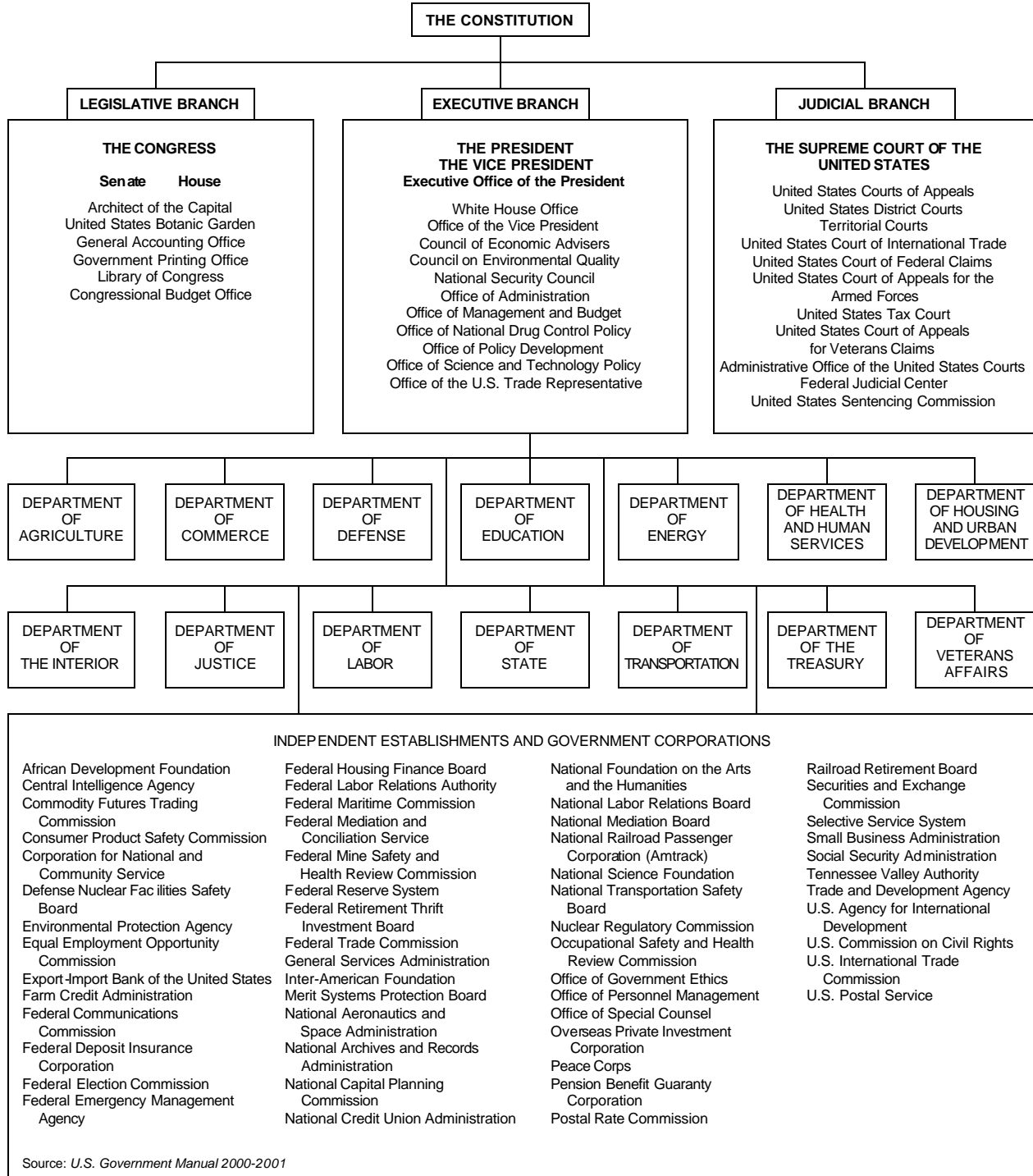
To fulfill its constitutional mandates, the U.S. Government undertakes a wide variety of programs to:

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

- Administer justice.

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

THE GOVERNMENT OF THE UNITED STATES



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

| Item of Interest | Amount for the United States | Information as of | Country Rank | Comments |
|---|------------------------------|-------------------|-----------------|--|
| Land area | 9,158,960 square kilometers | | 4th | Russia, China, and Canada are larger. |
| Population | 275.6 million | July 2000 est. | 3 rd | China and India are greater. |
| Gross domestic product | \$9.255 trillion | 1999 est. | 1 st | |
| Gross domestic product—per capita | \$33,900 | 1999 est. | 2 nd | Luxembourg was first. |
| Electricity—production | 3.62 trillion kilowatthour | 1998 | 1 st | This was 29.3 percent of world production. |
| Telephones—number of main lines in use | 178 million | 1999 | 1 st | |
| Military expenditures—dollar figure | \$276.7 billion | Fiscal 1999 est. | 1 st | |
| Military expenditures—percent of gross domestic product | 3.20 percent | Fiscal 1999 est. | 39th | North Korea was first with an estimate of 25-33 percent. |

SOURCE: Central Intelligence Agency's *The World Factbook 2000*

Financial Results

The excess of revenue over net cost figure (accrual basis) contained in these financial statements for fiscal 2000 is \$46.0 billion. In fiscal 2000, there was a unified budget surplus (primarily on the cash basis) of \$236.9 billion. The primary components of the difference that have been identified are increases in the liability for veteran compensation and burial benefits, \$62.5 billion; increases in the liability for civilian employee benefits, \$55.3 billion; increases in the liability for military employee benefits, \$39.5 billion; principal payments of pre-credit reform loans, \$24.1 billion; increases in environmental liabilities, \$19.6 billion; and decreases in capitalized fixed assets, \$31.6 billion. For more information on the detailed reconciliation, see the Reconciliation of the Excess of Revenue Over Net Cost to the Unified Budget Surplus in the Supplemental Information section.

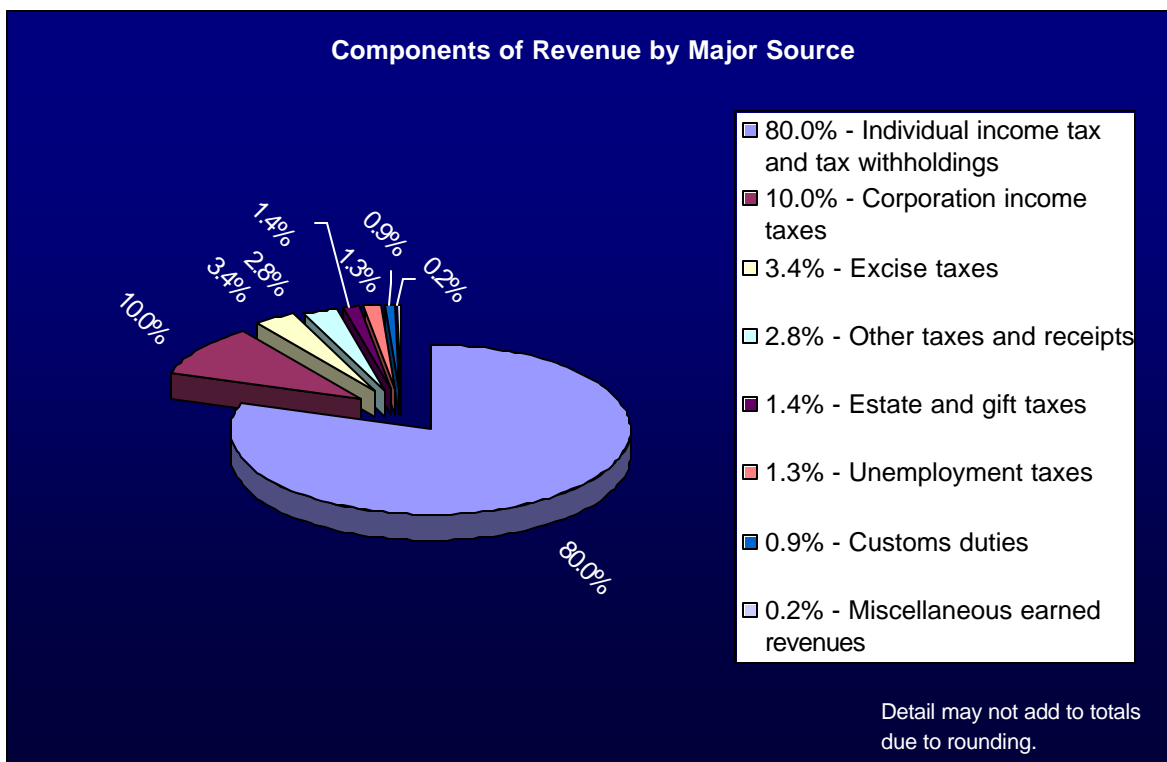
Revenue and Expense Summary

Revenue

Government revenue comes from two sources: nonexchange transactions and exchange transactions. Nonexchange revenues arise primarily from exercise of the Government's power to demand payments from the public (e.g., taxes, duties, fines, and penalties) but also include donations. Nonexchange revenue is the U.S. Government's primary source of revenue and totaled \$2,040.0 billion in fiscal 2000. More than 95 percent of this total came from tax receipts, with the remainder coming from customs duties and other miscellaneous receipts.

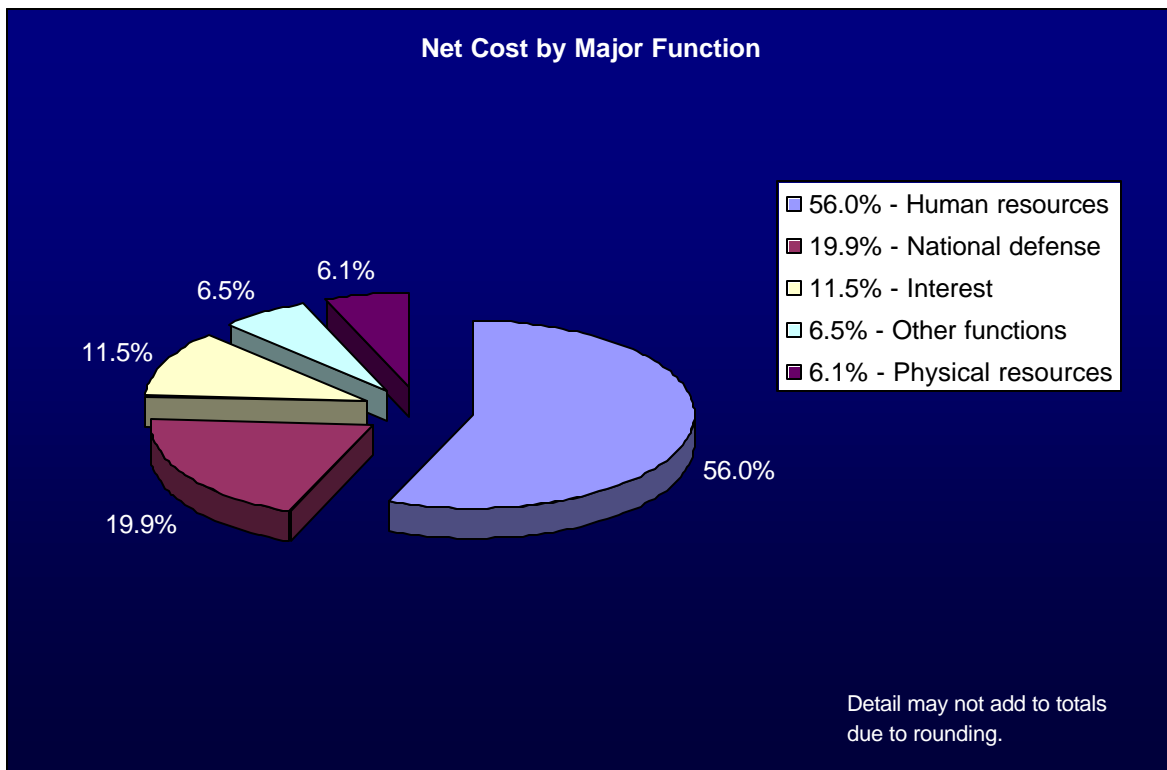
Exchange revenues arise when a Government entity provides goods and services to the public or to another Government entity for a price. Another term for exchange revenue is earned revenue. During fiscal 2000, the U.S. Government earned \$160.5 billion in exchange revenue. Of these revenues, \$155.7 billion is offset against the gross cost of the related functions to arrive at the function's net cost. The U.S. Government also earned \$4.8 billion that was not offset against the cost of any function (e.g., royalties on the Outer Continental Shelf lands).

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



Expenses by Function

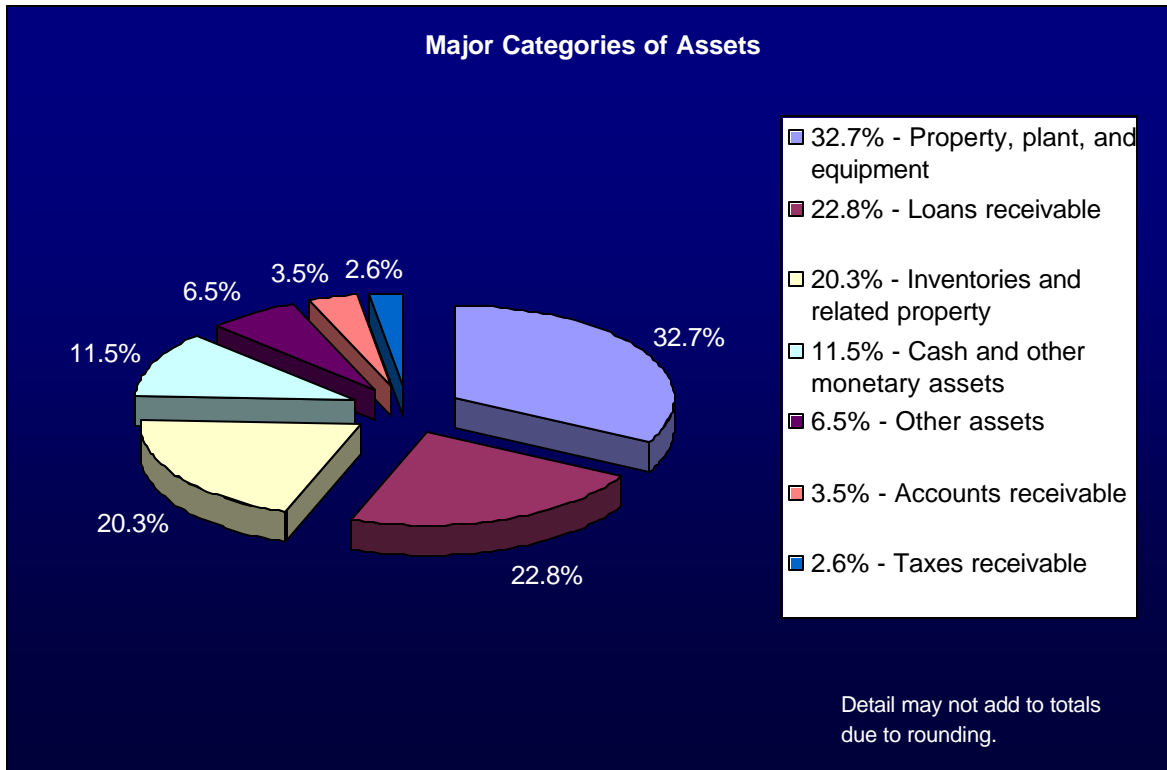
The net cost of U.S. Government operations was \$1,998.8 billion for fiscal 2000. Net cost represents the gross cost of operations less related earned revenues. The Statement of Net Cost reflects the cost incurred to carry out the national priorities identified by the President and the Congress. Costs are allocated to functions and subfunctions based on accounting standards and, in some cases, may be allocated differently than the budget. The functions and subfunctions used to accumulate costs associated with the national priorities are identified in the President's budget and described in detail in the Supplemental Information section of this *Financial Report*. The accompanying chart presents the percentage of the net cost of U.S. Government operations by each of the U.S. Government's major functions.



Asset and Liability Summary

Assets

The assets of the U.S. Government are the resources available to pay liabilities or to satisfy future service needs. The accompanying chart depicts the major categories of reported assets as of September 30, 2000, as a percentage of reported total assets. Detailed information about the components of these asset categories can be found in the Notes to the Financial Statements.

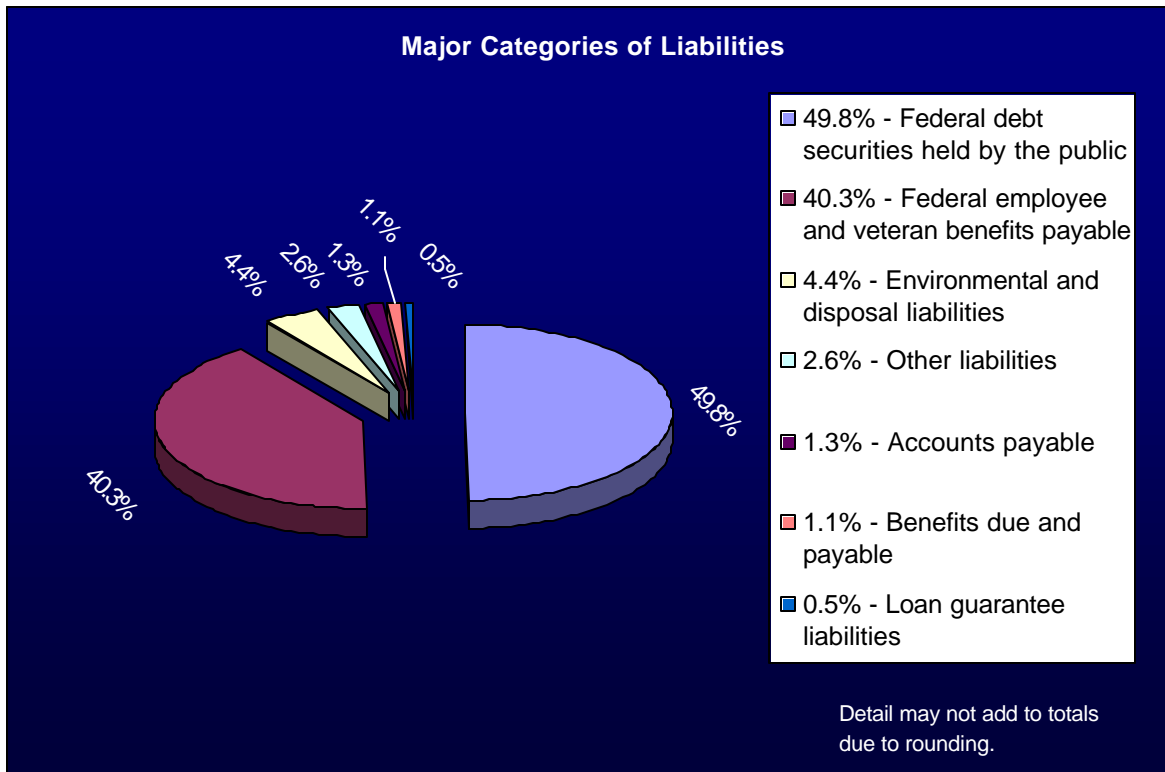


The assets presented on the Balance Sheet are not a comprehensive list of Federal resources. Natural resources, stewardship land (national parks, forests, and grazing lands), national defense assets, and heritage assets are examples of resources that are not included in the \$911.5 billion of Federal assets reported on the Balance Sheet at the end of fiscal 2000. Detailed information about national defense assets, stewardship land, and heritage assets can be found in the Stewardship Information section. Another example, the U.S. Government's most important financial resource, its ability to tax and regulate commerce, cannot be quantified and is not reflected.

Liabilities

At the end of fiscal 2000, the U.S. Government reported liabilities of \$6,848.6 billion. These liabilities are probable and measurable future outflows of resources arising out of past transactions or events. The largest component of these liabilities (\$3,408.5 billion) is represented by Federal debt securities held by the public. The next largest component (\$2,757.8 billion) relates to pension, disability, and health care costs for Federal civilian and military employees as well as for veterans. Included in this component is a Department of Veterans Affairs program whereby veterans or their dependents receive compensation benefits if the veteran was disabled or died from military service-connected causes. During fiscal 2000, changes in actuarial and interest rate assumptions were the primary factors contributing to the increase of \$62.5 billion for veterans compensation and burial payable. Another liability, which will likely require substantial future budgetary resources to liquidate, is related to environmental cleanup costs associated with environmental damage/contamination. As of September 30, 2000, the recognized cost of cleaning up environmental damage/contamination across Government programs was estimated to be \$301.2 billion.

The accompanying chart presents the percentage of total Federal liabilities represented by each of the categories of liabilities reported on the Balance Sheet. Additional details about the U.S. Government's reported liabilities can be found in the Notes to the Financial Statements.



Federal Debt and Budget Surpluses

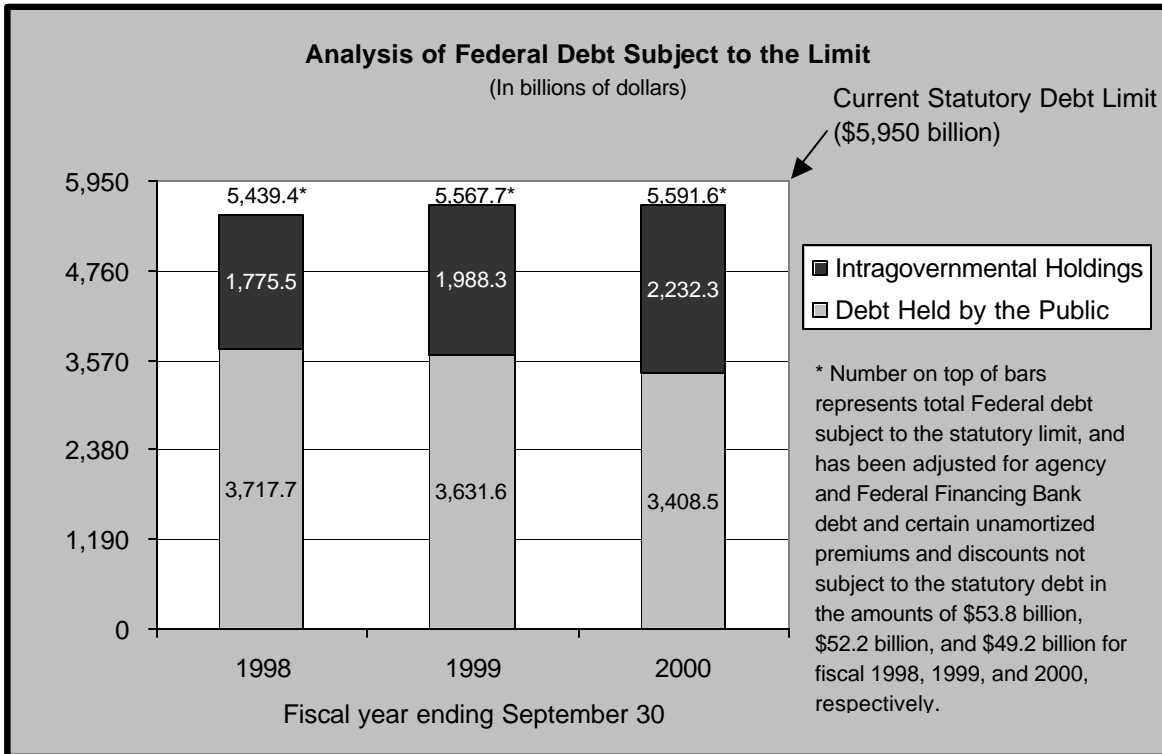
Now that the Federal Government has achieved budget surpluses coupled with projections of continuing surpluses, focus has started to shift to the impact of the surpluses on the Federal debt.

While we have had 3 consecutive years of budget surpluses, it is important to understand the composition of budget surpluses, and the relationship that these excess funds have had on reducing or changing the composition of the Federal debt. There are two components of Federal debt: debt held by the public and intragovernmental holdings.

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

Intragovernmental holdings include Government Account Series securities held by Government trust funds, revolving funds, and special funds; Federal Financing Bank securities held by Government trust funds; and Treasury securities and agency securities held by Government accounts. The laws establishing Government trust funds (such as the Social Security and Medicare Trust Funds) generally require the balances to be invested in special Treasury debt securities. Although intragovernmental holdings are used in the calculation of the Federal debt subject to the statutory debt limit, intragovernmental transactions are eliminated in the consolidation process of preparing this *Financial Report* since they are claims of one part of the Government against another part. However, they are important to an understanding of total debt because, as the intragovernmental securities are redeemed, other sources of funds will be identified to fund the redemptions.

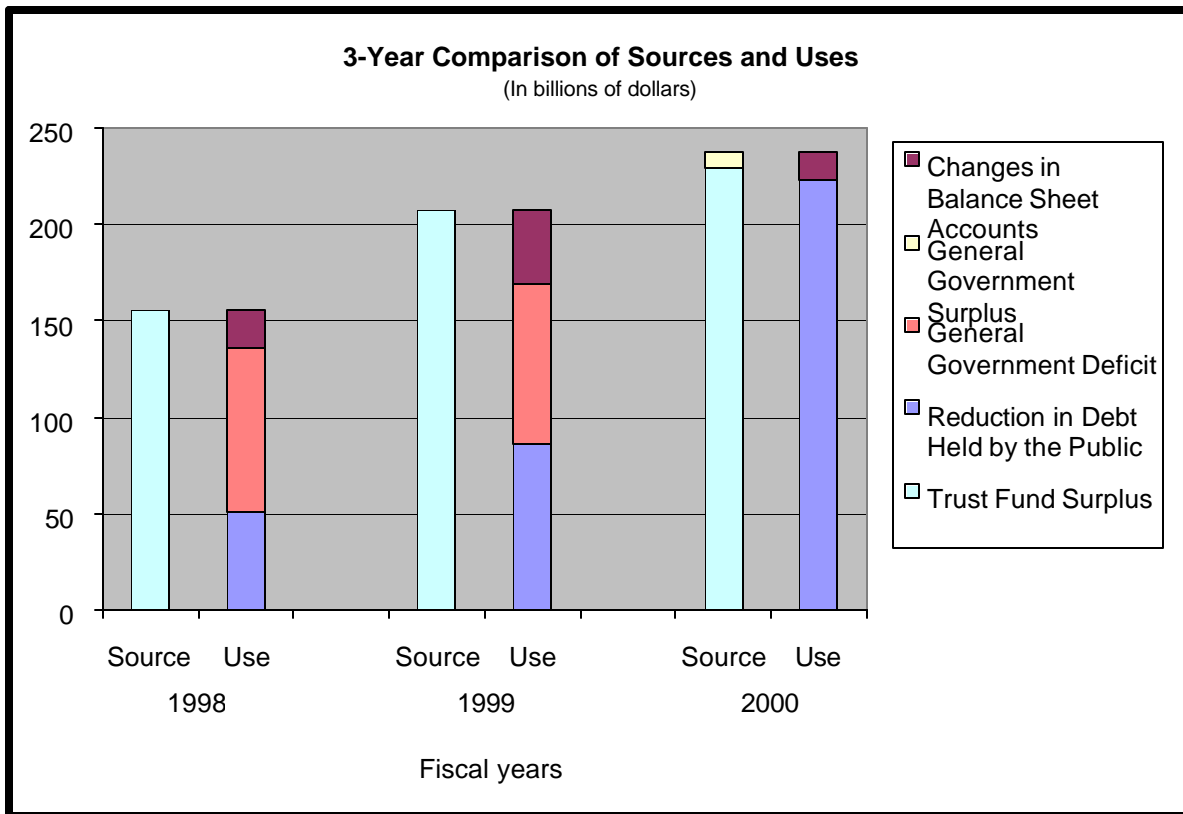
The following chart presents a 3-year comparison of the components of Federal debt subject to the statutory debt limit.



As can be seen from the above chart, debt held by the public has been reduced by over \$300 billion since 1998; however, total debt subject to the limit has risen by \$152.2 billion over the same period. This is because the intragovernmental holdings have risen faster than the debt held by the public has been repaid.

Due to the Government's improved cash position, Treasury's external borrowing needs have declined significantly. Debt maturing still exceeds the Government's cash surplus, however, and new securities continue to be issued. To adjust the Government's borrowing program, Treasury has taken a number of actions including initiating a buyback program, a competitive redemption process by which Treasury accepts offers to redeem certain marketable Treasury securities (debt held by the public) prior to their maturity date. During fiscal 2000, a total of 13 buybacks occurred involving the redemption of \$21.3 billion par amount of marketable Treasury securities at a total cost of \$26.7 billion.

Federal Government operations are composed of two parts: trust funds, which receive their funding from dedicated collections, and general government, which is funded from general revenues. Trust funds are funds that are designated by law as trust funds. For Federal Government trust funds, the beneficiaries do not own the moneys in the funds and the Congress may, and often does, unilaterally alter the collections, benefit levels, or other features of the programs financed by the funds. These Federal trust funds provide funding for specific programs and purposes. The income from the funds must be used only for the purposes designated by law. Many of the larger trust funds finance social insurance programs (such as Social Security and Medicare) and Federal military and civilian retirement programs. Other major trust funds finance highway and transit construction and airport development. The following chart illustrates a 3-year comparison of the surpluses or deficits of these two parts of Government and how the budget surpluses were used.



Trust fund surpluses (the white area in the chart) are invested in Treasury securities. The cash invested in the Treasury securities is mainly used for two purposes: to reduce the debt held by the public (the diagonally striped area) and to cover the general government deficits (the black area). Due to having a general government surplus in fiscal 2000, almost all of the budget surplus could be used to reduce the debt held by the public.

The budget surpluses, which are based primarily on a cash basis, are due almost entirely to the trust fund surpluses. General government operations experienced budget deficits for fiscal 1998 and 1999, but had a surplus for fiscal 2000.

Future Commitments

Social Security and Medicare: Fiscal Challenges Looming on the Horizon

For 65 years, Social Security has provided retirement security for tens of millions of Americans. Like Social Security, Medicare represents a promise that the Nation has made to its senior citizens. As demographics change and costs increase, ensuring that these two programs are strengthened for tomorrow's retirees and beneficiaries poses a long-term fiscal challenge. Reform is significantly easier to implement if done far in advance, so that individuals and families have time to adjust their personal plans and changes can be phased in slowly over time.

Both Social Security's and Medicare's spending paths are unsustainable in the long run, driven largely by demographic trends. First, longer life spans mean more benefit payments. Advances in health and well-being have led to significant increases in the average life span in the 21st century. The net result is that people are spending a growing proportion of their lives in retirement and facing the inevitable medical needs of aging persons. While longer life spans are clearly desirable, they also mean additional years of Social Security and Medicare payments, and a dramatic long-term increase in Government obligations.

Compounding this problem is the long-term decline in fertility rates. This means there will be fewer workers available to support each beneficiary once the baby boom generation starts to retire.

Under current legislation and using intermediate assumptions, the Trustees estimated in their 2001 report, released on March 19, 2001, that by 2016 cash disbursements for the Social Security programs will exceed cash receipts from taxes and by 2038 the combined trust fund assets, primarily investments in special Treasury securities, will be exhausted. When this occurs, dedicated tax revenues would be sufficient to pay only approximately 73 percent of the benefits due. Additional information about the Social Security program can be found in the Stewardship Information section of this *Financial Report*, along with updated information from the 2001 report.

While demographic trends will dramatically change spending for both Social Security and Medicare, the problem is likely to be more pronounced in Medicare due to the expected increases in health care costs per beneficiary. Today, Medicare covers only 53 percent of the average senior's annual medical expenses. Medicare per capita spending is projected to vastly outpace the Consumer Price Index for the next 25 years.

While it is true that the Hospital Insurance Trust Fund is projected to have a surplus over the next 10 years, it is misleading to focus so much attention on only one of the program's two trust funds representing only 60 percent of total Medicare spending. A full assessment of Medicare's finances reveals spending exceeds the total of tax receipts and premiums dedicated to Medicare today, and that "financing gap" is projected to widen dramatically. This annual gap was \$51 billion in fiscal 2000, growing to \$216 billion (using constant dollars) in 2020, and \$368 billion in 2030. Additional information on the Medicare program can be found in the Stewardship Information section of this *Financial Report*.

Economic and Budgetary Results

Fiscal 2000 was a very favorable year for the economy and for the budgetary position of the U.S. Government. Economic growth was even stronger than in the previous fiscal year, and the unemployment rate held at the lowest level in more than 30 years. Although large increases in oil prices resulted in a higher overall rate of inflation, "core" inflation (excluding energy and food) remained contained. Productivity rose at an even faster pace than in the preceding several years and helped to restrain inflationary pressures.

The Economy in Fiscal 2000

Economic growth in fiscal 2000 accelerated from the previous year, and the current expansion became the longest on record. Real gross domestic product (GDP) increased by a sizable 5.2 percent over the four quarters of the fiscal year (encompassing the fourth quarter of calendar 1999 through the third quarter of calendar 2000). That was the largest increase on a fiscal year basis in 16 years, although economic growth slowed considerably in the final quarter of the fiscal year. During the course of the fiscal year, the first three quarters grew at 8.3 percent, 4.8 percent, and 5.6 percent, while the last quarter (July-September) grew at only 2.2 percent.

Growth in fiscal 2000 was powered by strong gains in productivity. Average annual increases in labor productivity doubled to 3 percent over the past 5 years, compared to an average annual rate of about 1-1/2 percent from 1974 to 1995. Last year productivity growth accelerated even further, to an outsized 4.8 percent over the four quarters of the fiscal year.

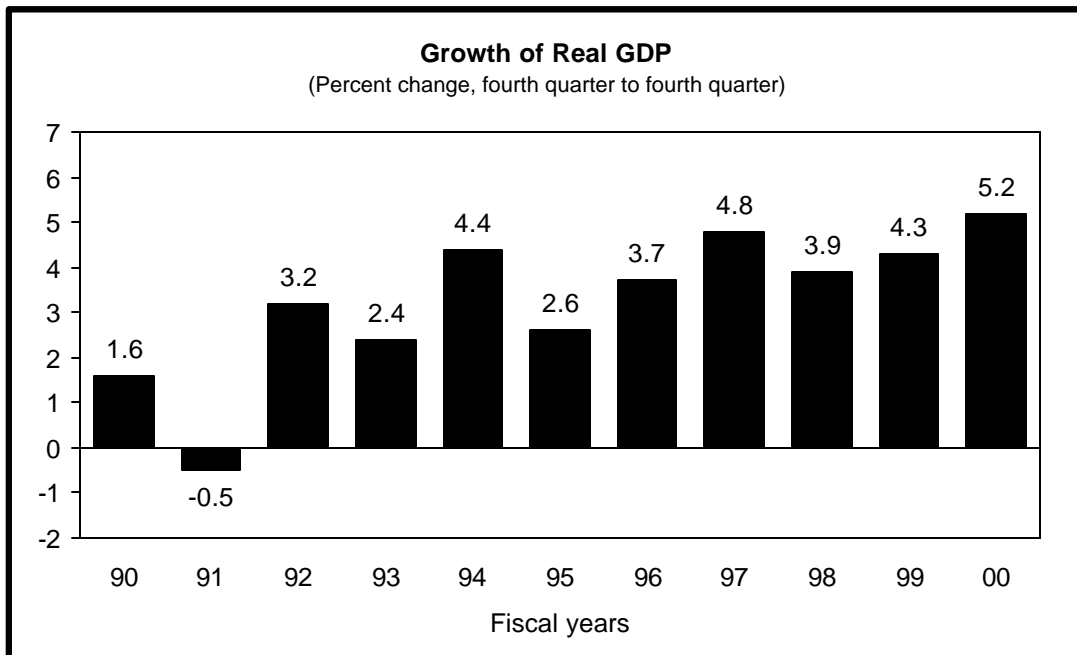
Growth in consumer spending and business investment in equipment and software was very rapid in fiscal 2000. Real consumer purchases increased by 5.3 percent over the year, matching the growth of fiscal 1999 as the fastest in 14 years.

Labor markets remained tight in fiscal 2000. The unemployment rate held within a narrow band of 3.9 percent to 4.1 percent during the fiscal year, the lowest readings in three decades.

The rate of inflation increased in fiscal 2000 due to higher oil prices, but underlying inflationary pressures remained contained even with strong economic growth and low unemployment. The acceleration in productivity growth to almost 5 percent over the fiscal year helped to hold down costs. The Consumer Price Index rose by 3.5 percent over the fiscal year compared with 2.6 percent in fiscal 1999. Increases in fiscal 2000 were led by a nearly 16 percent jump in energy prices. Excluding energy and food, growth in "core" consumer prices posted a moderate 2.5 percent increase, up a bit from 2.1 percent in the prior fiscal year but in line with gains over the prior 3 fiscal years.

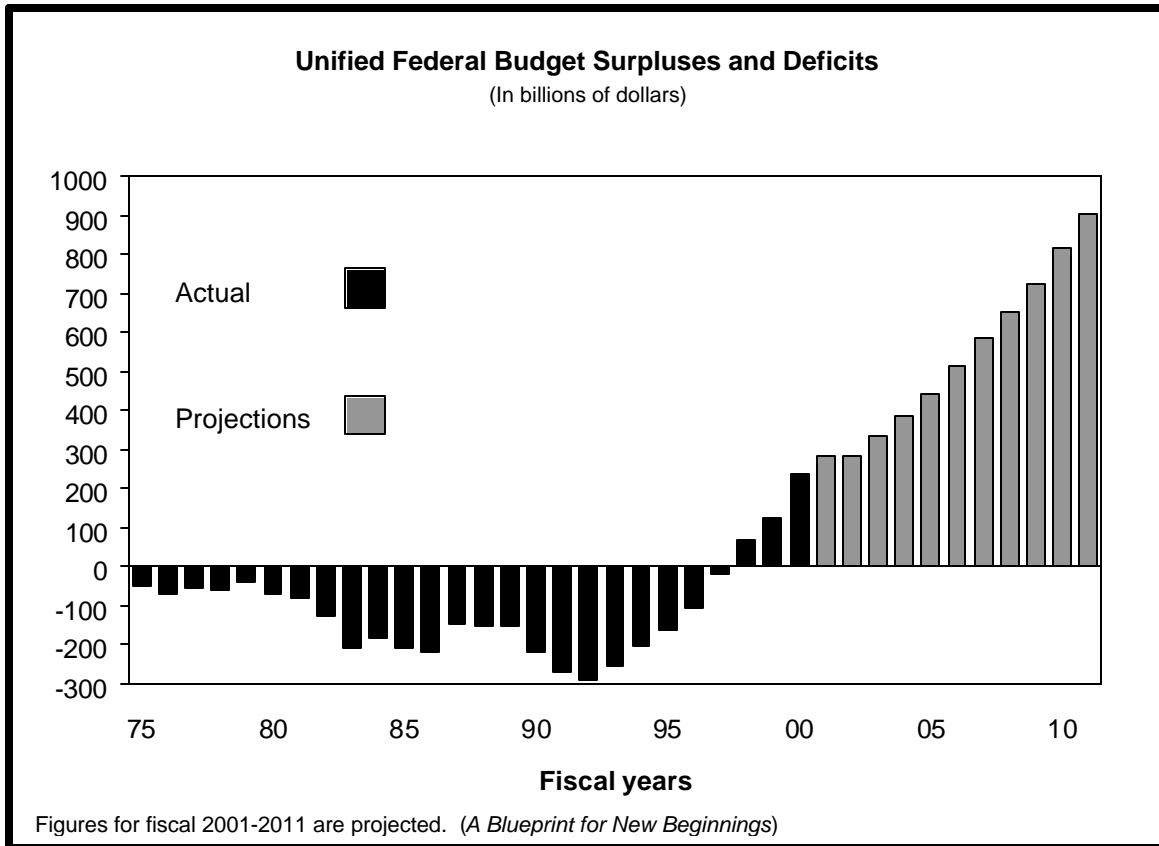
The Federal Reserve raised short-term interest rates four times over the course of fiscal 2000. The Federal Reserve described its actions as the appropriate policy for avoiding the inflationary risk of growth in demand, exceeding even the productivity-enhanced growth in potential supply. The targeted Federal funds rate (the rate that banks and other financial institutions charge one another for overnight loans) was raised from 5.25 percent to 6.5 percent. The discount rate (the rate the Federal Reserve charges banks for short-term funds) was raised from 4.75 percent to 6.0 percent.

Economic indicators have continued to decline since the end of fiscal 2000. The Bureau of Economic Analysis estimates that the real GDP only increased at an annual rate of 1.1 percent in the first quarter of fiscal 2001 (October-December). Furthermore, the Federal Reserve reduced both the Federal funds rate and the discount rate by one full percentage point in January 2001 and 0.5 percent in March 2001, citing that risks were weighted mainly toward economic weakness.



Budget Projections

New budget projections for fiscal 2001 and beyond (primarily on the cash basis) show the surplus is expected to rise to \$284 billion this fiscal year. Over the following 10 years, the unified budget surplus under the current services baseline (i.e., with no changes to tax and spending laws already enacted) is now projected to total a cumulative \$5.6 trillion.



Significant Performance Accomplishments

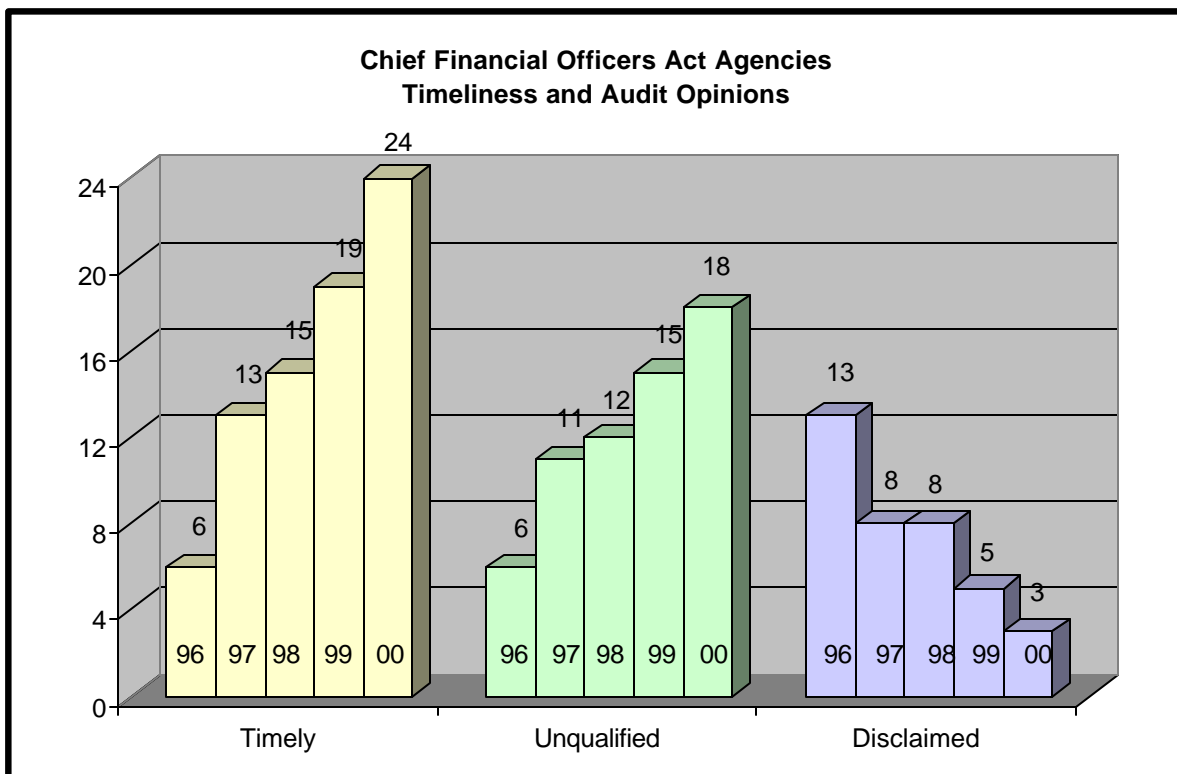
Many Goals Successfully Achieved

The Federal Government has devoted substantial efforts to tackling long-standing and difficult agency-specific and Governmentwide management challenges that defy easy solutions. By focusing coordinated, sustained, and intensive attention on these issues, Federal employees achieved significant contributions to improved Government management, including:

- Successful resolution of the Year 2000 (Y2K) problem. Y2K posed the single largest technological management challenge in history, and Federal agencies ensured that the transition occurred smoothly. The lessons learned from the Y2K experience are helping agencies deal with other information technology-related challenges.
- Census 2000 was completed on time, under budget, and with a higher than expected mail response.
- Efforts to protect the Government's critical infrastructure have led to greater incident response capabilities and an overall heightened awareness of the importance of computer security.

- The Internal Revenue Service (IRS) restructured its operations to ensure the fairness of tax administration and to improve customer service, productivity, and financial management. For example, it has expanded the hours when toll-free assistance is available and offered new electronic filing and payment options.
- The Department of Education's student aid performance-based organization issued the Government's first incentive-based information technology contract, estimated to save \$40-50 million by fiscal 2004. Electronic applications for student aid increased by one-third last year, reducing processing times and costs.
- The Immigration and Naturalization Service reduced its citizenship application processing time to approximately 6 months—down from 27 months only a few years ago.
- Electronic-Government (e-Gov) successes included the launching of FirstGov.gov, a one-stop gateway to all Government information on the Internet; FedBizOpps.gov, a single portal for contracting agencies; FedSales.gov, a website listing all available assets for transfer or sale to the public; and FedCommons.gov, a single source for applications and information about grants.

For the first time, in fiscal 2000, all of the 24 largest agencies met the March 1 deadline for completing and submitting their audited financial statements. Eighteen (75 percent) received clean (unqualified) opinions and three others received qualified opinions. This leaves only three agencies with disclaimed opinions, a condition where the auditors are unable to render an opinion, generally because of deficiencies in the accounting records. The following exhibit illustrates agencies' progress toward unqualified audit opinions on their financial statements. (Audits for all of the 24 major agencies were not required until 1996.)



Financial Challenges Remain

While significant progress has been made, three major agencies continue to have serious shortcomings in financial management reporting and systems that resulted in disclaimers. These agencies must satisfactorily address these problems to receive unqualified opinions on their financial statements and for the U.S. Government to receive an unqualified opinion on its financial statements.

Identifying and eliminating transactions between agencies (intragovernmental transactions) for Governmentwide reporting is still a problem for most agencies. If these transactions are not properly eliminated, total U.S. Government assets, liabilities, revenues, and expenses will be misstated. Significant improvements were

made in the area of intragovernmental fiduciary transaction issues during fiscal 2000, including the development of policies and procedures for accounting, reporting, and reconciliations; however, more improvements need to take place before this can be removed as a material deficiency.

Audits of agency financial statements disclose internal control weaknesses and other deficiencies that, among other things, impede compliance with Generally Accepted Accounting Principles (GAAP). As a result, despite progress over the past year, we again received a disclaimer of opinion from our auditors, the General Accounting Office (GAO).

Looking to the Future: The Administration's Blueprint for Improving Government Management

To meet the challenges and opportunities of tomorrow, the President has proposed a reexamination of the role of the Federal Government. He has called for "active, but limited" Government: one that empowers States, cities, and citizens to make decisions; ensures results through accountability; and promotes innovation through competition. The result should be a Government that is citizen-centered—not bureaucracy-centered; results-oriented—not process-oriented; and market-based—actively promoting, not stifling, innovation and competition.

To make Government citizen-centered, the President proposes: (1) flattening the Federal hierarchy to ensure that there is as little distance as possible between citizens and decision-makers; (2) using the Internet to provide citizens with access to information and to enable them to transact business; and (3) providing funds to support interagency electronic Government (e-Gov) initiatives.

To make Government results-oriented, the President proposes: (1) linking budget and management decisions to performance by establishing accountability systems that allow citizens to judge whether effective performance is taking place; (2) requiring agencies to pass their audits; (3) reducing erroneous payments to beneficiaries and other recipients of Government funds so that monies are being used for their intended purpose; (4) using capital planning to improve performance to ensure that information technology investments match agency strategic priorities and provide real benefits for the American people; (5) eliminating duplicative and ineffective programs to redeploy resources from old priorities to make room for new priorities; (6) expanding the use of performance-based contracts to focus on results rather than process; and (7) incorporating successful private sector reforms throughout the Federal workforce to reward achievement and encourage excellence.

To make Government market-based, the President proposes: (1) making e-procurement via the Internet the Governmentwide standard to produce significant cost savings through reduced transaction-processing costs, more efficient inventory management, and greater competition; and (2) opening Government activities to competition to ensure market-based pricing and encourage innovation, while saving taxpayer dollars.

Systems, Controls, and Legal Compliance

Systems

The Federal Government faces agency-specific and Governmentwide challenges in modernizing its financial management systems. Changing technology, as well as changing information needs, are occurring so rapidly that technology advances in today's systems become obsolete with identification of new data and systems requirements. The cornerstone of sound financial management, as well as performance measurement, is accurate, timely, and useful information. Many Federal financial systems are simply unable to provide the data needed to manage programs and make good decisions. Producing reliable, useful, and timely data throughout the year and at the end of the year requires overhauling financial and related management information systems. Agencies also must address problems with fundamental recordkeeping, incomplete documentation, and weak internal controls before their systems can produce reliable information on an ongoing basis. Simply put, many financial management systems need upgrading or replacing before they can provide information to support efforts to achieve the President's goal of a citizen-centered, results-oriented, and market-based Government.

Improvement in financial systems requires: (1) the ability to successfully plan, develop, operate, and maintain financial systems; (2) data standards that satisfy information requirements; and (3) the ability to use such information in a real-time environment to make informed decisions, satisfy customers, and measure performance. As data from systems is used, its timeliness and quality will continue to improve.

Controls

Numerous internal controls exist over Federal assets. These controls include the existence of a statutory budget and centralized cash management, debt, and disbursement functions. In addition, Treasury's Financial Management Service (FMS) publishes the "Monthly Treasury Statement of Receipts and Outlays of the United States Government" (MTS), a summary statement prepared from agency accounting reports. The MTS presents the receipts, outlays, resulting budget surplus or deficit, and Federal debt for the month and the fiscal year-to-date and compares those figures to the same period in the previous year.

Legal Compliance

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

Basis of Accounting and Reporting Entity

Accounting Standards

The accompanying financial statements were prepared based on GAAP standards developed by the Federal Accounting Standards Advisory Board (FASAB), except as noted in our auditor's report. These standards form the foundation for preparing consistent and meaningful financial statements both for individual Federal agencies and the Government as a whole.

GAAP for the Federal Government is tailored to the U.S. Government's unique characteristics and special needs. For example, stewardship land (land set aside for the use and enjoyment of present and future generations, and land on which military bases are located), heritage assets, weapon systems used in the performance of military missions, and vessels held as part of the National Defense Reserve Fleet (national defense assets) are reported in the Stewardship Information section rather than valued and reported on the Balance Sheet. The Government's responsibilities and policy commitments are much broader than the reported Balance Sheet liabilities. They include the social insurance programs disclosed in the Stewardship Information section, as well as a wide range of other programs under which the Government provides benefits and services to the people of this Nation.

Three Statements of Federal Financial Accounting Standards (SFFAS) were implemented in fiscal 2000 at the Governmentwide reporting level. SFFAS No. 17 includes accounting standards for Federal social insurance programs. The Statement covers the following programs: Social Security (Old-Age, Survivors, and Disability Insurance), Medicare (Hospital Insurance [Medicare Part A] and Supplementary Medical Insurance [Medicare Part B]), Railroad Retirement benefits, Black Lung benefits, and Unemployment Insurance. SFFAS No. 15 requires that general purpose Federal financial reports include a section devoted to MD&A. Finally, SFFAS No. 16 amended earlier standards with respect to multi-use heritage assets. The amending language requires that all acquisition, reconstruction, and betterment costs of multi-use heritage assets (i.e., heritage assets whose predominant use is general government operations) be capitalized and depreciated.

Accrual Basis

GAAP requires that these financial statements be prepared using the accrual basis of accounting. Under the accrual basis, transactions are reported when the events giving rise to the transactions occur, rather than when cash is received or paid (cash basis). In contrast, Federal budgetary reporting is generally on the cash basis in accordance with accepted budget concepts.

The most significant difference between these two 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. The effects of these differences are reflected in the Reconciliation of the Excess of Revenue Over Net Cost to the Unified Budget Surplus, which can be found in the Supplemental Information section of this Financial Report.

Coverage

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

Additional Information

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

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