CITIZEN'S GUIDE TO THE 2012 FINANCIAL REPORT OF THE UNITED STATES GOVERNMENT

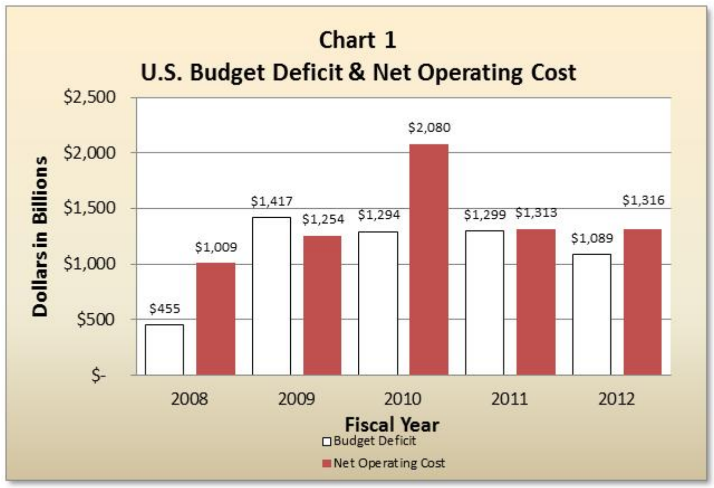
A Citizen's Guide to the Fiscal Year 2012 Financial Report of the United States Government

The Citizen's Guide (Guide) to the Fiscal Year (FY) 2012 Financial Report of the U.S. Government summarizes the current financial position and condition of the U.S. Government (See "Where We Are Now", p. ii) and discusses key financial topics, including fiscal sustainability (See "Where We Are Headed", p. v). This Guide and the Financial Report of the U.S. Government are produced by the U.S. Department of the Treasury in cooperation with the Office of Management and Budget (OMB). The Secretary of the Treasury, Deputy Director for Management of OMB, and Comptroller General of the United States at the Government Accountability Office (GAO) believe that the information discussed in this Guide is important to all Americans.

Where We Are Now

Comparing the Budget and the Financial Report

The ***Budget of the United States Government*** (Budget) is the Government's primary financial planning and control tool. It accounts for past Government receipts and spending, and presents the President's proposed receipt and spending plan. The Budget compares *receipts*, or cash received by the Government, with *outlays*, or payments made by the Government to the public, to derive a budget *surplus* (excess of receipts over outlays) or *deficit* (excess of outlays over receipts). Receipts and outlays are measured generally based on when the Government receives or dispenses cash.

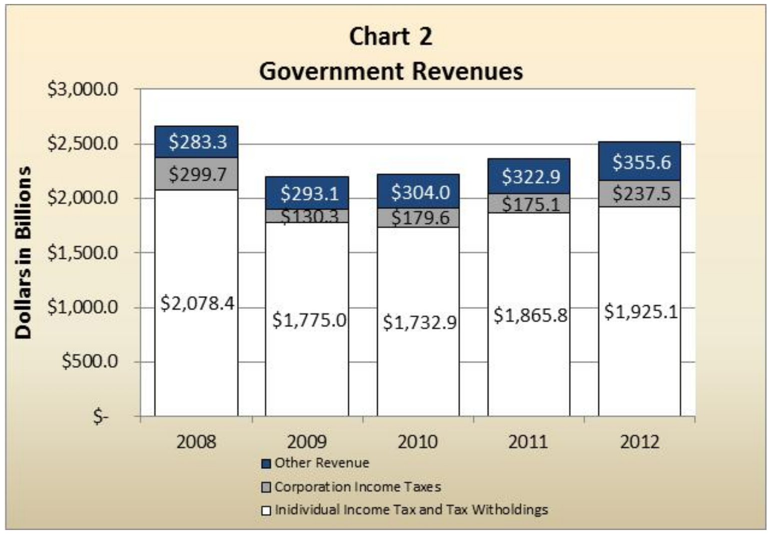


The ***Financial Report of the United States Government*** (*Report*) focuses on the Government's revenues and costs (what came in and what went out), assets and liabilities (what it owns and owes), and other important financial information. It compares *revenues* (what the Government has collected and expects to collect, but has not necessarily received), with its *costs* (what the Government has incurred, but has not necessarily paid) to derive net operating cost.

Chart 1 compares the Government's budget deficit and net operating cost for FY 2008-2012. The difference between the $1.1 trillion budget deficit and $1.3 trillion net operating cost in FY 2012 is predominantly due to: (1) non-cash costs associated with an increase in estimated liabilities related to Federal employee and veteran benefits, and (2) a partially offsetting decrease in costs associated with lower projected liabilities to the Government-Sponsored Enterprises (GSEs), specifically Fannie Mae and Freddie Mac. Together, the Budget and the *Report* present complementary perspectives on the Government's financial position and condition, and provide a valuable decision-making and management tool for the Nation's leaders.

What Came In and What Went Out

What came in? Chart 2 shows that increases in each of the three revenue categories (individual income tax and withholdings, corporate income taxes, and other revenue) combined to increase total Government revenues by $154.4 billion (6.5 percent) to just over $2.5 trillion for FY 2012. Together, individual and corporate taxes accounted for about 86 percent of total revenues. Other revenues include excise and unemployment taxes, and customs duties.



What went out? The Government derives its net cost ($3.8 trillion in FY 2012) by subtracting revenues earned from Government programs (e.g., Medicare premiums, National park entry fees, and postal fees) from its gross costs and adjusts the amount for gains or losses from changes in actuarial assumptions used to estimate future liabilities for Federal employee and veteran benefits. The Government deducts taxes and other revenues shown in Chart 2, as well as adjustments for unmatched transactions and balances, from its net cost to arrive at its "bottom line" net operating cost, which increased by $3.7 billion (less than one-half of one percent), to remain essentially unchanged at $1.3 trillion in FY 2012. However, this minimal change includes significant offsetting changes, primarily: (1) a $292.1 billion increase in certain cost estimates for federal employee and veteran benefits; and (2) a $288.7 billion cost decrease[1] associated with changes in Government liabilities to the GSEs.

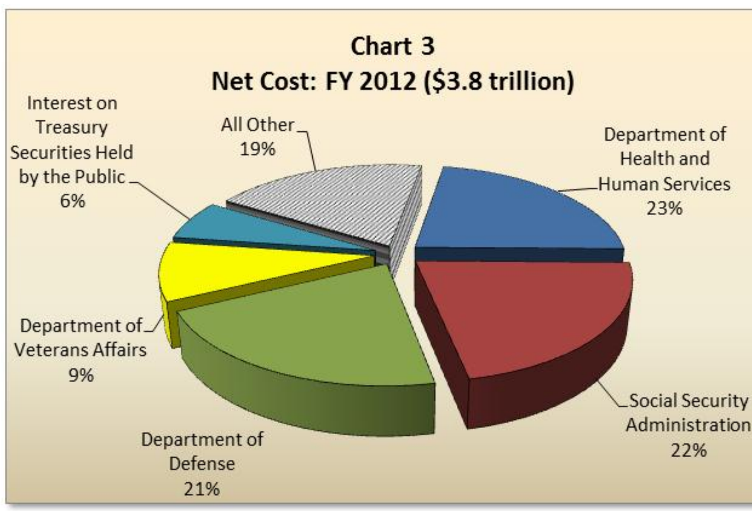


Chart 3 shows that the largest contributors to the Government's net cost in FY 2012, as is the case in most years, include the Departments of Health and Human Services (HHS) and Defense (DoD) and the Social Security Administration (SSA). The bulk of HHS and SSA costs come from major social insurance and postemployment benefits programs administered by those agencies (e.g., Medicare for HHS, and Social Security for SSA). While much of DoD's total costs relate to military operations and personnel, most of the increase in DoD's cost during FY 2012 was attributed to its Military Retirement Fund and other benefits programs.

[1] Department of the Treasury's FY 2012 Annual Financial Report, p. 101.

What We Own and What We Owe

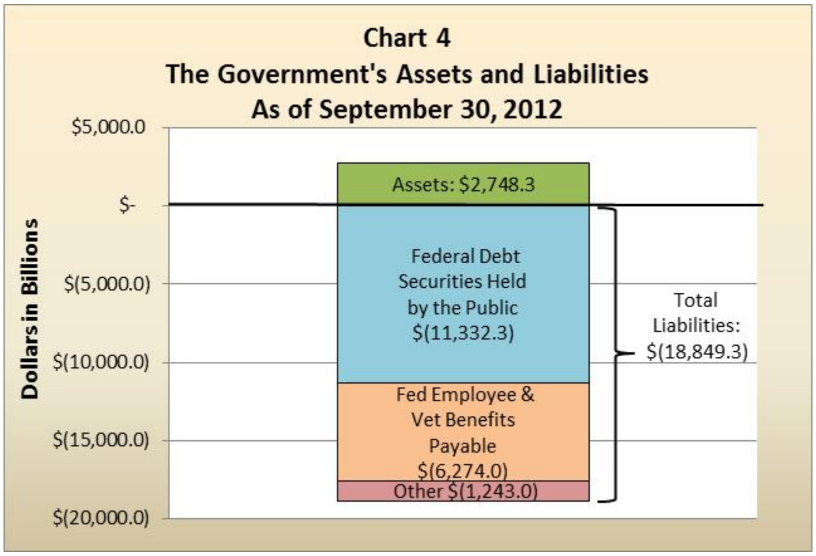


Chart 4 is a summary of what the Government owns in assets and what it owes in liabilities. As of September 30, 2012, the Government held about $2.7 trillion in assets, comprised mostly of net property, plant, and equipment ($855.0 billion) and a combined total of $1,009.1 billion in net loans receivable (e.g., student loans) and direct loans and investments associated with the Troubled Asset Relief Program (TARP) and the GSEs (which relate to the Government's economic recovery efforts). In recent years, with the ongoing wind-down of these programs, the balances of many of these investments have declined primarily through repayments and sales. Beyond these assets, other significant resources are available to the Government, including stewardship assets, such as natural resources, and the Government's power to tax and set monetary policy.

The $18.8 trillion in total liabilities is comprised mostly of: (1) $11.3 trillion in Federal debt securities held by the public and accrued interest[2] and (2) $6.3 trillion in Federal employee and veteran benefits payable. The Government also reports about $4.9 trillion of intragovernmental debt outstanding, which arises when one part of the Government borrows from another. For example, Government funds (e.g., Social Security and Medicare trust funds) are typically required to invest excess annual receipts in Federal debt securities issued by the Treasury Department, thus creating liabilities of the Treasury and assets of the trust funds. These respective amounts are included in individual Treasury Department and investing agency financial statements, but offset each other when the Governmentwide consolidated financial statements are prepared.

The sum of debt held by the public and intragovernmental debt equals gross Federal debt, which, with some adjustments, is subject to a statutory ceiling (i.e., the debt limit), which was most recently raised by $1.2 trillion to $16.394 trillion in January 2012 pursuant to the Budget Control Act (BCA) of 2011. As of September 30, 2012, the Government's total debt outstanding subject to the debt limit was $16.027 trillion, $367 billion below the current limit. As budget deficits continue to occur, the Government will have to borrow more from the public. Instances where the debt held by the public increases faster than the economy[3] for extended periods can pose additional challenges.

[2] Debt held by the public and accrued interest, as reported on the Government's balance sheet, primarily consists of Treasury securities, net of unamortized discounts and premiums, and accrued interest. The "public" consists of individuals, corporations, state and local governments, Federal Reserve Banks, foreign governments, and other entities outside the Federal Government.

[3] Considering key macroeconomic indicators can help place the discussion of the Government's financial results in a broader context. During FY 2012, the economy continued to grow, and at a faster rate than the previous year, job creation accelerated, and the unemployment rate declined. These and other economic and financial developments are discussed in greater detail in the *Report*.

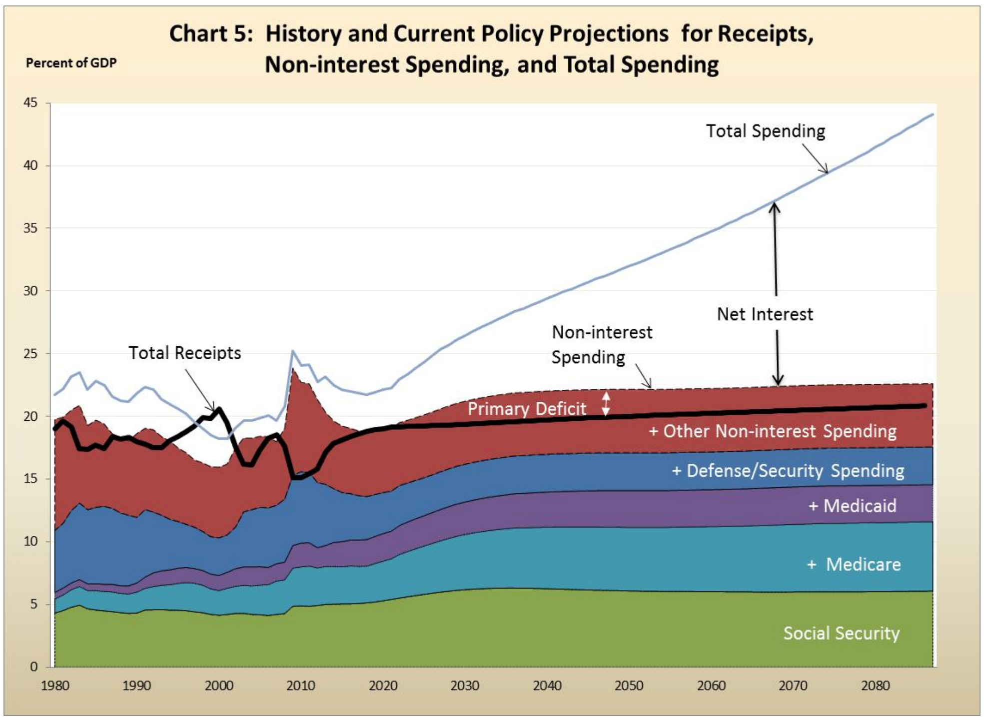
Where We Are Headed

An important purpose of this Guide and the *Report* is to help citizens understand current fiscal policy, and the importance and magnitude of policy reforms necessary to make it sustainable. A sustainable policy is one where the ratio of debt held by the public to Gross Domestic Product (GDP) (the debt-to-GDP ratio) is ultimately stable or declining. To determine if current fiscal policy is sustainable, the projections discussed in this Guide assume current policy will be sustained indefinitely and draw out the implications for the growth of the debt-to-GDP ratio.[4] The projections are therefore neither forecasts nor predictions. As policy changes are enacted, then actual financial outcomes will, of course, be different than those projected.

The projections presented in this *Report* were finalized prior to the enactment of the American Taxpayer Relief Act (ATRA) in January 2013.[5]

Receipts, Spending, and the Debt

Chart 5 shows historical and current policy projections for receipts, non-interest spending by major category, and total spending expressed as a percent of GDP. The difference between the receipts and non-interest spending shares of GDP - the primary deficit-to-GDP ratio, grew rapidly in 2009 due to the financial crisis and the recession, and the Federal Government's response. The ratio stayed large from 2010 to 2012 despite shrinking in each successive year, but is projected to fall rapidly



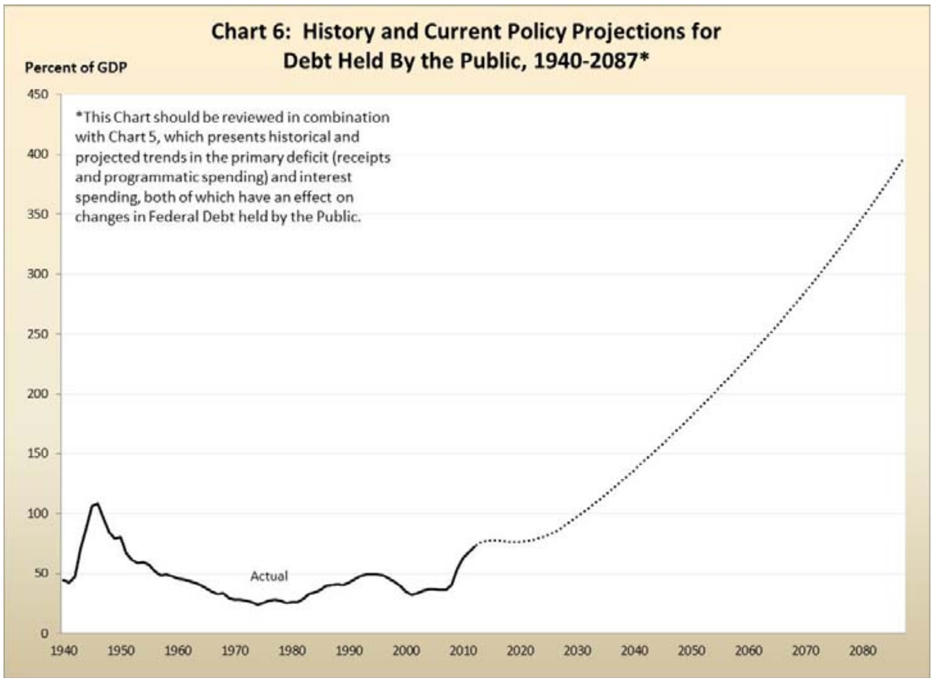
between 2013 and 2018 as the economy recovers and spending reductions called for in the BCA take effect, reaching primary balance in 2018, and remaining relatively flat and near zero until 2021. Between 2022 and 2039, however, increased spending for Social Security and health

[4] Current policy in the projections is based on current law, but includes extension of certain policies that expire under current law but are routinely extended or otherwise expected to continue, such as extension of relief from the Alternative Minimum Tax (AMT). In addition, for this year's *Report*, the projections include the extension of all 2001/2003 tax cuts indefinitely, whereas in the FY 2011 *Report*, it was assumed that the high income tax cuts were allowed to expire.

[5] ATRA did not extend the 2001/2003 tax cuts for high income individuals and families that were assumed to occur in the projections. Updating the projections in this *Report* to account for ATRA would therefore modestly reduce projected long term fiscal imbalances.

programs[6] due to continued aging of the population and anticipated rising health costs is expected to cause the primary deficit-to-GDP ratio to steadily deteriorate, reaching 2.3 percent of GDP in 2039. After 2039, the ratio is projected to slowly decline to 1.7 percent of GDP in 2087 as the impact of the baby boom generation retiring dissipates. In these projections, the Affordable Care Act (ACA)[7] provision of health insurance subsidies and expanded Medicaid coverage boost federal spending, and other provisions significantly reduce per-beneficiary Medicare and Medicaid cost growth. Overall, the ACA is projected to substantially reduce federal expenditures over the next 75 years. However, as noted in the *Report*, there is uncertainty about the effectiveness of the ACA's provisions designed to reduce health care cost growth. Even if those provisions work as intended and as assumed in these projections, Chart 5 still shows a persistent gap between projected receipts and total non-interest spending.

The primary deficit projections in Chart 5, along with those for interest rates and GDP, determine the debt-to-GDP ratio projections shown in Chart 6. That ratio was 73 percent at the end of FY 2012 and under current policy is projected to grow to 78 percent in 2022, 145 percent in 2042, and 395 percent in 2087. While these projections are subject to considerable uncertainty, the debt-to-GDP ratio would continue to rise unsustainably under current policy.



The Fiscal Gap and the Cost of Delaying Policy Reform

It is estimated that preventing the debt-to-GDP ratio from rising over the next 75 years would require some combination of expenditure reductions and revenue increases that amount, on average, to 2.7 percent of GDP over each of the next 75 years. The timing of changes to non-interest spending and receipts that close this "75-year fiscal gap" has important implications for the well-being of future generations. For example, relative to a policy that begins immediately, it

[6] The 2012 Medicare Trustees Report projects that, assuming full implementation of the Affordable Care Act (ACA) provisions, the Hospital Insurance (HI) Trust Fund will remain solvent under current law until 2024, at which point the share of estimated HI costs that could be paid from trust fund income is 87 percent, declining to 69 percent by 2086. As for Social Security, under current law, the Old-Age, Survivors, and Disability Insurance (OASDI) Trust Funds are projected to be exhausted in 2033, at which time the projected share of scheduled benefits payable from trust fund income is 75 percent, declining to 73 percent in 2086. The projections assume full Social Security and Medicare benefits are paid after the corresponding trust funds are exhausted. See http://www.ssa.gov/oact/trsum/index.html.

[7] The ACA refers to P.L. 111-148, as amended by P.L. 111-152. The ACA expands health insurance coverage, provides health insurance subsidies for low-income individuals and families, includes many measures designed to reduce health care cost growth, and significantly reduces Medicare payment rates.

is estimated that the magnitude of reforms necessary to close the 75-year fiscal gap increases by nearly 20 percent if action is delayed by 10-years and for more than 50 percent if action is delayed 20 years.

Conclusion

The Government took potentially significant steps towards fiscal sustainability by enacting: (1) the ACA in 2010 and (2) the BCA in 2011. The ACA holds the prospect of lowering the long-term per beneficiary spending growth for Medicare and Medicaid, and the BCA significantly curtails discretionary spending. Together, these two laws substantially reduce the estimated long-term fiscal gap. But even with these new laws, the Government's debt-to-GDP ratio is projected to increase continuously over the next 75 years and beyond if current policy is kept in place, which implies that current policy is not sustainable. Subject to the important caveat that changes in policy not be so abrupt that they slow the economy's recovery, the sooner policies are put in place to avert these trends, the smaller the revenue increases and/or spending decreases will need to be to return the Government to a sustainable fiscal path.[8]

The Nation By The Numbers

The *Report* provides the President, Congress, and the American people a comprehensive view of how the Government is managing taxpayer dollars. It discusses the Government's financial position and condition, its revenues and costs, assets and liabilities, and other responsibilities and commitments, as well as important financial issues that affect the Nation and its citizens both now and in the future. The table on the following page presents several key indicators of the Government's financial position and condition, which are summarized in this Guide and discussed in greater detail in the *Report*.

The Government Accountability Office's (GAO) audit report on the U.S. Government's consolidated financial statements can be found beginning on page 223 of the full *Report*. GAO disclaimed an opinion on the 2012, 2011, and 2010 Statements of Social Insurance (SOSI) and the 2012 and 2011 Statements of Changes in Social Insurance Amounts because of significant uncertainties (discussed in Note 26 in the *Report*) primarily related to the achievement of projected reductions in Medicare cost growth reflected in the 2012, 2011, and 2010 SOSI. However, GAO issued an unqualified or "clean" opinion on the 2009 and 2008 SOSI.[9] In addition, certain material financial reporting control weaknesses and other limitations on the scope of its work prevented GAO from expressing an opinion on the remaining FY 2012 and 2011 financial statements in the *Report*.

[8] Further information about these fiscal projections and the underlying assumptions can be found in the Required Supplementary Information section of the Financial Report at www.fms.treas.gov/fr.

[9] In conformity with Federal accounting standards, Statements of Social Insurance are presented for the current year and each of the four preceding years.

NATION BY THE NUMBERS

A Snapshot of The Government's Financial Position & Condition

billions of dollars	2012	2011
Gross Costs	**$ (3,844.9)**	**$ (3,998.3)**
Less: Earned Revenues	$ 350.8	$ 365.6
Gain/(Loss) from Changes in Assumptions	$ (320.2)	$ (28.1)
Net Cost	**$ (3,814.3)**	**$ (3,660.8)**
Less: Total Taxes and Other Revenues	**$ 2,518.2**	**$ 2,363.8**
Unmatched Transactions and Balances	$ (20.2)	$ (15.6)
Net Operating Cost	**$ (1,316.3)**	**$ (1,312.6)**
Assets:	**$ 2,748.3**	**$ 2,707.3**
Less: Liabilities, comprised of:		
Debt Held By the Public & Accrued Interest	$ (11,332.3)	$ (10,174.1)
Federal Employee & Veteran Benefits	$ (6,274.0)	$ (5,792.2)
Other	$ (1,243.0)	$ (1,526.4)
Total Liabilities	**$ (18,849.3)**	**$ (17,492.7)**
Net Position (Assets Minus Liabilities)	**$ (16,101.0)**	**$ (14,785.4)**
Sustainability Measures:		
Social Insurance Net Expenditures[1]	$ (38,554)	$ (33,830)
Total Non-Interest Net Expenditures[2]	$ (16,500)	$ (6,400)
Sustainability Measures as Percent of Gross Domestic Product (GDP):		
Social Insurance Net Expenditures[3]	-4.2%	-3.8%
Total Federal Government Non-Interest Net Expenditures	-1.7%	-0.7%
Budget Results		
Unified Budget Deficit	**$ (1,089.4)**	**$ (1,298.6)**

1 Source: Statement of Social Insurance. Amounts equal present value of projected revenues and expenditures for scheduled benefits over the next 75 years of certain benefit programs that are referred to as Social Insurance (e.g., Social Security, Medicare). Amounts represent 'open group' population (all current and future beneficiaries). These amounts are not considered liabilities on the balance sheet.

2 Represents the 75-year projection of the Federal Government's receipts less non-interest spending as reported in the 'Statement of Long Term Fiscal Projections' in the Required Supplementary Information section of the Financial Report of the U.S. Government.

3 GDP values used represent the average of 75-year present value of nominal GDP for 2012 and 2011 from the Social Security and Medicare Trustees Reports.

Find Out More

The *2012 Financial Report of the United States Government* and other information about the Nation's finances are available at:

- U.S. Department of the Treasury, http://www.fms.treas.gov/fr.html;
- OMB's Office of Federal Financial Management, http://www.whitehouse.gov/omb/financial/index.html; and
- GAO, http://www.gao.gov/financial.html.