DEPARTMENT OF THE TREASURY

WASHINGTON, D.C.

SECRETARY OF THE TREASURY

A Message from the Secretary of the Treasury

This report provides another sobering picture of our long-term fiscal challenges.

Our actual and projected deficits are too high, swollen by the tax cuts and spending decisions of the previous decade, exacerbated by the economic crisis, and, over the longer run, enlarged by the aging of the population and the rising cost of health care.

The President and the Congress have enacted reforms that make a substantial contribution to dealing with these challenges. Caps on discretionary spending, combined with the automatic spending cuts that take effect at the start of 2013, will cut the 10-year deficits by $2.1 trillion – half of what is necessary to reduce deficits to the point where our overall debt burden starts to fall as a share of the economy. The spending sequester and the scheduled expiration of the tax cuts enacted in 2001 and 2003 provide a strong incentive for agreement on further reforms by the end of 2012. The Affordable Care Act reforms are projected to reduce the cost of providing health care for seniors substantially over the next two decades.

Restoring fiscal sustainability will require substantial additional changes, including tax reforms to increase revenue and changes to make our entitlement programs sustainable over time. But these reforms, if done in a broad-based and balanced way and phased in over time to give Americans a chance to plan and adjust, will not impose an unfair or excessive burden on the citizens of this country.

These fiscal challenges are not, of course, the only economic challenge facing the United States. The economy is still healing from the terrible damage caused by the financial crisis. The economy has been expanding and businesses are investing and hiring, but the pace of growth has been moderate. Creating conditions for stronger economic growth will require, among other things, a substantial program of public investment combined with incentives for private investment and reforms to improve education and to help drive innovation.

Timothy F. Geithner

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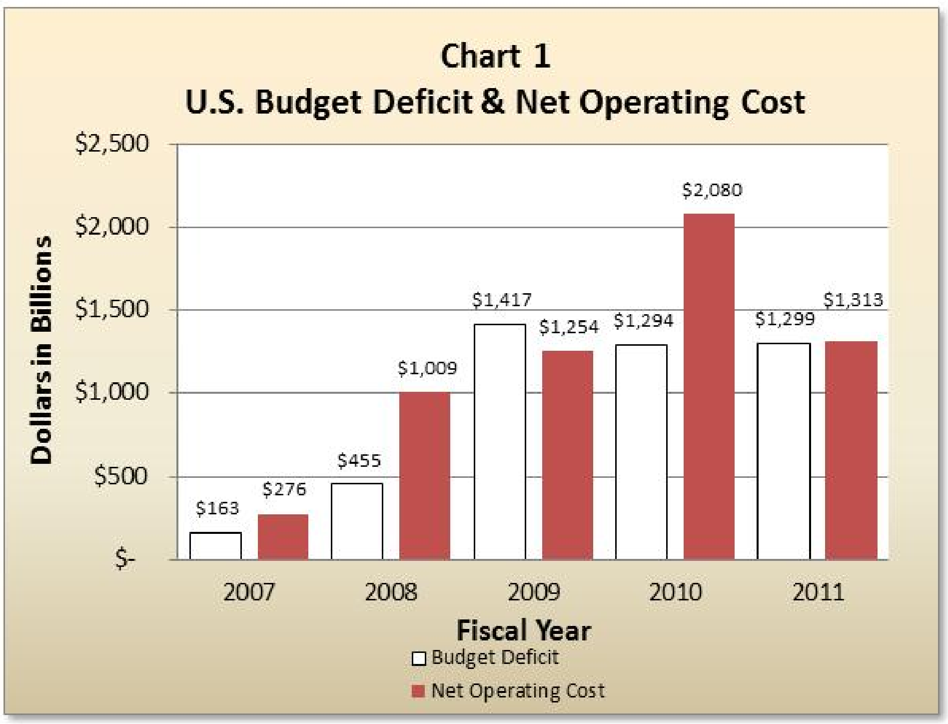
CITIZEN'S GUIDE TO THE 2011 FINANCIAL REPORT OF THE UNITED STATES GOVERNMENT

A Citizen's Guide to the Fiscal Year 2011 Financial Report of the United States Government

OVERVIEW

The Citizen's Guide to the Fiscal Year (FY) 2011 Financial Report of the U.S. Government presents the Nation's financial position and condition of the U.S. Government and discusses key financial topics, including continuing economic recovery efforts and fiscal sustainability. This Guide and the full Report are produced by the U.S. Department of the Treasury in cooperation with the Office of Management and Budget (OMB).

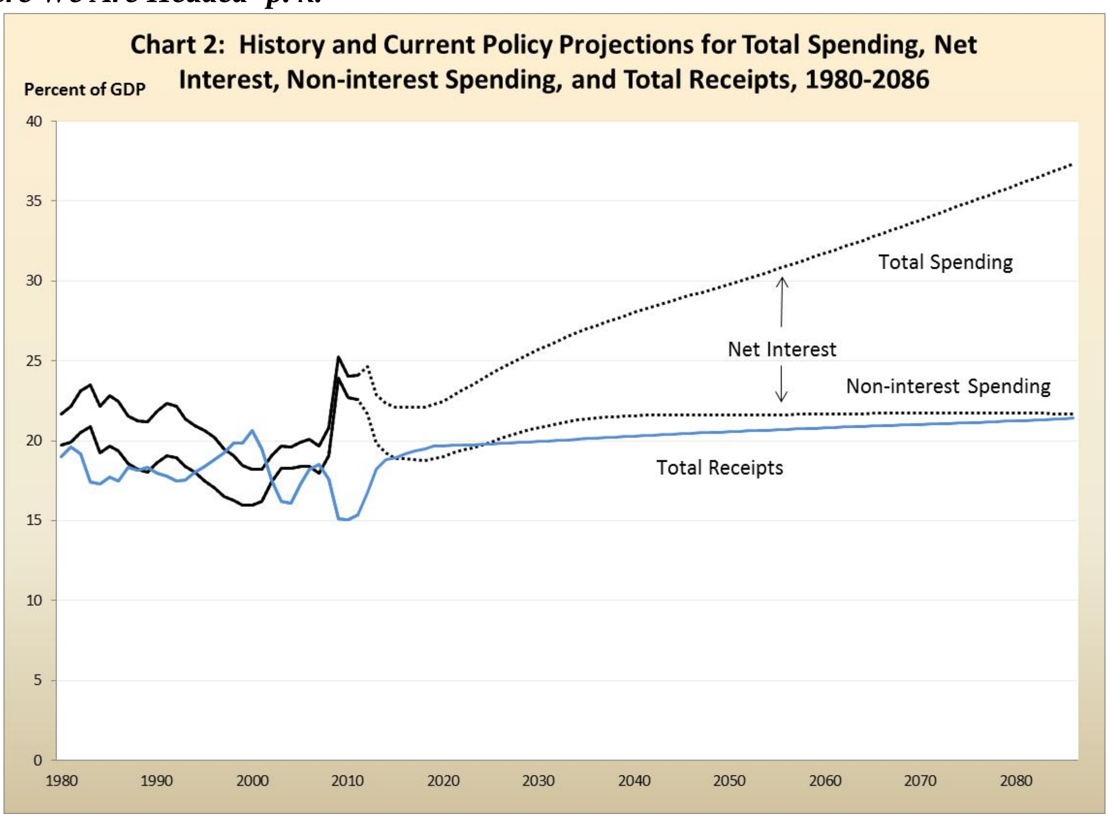
During FY 2011, nearly equivalent increases in Federal tax receipts and outlays resulted in a cash-based U.S. budget deficit that remained essentially flat at $1.3 trillion. The Government's net cost decreased from $4.3 trillion to $3.7 trillion due in large part to decreased estimated costs for federal employee and veteran benefits as well as a decline in projected costs for the Government's economic recovery programs and a slight revenue increase from $2.2 trillion to $2.4 trillion. The net cost of $3.7 trillion and revenue of $2.4 trillion yield a "bottom line" net operating cost figure for the Federal Government of $1.3 trillion, a $768 billion or 37 percent decrease from $2.1 trillion in FY 2010 (see Chart 1). ***See 'Where We Are Now', p.* iv.**



Some Government programs act as "automatic stabilizers," helping to support the economy during a downturn by increasing spending and reducing tax collections. This support is "automatic" because increased spending on programs like unemployment benefits, Social Security, and Medicaid and a reduction in tax receipts happen even without any legislative changes in policies. These automatic stabilizers had caused deficits and net operating costs to increase in recent years, but should decline as the economy recovers.

During FY 2011, the economy continued to grow, albeit at a slower pace than in the previous year, residential homebuilding increased for the first time since FY 2005, and the economy added about 1.9 million non-farm payroll jobs. Policies enacted to foster economic recovery, including the Housing and Economic Recovery Act of 2008 (HERA), the Emergency Economic Stabilization Act of 2008 (EESA), and the American Recovery and Reinvestment Act of 2009 (Recovery Act or ARRA), represented unprecedented efforts to stabilize the financial markets, jump-start the Nation's economy, and create or save millions of jobs. The Government and the taxpayer continue to see returns on many of these investments as evidenced by repayments made under the Troubled Assets Relief Program (TARP) and the selling of many Government investments during FY 2011.   ***See 'Review of the Government's Stabilization Efforts', p. viii.***

While the Government's immediate priority is to continue to promote policies that foster economic recovery, there are longer term fiscal challenges that must ultimately be addressed. The aging of the population due to the retirement of the "baby boom" generation, increasing longevity, and persistent growth of health care costs will make it increasingly difficult to fund critical social programs, including notably Medicare, Medicaid, and Social Security. Chart 2 shows this growing gap between receipts and total spending, indicating that, as currently structured, the Government's fiscal path cannot be sustained indefinitely. Legislative initiatives, such as the Affordable Care Act (ACA) of 2010 and the Budget Control Act (BCA) of 2011 are expected to help bring the Government's expenditures more in line with its receipts.   ***See 'Where We Are Headed' p. x.***



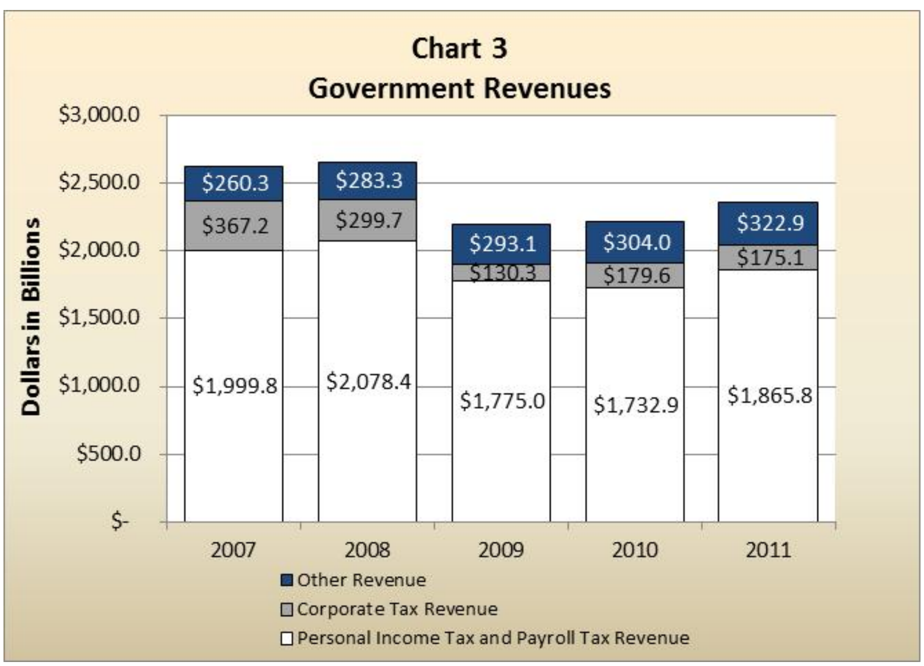
This Guide highlights important information contained in the *2011 Financial Report of the United States Government*. The Secretary of the Treasury, Director of the Office of Management and Budget (OMB), and Comptroller General of the United States believe that the information discussed in this Guide is important to all Americans.

Where We Are Now

The Economy

The economy continued to grow during FY 2011. Consumer spending rose at a moderate pace. Residential investment grew on a fiscal year basis for the first time since FY 2005, and nonresidential investment strengthened slightly. Job creation accelerated in FY 2011, with the economy adding about 1.9 million private nonfarm payroll jobs (after creating nearly 350,000 private nonfarm payroll jobs during the previous fiscal year). Overall inflation increased during the course of the year, reflecting higher energy and food prices. The core inflation rate (which excludes food and energy) also increased from the previous fiscal year's very low level, but remained low by historical standards. Real wages fell due to a combination of slower nominal wage growth and rising consumer prices. The level of corporate profits increased in FY 2011, but at a slower pace than in the previous fiscal year. Federal spending grew and tax receipts increased in FY 2011, which resulted in the Federal unified budget deficit remaining essentially flat at $1.3 trillion. However, the deficit narrowed as a share of GDP to 8.7 percent from 9.0 percent in FY 2010. The economy continued to receive significant support during the fiscal year by a wide variety of measures implemented under the American Recovery and Reinvestment Act of 2009 (Recovery Act or ARRA). It was also supported by additional measures, including a new Small Business Jobs and Wages Tax Credit, supplemental support for State and local Governments to support jobs and medical services, a 2 percent payroll tax cut, extensions of unemployment benefits, and refundable tax credits, and a two-year extension of the 2001 tax cuts.

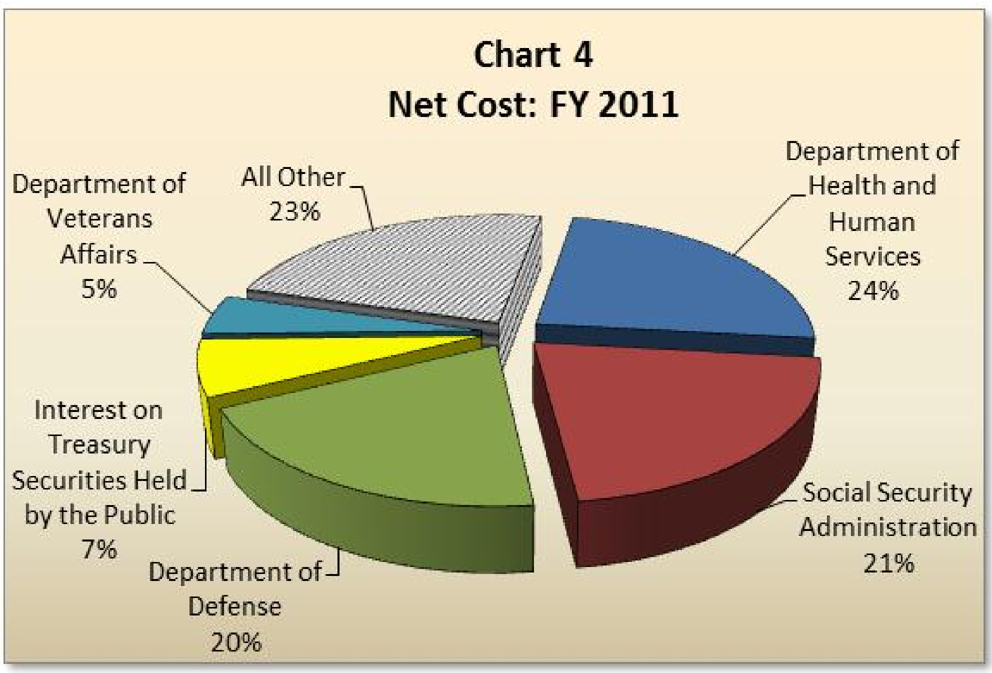
What Came In and What Went Out



What came in? Total Government revenues (calculated using a modified cash basis of accounting) increased slightly from $2.2 trillion to $2.4 trillion in FY 2011. Chart 3 shows that a $133 billion or 7.7 percent increase in personal income and payroll tax revenues during FY 2011 was partially offset by a $5 billion or 2.5 percent decrease in corporate tax revenues. Together, personal and corporate taxes accounted for about 86 percent of total revenues. The other 14 percent is attributed to other revenues, including excise taxes, unemployment taxes, and customs duties.

What went out? To derive its net cost ($3.7 trillion in FY 2011), the Government subtracts revenues earned from Government programs (e.g., Medicare premiums, National Park entry fees, and postal service fees) from its gross costs and adjusts the net amount for gains or losses from changes in actuarial assumptions used to estimate federal employee pensions, other retirement benefits, and other postemployment benefits. For FY 2011, total net costs declined by $635 billion (about 15 percent). This decline is mostly due to significant decreases in estimates of certain non-cash costs from FY 2010 to FY 2011 relating to federal employee and veterans benefits and federal government economic recovery efforts. The amounts associated with these declines are reflected in the 'Change' column of Table 1 and discussed further below.

Chart 4 shows that the largest contributors to the Government's net cost in FY 2011, 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 are attributable to major social insurance and postemployment benefits programs administered by those agencies. Similarly, much of DoD's costs are also associated with its Military Retirement Fund and other benefits programs, as well as its current operations. In fact, across the Government, just the change in current costs of and actuarial and other estimated costs associated with the change in Federal Employee and Veterans Benefits Payable for the Government's three largest postemployment benefits programs ($431.2 billion decrease as shown in Table 1 on the following page) accounted for more than two-thirds of the total $635.2 billion decrease in the Government's net cost and more than half of the $767.7 billion decrease in the bottom line net operating cost, as described below, for FY 2011. Further, the long-term nature of these costs and their sensitivity to a wide range of complex assumptions can, in some cases, cause significant fluctuation in agency and government-wide costs from year to year.



To arrive at the Government's "bottom line" net operating cost, the Government subtracts taxes and other revenues (Chart 3) from its net cost. The 15 percent decrease in net cost combined with a 6.6 percent increase in taxes and other revenues, translated into a $768 billion (37 percent) decrease in the Government's "bottom line" net operating cost from $2.1 trillion in FY 2010 to $1.3 trillion in FY 2011.

Cost vs. Deficit: What's the Difference?

The ***Budget of the United States Government*** (President's Budget) is the Government's primary financial planning and control tool. It describes how the Government spent and plans to spend the public's money, comparing *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). Outlays are measured primarily on a cash basis and receipts are measured on a purely cash basis – or essentially they are measured when the Government receives or dispenses cash.

The ***Financial Report of the United States Government*** (Report) reports on the Government's accrual-based costs, the sources used to finance those costs, how much the Government owns and owes, and the outlook for fiscal sustainability. It compares the Government's *revenues*, or amounts that the Government has collected and expects to collect, but has not necessarily received, with its *costs* (recognized when owed, but not necessarily paid) to derive net operating cost. Together, the President's Budget and the Financial Report present complementary perspectives on the Nation's financial health and provide a valuable decision-making and management tool for the Nation's leaders.

Table 1 shows that, the difference between the budget deficit and net operating cost were comparatively minimal for FY 2011 ($14 billion in FY 2011compared to $786.2 billion in FY 2010). However, in both cases, the significant non-cash costs (i.e. changes in estimated liabilities) relating to Federal employee and veteran benefits, as well as future spending on investments in Government Sponsored Enterprises (GSEs), specifically Fannie Mae and Freddie Mac, account for most of the change difference between budget deficit and net operating cost. Further, the changes in these amounts (see 'Change' column in Table 1) account for most of the change in the Government's net cost between FY 2010 and FY 2011. See the Financial Report of the U.S. Government for a more detailed analysis of these issues.

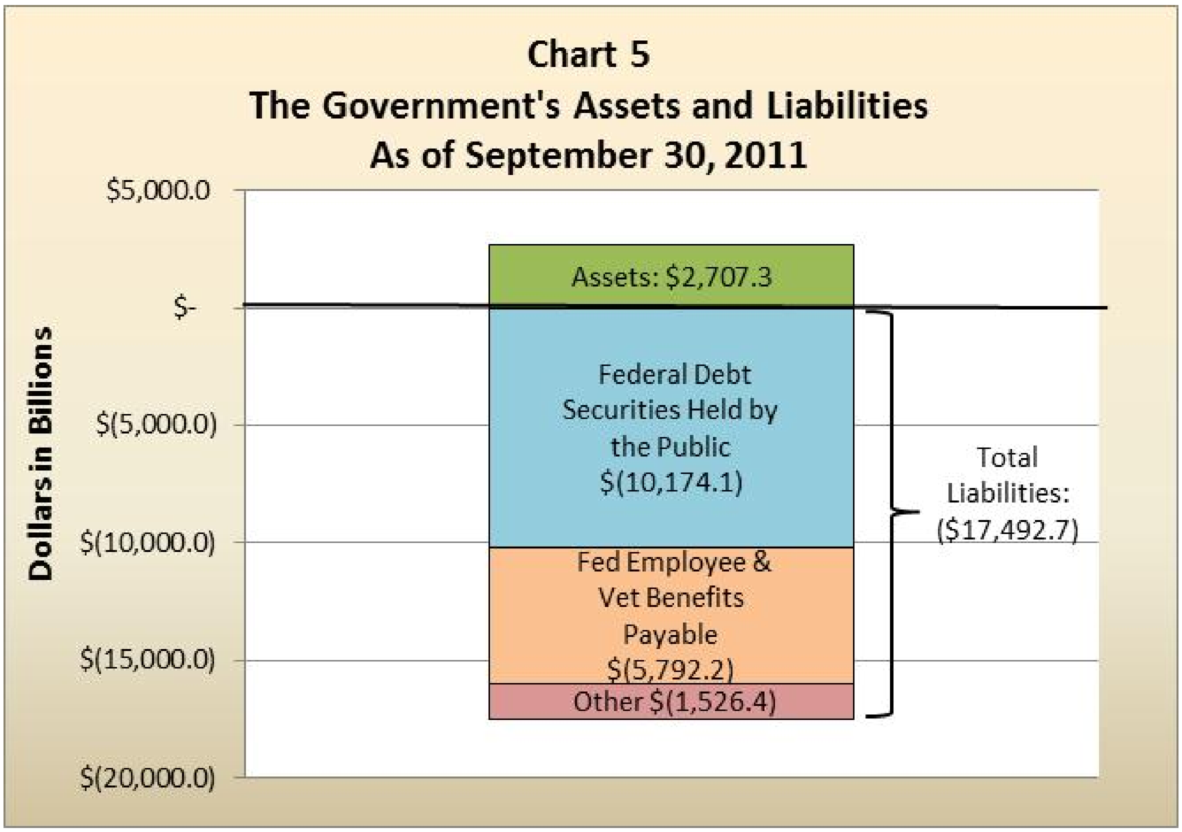
Table 1: Budget Deficit vs. Net Operating Cost

Dollars in Billions	2011	2010	Increase / (Decrease)
Net Operating Cost	**$ (1,312.6)**	**$ (2,080.3)**	**$ (767.7)**
Change in:			
Federal Employee and Veterans Benefits Payable	$ 71.9	$ 503.1	$ (431.2)
Liabilities for Government Sponsored Enterprises	$ (43.7)	$ 268.0	$ (311.7)
Other, Net	$ (14.2)	$ 15.1	$ (29.3)
Subtotal - Net Difference:	$ 14.0	$ 786.2	$ (772.2)
Budget Deficit	**$ (1,298.6)**	**$ (1,294.1)**	**$ 4.5**

What We Own and What We Owe

Chart 5 is a summary of what the Government owns in assets and what it owes in liabilities. As of September 30, 2011, the Government held about $2.7 trillion in assets, comprised mostly of net property, plant, and equipment ($852.8 billion) and a combined total of $985.2 billion in net loans receivable, mortgage-backed securities, and investments. During FY 2011, the Government's total assets decreased by $176.5 billion, due mostly to elimination of the cash deposits with the Federal Reserve under the Supplementary Financing Program (SFP). Under the SFP, the Treasury issued special bills, which provided cash that the Federal Reserve used to manage its authorized lending and liquidity initiatives.

As indicated in Chart 5, the Government's largest liabilities are: (1) Federal debt held by the public and accrued interest, [1] the balance of which increased from $9.1 trillion to $10.2 trillion during FY 2011, and (2) Federal employee postemployment and veteran benefits payable, which increased slightly during FY 2011, from $5.7 trillion to $5.8 trillion.



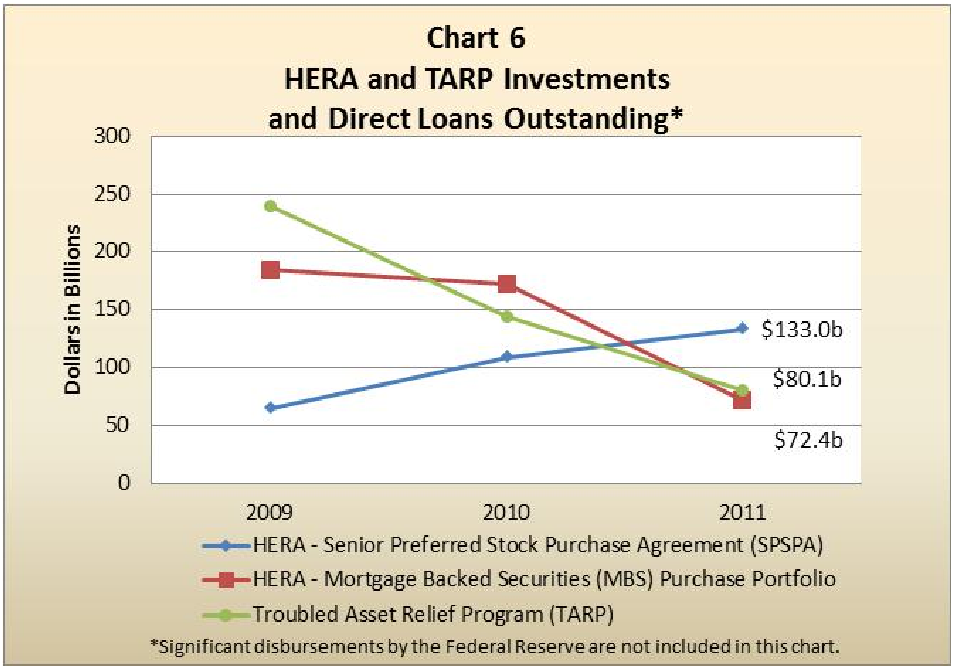
In addition to debt held by the public, the Government reports about $4.7 trillion of intragovernmental debt outstanding, which arises when one part of the Government borrows from another. It represents debt held by Government funds, including the Social Security and Medicare trust funds, which are typically required to invest any excess annual receipts in Federal debt securities. Because these amounts are both liabilities of the Treasury and assets of the Government trust funds, they are eliminated in the consolidation process for the Government-

[1] Debt held by the public, as reported on the Government's balance sheet, 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.

wide financial statements. 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). During FY 2011, the debt limit was raised twice, by $400 billion in August 2011 to $14.694 trillion and by $500 billion in September 2011 to $15.194 trillion, pursuant to the Budget Control Act (BCA) of 2011. The BCA also provides for an additional debt limit increase once certain conditions are met.

If 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 for extended periods can pose additional challenges.

Review of the Government's Stabilization Efforts



Since the financial crisis in 2008, the Treasury Department, the Federal Reserve, the Federal Deposit Insurance Corporation (FDIC), and other U.S. Government bodies have taken actions to help stabilize financial markets and pave the way for sustained economic recovery. Among these actions were financial support to provide liquidity to the housing market and the financial system and the American Recovery and Reinvestment Act (Recovery Act or ARRA), which provided much-needed support for American families and spurred investment, thereby providing a critical boost to the economy. Chart 6 summarizes the outstanding balances of investments and direct loans related to key economic recovery programs described below.

The Housing and Economic Recovery Act of 2008 (HERA) established the Federal Housing Finance Agency (FHFA), to regulate the housing GSEs, including Fannie Mae and Freddie Mac. HERA also authorized the Treasury Department to provide financial support for the housing GSEs through such programs as the Senior Preferred Stock Purchase Agreements (SPSPA) program, which provides that the Government will make funding advances to Fannie Mae and Freddie Mac as needed to ensure that the GSEs have sufficient assets to support their liabilities; and the GSE-guaranteed mortgage-backed securities (MBS) purchase program (which was terminated as of December 31, 2009). These efforts helped bring down mortgage rates to historically low levels and helped provide liquidity to housing markets.

As of September 30, 2011, Treasury's payments under the SPSPA program to Fannie Mae and Freddie Mac totaled a cumulative combined $169.0 billion, reflected on the Government's balance sheet at fair value at $133.0 billion and a combined $316.2 billion has been accrued as a contingent liability under this program. Between October 2008 and December 31 2009, Treasury purchased $225 billion in agency-guaranteed MBS. In March 2011, Treasury began selling off its MBS purchases, reducing the outstanding portfolio by more than half from $172.2 billion as of the end of FY 2010 to $72.4 billion as of September 30, 2011 and by more than two-thirds when compared to Treasury's initial purchases (see Chart 6).

The Emergency Economic Stabilization Act of 2008 (EESA) created the Troubled Asset Relief Program (TARP), which gave the Secretary of the Treasury authorities and facilities necessary to help restore liquidity and stability to the U.S. financial system and help ensure that such authorities are used in a manner that protects home values, college funds, retirement accounts, and life savings; preserves homeownership; promotes jobs and economic growth; maximizes overall returns to taxpayers; and provides public accountability. EESA provided authority for TARP to purchase or guarantee up to $700 billion in troubled assets. The Dodd-Frank Wall Street Reform and Consumer Protection Act reduced cumulative authority to $475 billion, in line with expected investment amounts.

TARP's bank programs are now producing a profit for taxpayers. The Treasury Department reduced its stake in General Motors Company by 50 percent and fully exited its investment in Chrysler Group, as Chrysler Group repaid its loans six years earlier than the loans' maturity dates. In addition, Treasury, working with other Federal entities, closed on a major restructuring plan for American International Group (AIG), putting the Government in a better position to recover its investment. Chart 6 shows how TARP's net investments have changed since FY 2009. Since TARP's inception through September 30, 2011, Treasury has disbursed $413.4 billion in direct loans and investments, and for the Housing programs under TARP, collected $276.9 billion from repayments and sales, and reported nearly $40 billion from cash received through interest and dividends, as well as from proceeds from the sale and repurchase of assets in excess of cost. As of September 30, 2011, TARP had $122.4 billion in gross outstanding direct loans and equity investments, valued at $80.1 billion (see Chart 6).

The ultimate cost of TARP investments is subject to uncertainty, and will depend on, among other things, how the economy, financial markets, and particular companies perform. Additional information concerning the TARP program and other related initiatives can be found at www.financialstability.gov.

The economic recovery initiatives and efforts undertaken since the spring of 2009 reflect a broad and aggressive policy response that included the HERA and TARP initiatives and programs, other financial stability policies implemented by the FDIC and the Board of Governors of the Federal Reserve, accommodative monetary policy, and the Recovery Act. The purpose of the original $787 billion ARRA package was to jump-start the economy and to create and save jobs, with one-third of ARRA dedicated to tax provisions to help businesses and working families, another third for emergency relief for those who have borne the brunt of the recession, and the final third devoted to investments to create jobs, spur economic activity, and lay the foundation for future sustained growth. Cumulative ARRA amounts paid out by Federal agencies as of September 30, 2011 totaled $421.4 billion, as compared to $307.9 billion as of September 30, 2010.[2] Readers may find the most up-to-date information on where and how Recovery Act funds are being used at www.recovery.gov.

[2] Agency Financial & Activity Reports as of September 30, 2011 and 2010. For more information, see the Recovery Act website at www.Recovery.gov.

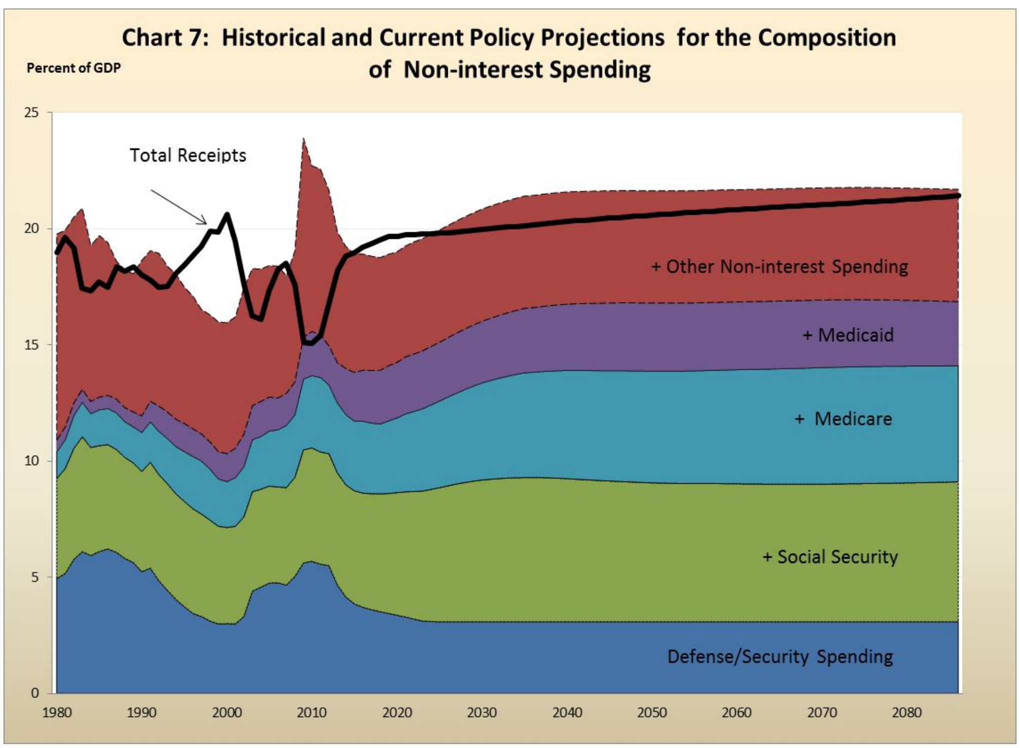
Where We Are Headed

An important purpose of the Financial Report is to help citizens and policymakers assess whether current fiscal policy is sustainable and, if it is not, the urgency 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 GDP (the debt-to-GDP ratio) is stable in the long run. Sustainability concerns only whether long-run revenues and expenditures are in balance; it does not concern fairness or efficiency implications of the reforms necessary to achieve sustainability.

To determine if current fiscal policies are sustainable, the projections in this report assume current policies will be sustained indefinitely and draw out the implications for the growth of public debt as a share of GDP.[3] The projections are therefore neither forecasts nor predictions. If policy changes are enacted, then actual financial outcomes will of course be different than those projected.[4]

The Primary Deficit, Interest, and the Debt

The primary deficit – the difference between non-interest spending and receipts – is the only determinant of the ratio of debt held by the public to GDP that the Government controls directly. (The other determinants are interest rates and growth in GDP). Chart 7 shows receipts, non-interest spending, and the difference – the primary deficit – expressed as a share of GDP. The primary deficit-to-GDP ratio grew rapidly in 2009 and stayed large in 2010 and 2011due to the financial crisis and the recession, and the policies pursued to combat both. The primary deficit-to-GDP ratio is projected to fall rapidly between 2012 and 2019 (turning to surplus in 2015) as spending reductions called for in the Budget Control Act (BCA) of 2011 take



[3] 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).

[4] Further information about the projections summarized in this section and the underlying assumptions can be found in the Supplemental Information section of the Financial Report.

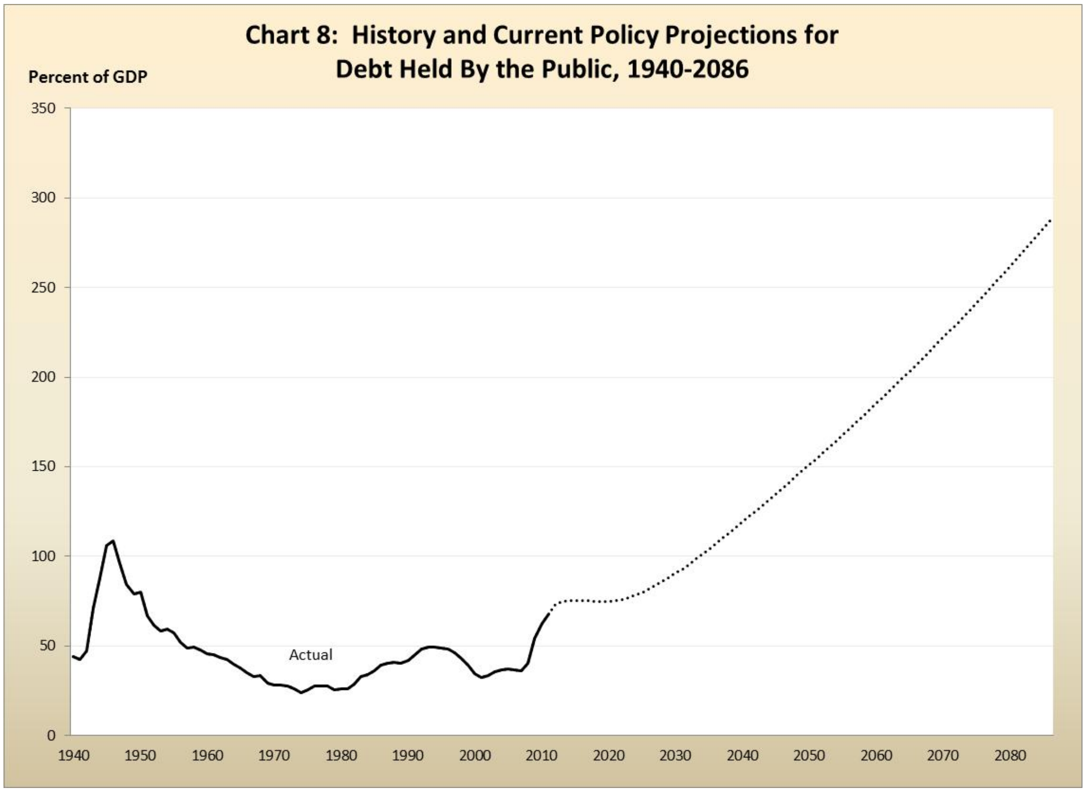
effect and the economy recovers. Between 2019 and 2035, increased spending for Social Security and health programs due to continued aging of the population is expected to cause the primary balance to steadily deteriorate. A primary deficit is expected to reappear in 2025 that reaches 1.3 percent of GDP in 2035. After 2035, the projected primary deficit-to-GDP ratio slowly declines as the impact of the baby boom generation retiring dissipates. Between 2035 and 2086, the projected primary deficit averages 0.9 percent of GDP.

The revenue share of GDP fell substantially in 2009 and 2010 and increased only modestly in 2011 because of the recession and tax reductions enacted as part of ARRA and the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, and is projected to return to near its long-run average as the economy recovers and these temporary tax cuts expire. After the economy is fully recovered, receipts are projected to grow slightly more rapidly than GDP as increases in real incomes cause more taxpayers and a larger share of income to fall into higher individual income tax brackets. These projections assume that Congress and the President will continue to enact legislation to prevent the share of income subject to the Alternative Minimum Tax from rising.

The non-interest spending share of GDP is projected to fall from its current level of 22.6 percent to about 20 percent in 2013, to stay at or below that level until 2026, and then to rise gradually and plateau at about 22 percent beginning in about 2040. The reduction in the non-interest spending share of GDP over the next two years is mostly due to caps on discretionary spending and further automatic spending cuts enacted in the BCA, and the subsequent increase is principally due to growth in Medicare, Medicaid, and Social Security spending.[5] The retirement of the baby boom generations over the next 25 years is projected to increase the Social Security, Medicare, and Medicaid spending shares of GDP by about 1.4 percentage points, 1.3 percentage points, and 1.0 percentage points, respectively. After 2035, the Social Security spending share of GDP is relatively steady, while the Medicare and Medicaid spending share of GDP continues to increase, albeit at a slower rate, due to projected increases in health care costs. The Affordable Care Act (ACA) significantly reduces projected Medicare and Medicaid cost growth from the levels projected in the 2009 Financial Report. However, there is uncertainty about whether the projected cost savings, productivity improvements, and reductions in physician payment rates will be sustained in a manner consistent with the projected cost growth over time.

[5] The 2011 Medicare Trustees Report projects that, assuming full implementation of ACA provisions, the Hospital Insurance (HI) Trust Fund will remain solvent until 2024 under current law – five years earlier than was projected in the 2010 Trustees Report. The projected share of scheduled benefits that can be paid from trust fund income is 90 percent in 2024, declines to about 76 percent in 2050, and then increases to 88 percent by 2085. As for Social Security, under current law, the Old-Age, Survivors, and Disability Insurance (OASDI) Trust Funds are projected to be exhausted in 2036, at which time the projected share of scheduled benefits payable from trust fund income is 77 percent, declining to 74 percent in 2085. More information is available at http://www.ssa.gov/oact/trsum/index.html .

The primary deficit projections in Chart 7, along with those for interest rates and GDP, determine the projections for the ratio of debt held by the public to GDP that are shown in Chart 8. That ratio was 68 percent at the end of fiscal year 2011, and under current policy is projected to exceed 76 percent in 2022, 125 percent in 2042, and 287 percent in 2086. The continuous rise of the debt-to-GDP ratio illustrates that current policy is unsustainable.



This year's projections are somewhat more favorable than were the projections in the 2010 Financial Report. Last year's report projected the debt-to-GDP ratio to reach 352 percent in 2085, which compares with 283 percent projected in this year's report. The more favorable outlook is mainly due to spending reductions called for in the Budget Control Act of 2011 that are partly offset by somewhat less favorable economic and technical assumptions.

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 running primary surpluses over the period that average 1.1 percent of GDP. This compares with an average primary deficit of 0.7 percent of GDP under current policy. The difference, the "75-year fiscal gap," is 1.8 percent of GDP, which is about 9 percent of the 75-year present value of projected receipts and of non-interest spending.

Closing the 75-year fiscal gap requires some combination of expenditure reductions and revenue increases that amount to 1.8 percent of GDP on average over the next 75 years. The timing of such changes has important implications for the well-being of future generations. For example, it is estimated that the magnitude of reforms necessary to close the 75-year fiscal gap is 60 percent larger if reforms are concentrated into the last 55 years of the 75-year period than if they are spread over the entire 75 years.

Conclusion

The United States took potentially significant steps towards fiscal sustainability by enacting the ACA in 2010 and the BCA in 2011. The ACA holds the prospect of lowering the long-term growth trend for Medicare and Medicaid spending, and the BCA significantly curtails discretionary spending. Together, these two laws substantially reduce the estimated long-term fiscal gap. But even with the new law, the debt-to-GDP ratio is projected to increase over the next 75 years and beyond if current policies are kept in place, which means current policies are not sustainable. Subject to the important caveat that policy changes 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 necessary to return the Nation to a sustainable fiscal path.

While this Report's projections of expenditures and receipts under current policies are highly uncertain, there is little question that current policies cannot be sustained indefinitely.

Looking Ahead

The Nation continues to face extraordinary financial and fiscal challenges. Signs of progress are already evident as Treasury and the Government as a whole continue to develop and implement an array of efforts to foster continued economic recovery. Realizing the true return on those efforts requires perseverance and patience. However, even as the Government continues its current efforts to foster economic growth, it should not lose sight of the long-term fiscal challenges associated with its social insurance programs compared to expected future levels of revenue. The Nation must bring social insurance expenses and resources into balance before the deficit and debt reach unprecedented heights. Delays will only increase the magnitude of the reforms needed and will place more of the burden on future generations. While there is still more work to be done and both near- and long-term challenges remain, the Federal Government has already accomplished a great deal during this fiscal year and anticipates continued progress in the years to come.

Find Out More

You will find more detail on the issues discussed in this Guide in the *2011 Financial Report of the United States Government*, issued by the U.S. Department of the Treasury. The Report provides a comprehensive view of both the Government's current financial position and prospects for moving forward. It further discusses the steps the Federal Government has taken to restore stability in the U.S. financial system and the fiscal challenges of the future. The issues discussed in the Citizens' Guide and the full Report affect, and should be of interest to, every citizen. The *Financial Report's* comprehensive reporting is intended to inform and support the decision-making needs of lawmakers and the public and to help keep the United States on solid financial ground.

You are encouraged to explore the information the Report contains and to ask questions about how the Government manages taxpayers' money. The *2011 Financial Report of the United States Government* and other information about the Nation's finances are available at:

- U.S. Department of the Treasury's Financial Management Service, 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.

This Citizen's Guide highlights information in the 2011 Financial Report of the U.S. Government (Report). The Government Accountability Office's (GAO) audit report on the U.S. Government's consolidated financial statements can be found beginning on page 211 of the Report. GAO disclaimed an opinion on the 2011 and 2010 Statements of Social Insurance (SOSI) and the 2011 Statement 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 2011 and 2010 SOSI. However, GAO issued an unqualified or "clean" opinion on the 2009, 2008, and 2007 SOSI. 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 2011 and 2010 financial statements in the Report.

Government's Financial Position and Condition

The Financial Report of the U.S. Government (Report) provides the President, Congress, and the American people a comprehensive view of how the Federal 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 following table presents several key indicators of the Government's financial position and condition, which are discussed in greater detail in the Report.

NATION BY THE NUMBERS

A Snapshot of The Government's Financial Position & Condition

billions of dollars		2011		2010
Gross Costs	**$**	**(3,998.3)**	**$**	**(4,472.3)**
Less: Earned Revenues	$	365.6	$	309.2
Gain / (Loss) from Changes in Assumptions	$	(28.1)	$	(132.9)
Net Cost	**$**	**(3,660.8)**	**$**	**(4,296.0)**
Less: Total Taxes and Other Revenues	**$**	**2,363.8**	**$**	**2,216.5**
Unmatched Transactions and Balances	$	(15.6)	$	(0.8)
Net Operating Cost	**$**	**(1,312.6)**	**$**	**(2,080.3)**
Assets:	**$**	**2,707.3**	**$**	**2,883.8**
Less: Liabilities, comprised of:				
Debt Held By the Public & Accrued Interest	$	(10,174.1)	$	(9,060.0)
Federal Employee & Veteran Benefits	$	(5,792.2)	$	(5,720.3)
Other	$	(1,526.4)	$	(1,576.3)
Total Liabilities	**$**	**(17,492.7)**	**$**	**(16,356.6)**
Net Position (Assets Minus Liabilities)	**$**	**(14,785.4)**	**$**	**(13,472.8)**
Sustainability Measures:				
Social Insurance Net Expenditures[1]	$	(33,830)	$	(30,857)
Total Non-Interest Net Expenditures[2]	$	(6,400)	$	(16,300)
Sustainability Measures as Percent of Gross Domestic Product (GDP)[3]:				
Social Insurance Net Expenditures		-3.8%		-3.7%
Total Federal Government Non-Interest Net Expenditures		-0.7%		-1.9%
Budget Results				
Unified Budget Deficit	**$**	**(1,298.6)**	**$**	**(1,294.1)**

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). Not considered liabilites 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 Supplemental Information section of the Financal Report of the U.S. Government.

3 GDP values represent the average of 75-year present value of nominal GDP values from 2011 and 2010 for Social Security and Medicare from the Social Security and Medicare Trustees Reports.

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MANAGEMENT'S DISCUSSION AND ANALYSIS

Introduction

The fiscal year (FY) *2011 Financial Report of the United States Government (Report)* provides the President, Congress, and the American people with a comprehensive view of the Federal Government's finances, i.e., its financial position and condition, its revenues and costs, assets and liabilities, and other obligations and commitments. The Report also discusses important financial issues and significant conditions that may affect future operations. This year's Report emphasizes two key issues: the Government's ongoing efforts to strengthen the economy and create jobs and the need to achieve fiscal sustainability over the medium and long term.

Pursuant to 31 U.S.C. § 331(e)(1), the Department of the Treasury must submit the Report, which is subject to audit by the Government Accountability Office (GAO), to the President and Congress no later than six months after the September 30 fiscal year end. To encourage timely and relevant reporting, the Office of Management and Budget (OMB) accelerated both individual agency and government-wide reporting deadlines.

The Report is prepared from the audited financial statements of specifically designated Federal agencies, including the Cabinet departments and many smaller, independent agencies (see organizational chart on the next page). GAO issued, as it has for the past fourteen years, a "disclaimer" of opinion on the accrual-based consolidated financial statements for the fiscal years ended September 30, 2011 and 2010. Additionally, GAO issued disclaimers of opinion on the 2011 and 2010 Statements of Social Insurance (SOSI), following unqualified opinions on the 2007, 2008, and 2009 SOSI, and a disclaimer of opinion on the 2011 Statement of Changes in Social Insurance Amounts (SCSIA). A disclaimer of opinion indicates that sufficient information was not available for the auditors to determine whether the reported financial statements were fairly presented. In FY 2011, 32[1] of the 35 most significant agencies earned unqualified opinions on their financial statement audits.[2]

The FY 2011 *Report* consists of:

- Management's Discussion and Analysis (MD&A), which provides management's perspectives on and analysis of information presented in the Report, such as financial and performance trends;
- Principal financial statements and the related footnotes to the financial statements, including a new Statement of Changes in Social Insurance Amounts;
- Supplemental and Stewardship Information; and
- GAO's Audit Report.

In addition, the Government has produced a Citizen's Guide to provide the American taxpayer with a quick reference to the key issues in the Report and an overview of the Government's financial position and condition.

Mission & Organization

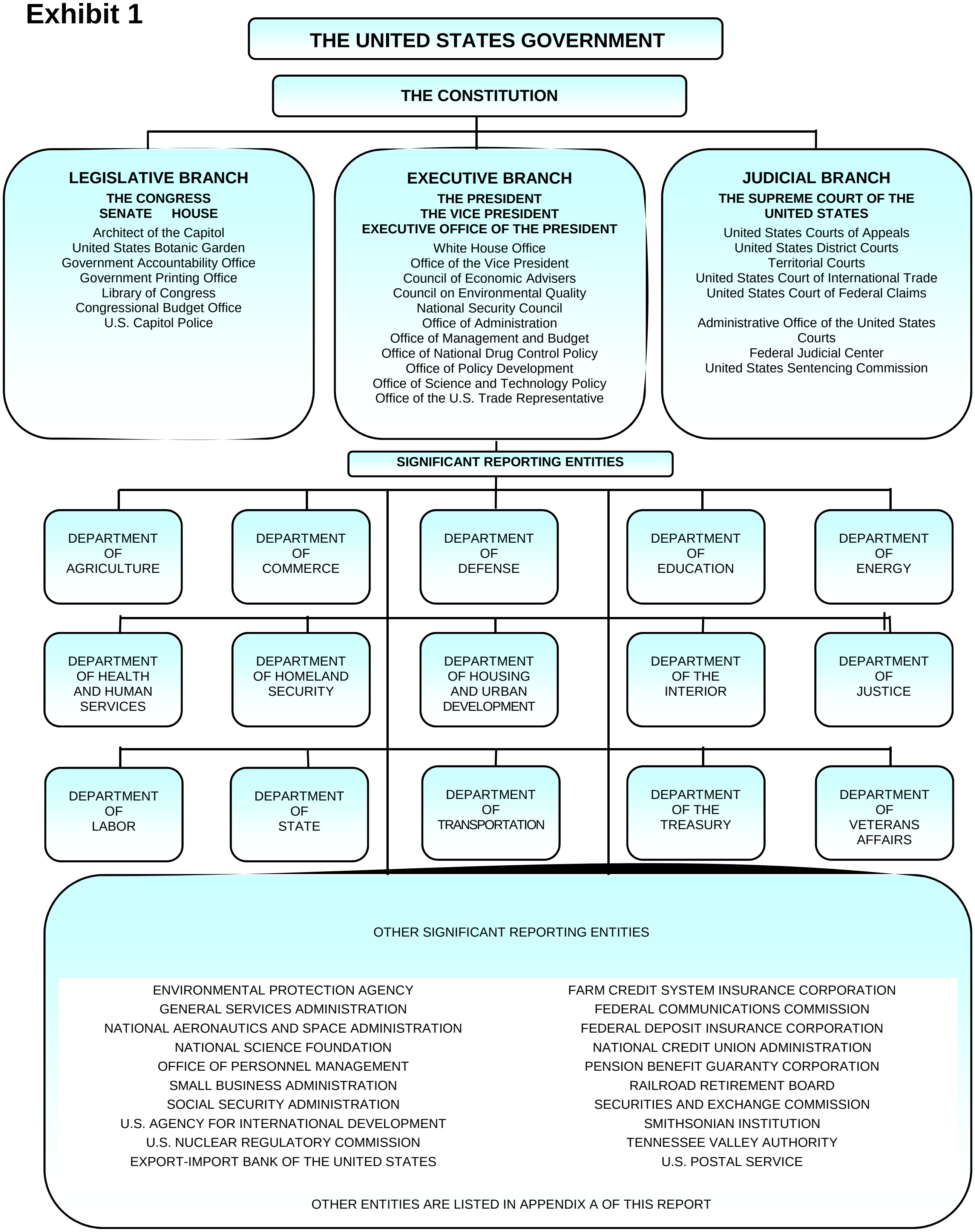
The Government's fundamental mission is derived from the Constitution: ***"…to form a more perfect union, establish justice, insure domestic tranquility, provide for the common defense, promote the general welfare and secure the blessings of liberty to ourselves and our posterity."*** The Congress authorizes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

[1] The Department of Health and Human Services received a disclaimer of opinion on its 2011 SOSI and SCSIA.

[2] The Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), and the Farm Credit System Insurance Corporation (FCSIC) are among the 35 significant entities. However, because these entities operate on a calendar year basis (December 31 year-end), their 2011 audits are not yet complete. Statistic reflects 2010 audit results for these organizations.

Exhibit 1 provides an overview of how the U.S. Government is organized.

Exhibit 1



The Government's Financial Position and Condition

A complete assessment of the Government's financial or fiscal condition requires analysis of historical results, projections of future revenues and expenditures, and an assessment of the Government's long-term fiscal sustainability. This Report discusses the Government's financial position at the end of the fiscal year, explains how and why the financial position changed during the year, and provides insight into how the Government's financial condition may change in the future.

Table 1
The Federal Government's Financial Position and Condition

Dollars in Billions	2011	2010	Increase / (Decrease) $	Increase / (Decrease) %
FINANCIAL MEASURES				
Gross Cost	$ (3,998.3)	$ (4,472.3)	**$ (474.0)**	**(10.6%)**
Less: Earned Revenue	$ 365.6	$ 309.2	$ 56.4	18.2%
Gain/(Loss) from Changes in Assumptions	$ (28.1)	$ (132.9)	$ (104.8)	(78.9%)
Net Cost[1]	**$ (3,660.8)**	**$ (4,296.0)**	**$ (635.2)**	**(14.8%)**
Less: Taxes and Other Revenue:	$ 2,363.8	$ 2,216.5	$ 147.3	6.6%
Unmatched Transactions & Balances	$ (15.6)	$ (0.8)	$ 14.8	1850.0%
Net Operating Cost[2]	**$ (1,312.6)**	**$ (2,080.3)**	**$ (767.7)**	**(36.9%)**
Assets[3]:				
Cash & Other Monetary Assets	$ 177.0	$ 428.6	$ (251.6)	(58.7%)
Loans Receivable and Investments, Net[4]	$ 985.2	$ 942.5	$ 42.7	4.5%
Property, Plant & Equipment, Net	$ 852.8	$ 828.9	$ 23.9	2.9%
Other	$ 692.3	$ 683.8	$ 8.5	1.2%
Total Assets	**$ 2,707.3**	**$ 2,883.8**	**$ (176.5)**	**(6.1%)**
Liabilities[3]:				
Federal Debt Held by the Public & Accrued Interest	$ (10,174.1)	$ (9,060.0)	$ 1,114.1	12.3%
Federal Employee & Veterans Benefits	$ (5,792.2)	$ (5,720.3)	$ 71.9	1.3%
Other	$ (1,526.4)	$ (1,576.3)	$ (49.9)	(3.2%)
Total Liabilities	**$ (17,492.7)**	**$ (16,356.6)**	**$ 1,136.1**	**6.9%**
Net Position (Assets minus Liabilities)	**$ (14,785.4)**	**$ (13,472.8)**	**$ (1,312.6)**	**(9.7%)**
SUSTAINABILITY MEASURES				
Social Insurance Net Expenditures[5]:				
Social Security (OASDI)	$ (9,157)	$ (7,947)	$ 1,210	15.2%
Medicare (Parts A, B, & D)	$ (24,572)	$ (22,813)	$ 1,759	7.7%
Other	$ (101)	$ (97)	$ 4	4.1%
Total Social Insurance Net Expenditures	**$ (33,830)**	**$ (30,857)**	**$ 2,974**	**9.6%**
Total Federal Government Noninterest Net Expenditures[6]	**$ (6,400)**	**$ (16,300)**	**$ (9,900)**	**(60.7%)**
BUDGET DEFICIT				
Unified Budget Deficit[7]	**$ (1,298.6)**	**$ (1,294.1)**	**$ 4.5**	**0.3%**

1 Source: Statement of Net Cost.

2 Source: Statements of Operations and Change in Net Position.

3 Source: Balance Sheet.

4 Includes Loans Receivable and Mortgage-Backed Securities, Troubled Asset Relief Program (TARP) Investments, and Investments in Government-Sponsored Enterprises (GSEs).

5 Source: Statements of Social Insurance (SOSI). Amounts equal estimated present value of projected revenues and expenditures for scheduled benefits over the next 75 years of certain 'Social Insurance' programs (Social Security, Medicare Parts A, B, & D, Railroad Retirement - Black Lung is projected through 2040). Amounts reflect 'Open Group' totals (all current and projected program participants during the 75-year projection period).

6 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 Supplemental Information section of the Financial Report.

7 Source: Final Monthly Treasury Statement (as of 9/30/2011 and 9/30/2010).

Note: totals may not equal sum of components due to rounding.

Table 1 on the previous page and the following summarize the Federal Government's financial position:

- The Government's gross costs decreased nearly 11 percent to $4.0 trillion. Deducting $365.6 billion in revenues earned for services provided (e.g., national park fees) and adding $28.1 billion in losses from changes in assumptions yields a net cost of $3.7 trillion.
- Taxes and other revenues increased $147 billion to $2.4 trillion, which, when offset against the Government's net cost, results in a "bottom line" net operating cost of $1.3 trillion.
- Comparing total 2011 Government assets of $2.7 trillion to total liabilities of $17.5 trillion yields a negative net position of $14.8 trillion. Government liabilities are comprised mostly of $10.2 trillion in Federal debt held by the public and accrued interest payable[3] and $5.8 trillion of Federal employee and veterans benefits payable.
- As of September 30, 2011, the Government's total debt subject to the debt limit was $14.747 trillion. Pursuant to the Budget Control Act of 2011 (BCA), the debt limit was increased by a combined $900 billion to $15.194 trillion during FY 2011.

This Report also contains information about potential impacts on the Government's future financial condition. Under Federal accounting rules, social insurance expenditures, as reported in the Statement of Social Insurance (SOSI) and the Statement of Long-Term Fiscal Projections (included in the Supplemental Information section of the Report) are not considered liabilities of the Federal Government. They can, however, provide a valuable perspective on the sustainability of the Government's fiscal path:

- The SOSI compares the actuarial present value of the Government's projected expenditures for scheduled benefits for Social Security, Medicare Parts A, B and D, and other social insurance programs over 75 years[4] to a subset of the revenues[5] supporting these programs. In the 2011 SOSI, projected social insurance expenditures exceeded projected revenues by $34 trillion, a $3 trillion increase over 2010 projections.
- From a government-wide perspective, projected expenditures for other major programs (including defense, Medicaid, and education) and future tax revenues will also affect the Government's future fiscal condition. Over the next 75 years, under current policy, the Government's total projected, non-interest expenditures (including its social insurance programs) are projected to exceed total projected receipts by $6.4 trillion.

The Government's current financial position and long-term financial condition can be evaluated both in dollar terms and in relation to the economy as a whole. Gross Domestic Product (GDP) measures the size of the Nation's economy in terms of the total value of all final goods and services that are produced in a year. Considering financial results relative to GDP is a useful indicator of the economy's capacity to sustain the Government's many programs. For example:

- Outlays of $3.6 trillion net of receipts of $2.3 trillion yielded a FY 2011 unified budget deficit that remained essentially flat compared to FY 2010 at $1.3 trillion (8.7 percent of GDP).[6]
- The Government borrows from the public to finance the gap between cash-based outlays and receipts and to finance certain cash transactions that are not reflected in the deficit. For FY 2011, debt held by the public, excluding interest payable, of $10.1 trillion, equates to 67.7 percent of GDP.
- The projected $34 trillion excess of expenditures over receipts over 75 years for the programs reported in the 2011 SOSI represents about 3.8 percent of the present value of GDP over 75 years. The excess of total projected non-interest spending over receipts of $6.4 trillion discussed in the 'Statement of Long Term Fiscal Projections' in the Supplemental Information section of the Report represents 0.7 percent of GDP. As discussed in this report, these projections can, in turn, have a significant impact on projected debt as a percent of GDP.

[3] On the Government's balance sheet, debt held by the public and accrued interest payable consists of Treasury securities, net of unamortized discounts and premiums, and accrued interest payable. The "public" consists of individuals, corporations, state and local governments, Federal Reserve Banks, foreign governments, and other entities outside the Federal Government.

[4] The Black Lung Program is projected through September 30, 2040.

[5] Social Security and Medicare Part A are funded by the payroll taxes and revenue from taxation of benefits and premiums that support those programs. Medicare Parts B and D are primarily financed by general revenues. By accounting convention, general revenues are eliminated in consolidation at the government-wide level and, as such, are not included in SOSI projections.

[6] Final Monthly Treasury Statement (as of September 30, 2011 and 2010).

Fiscal Year 2011 Financial Statement Audit Results

For FY 2011, the Government Accountability Office (GAO) issued a fifteenth consecutive disclaimer of audit opinion on the accrual-based government-wide financial statements. In addition, GAO issued disclaimers of opinion on the 2011 and 2010 audits of the Statements of Social Insurance (SOSI), following unqualified SOSI opinions on the 2009, 2008, and 2007 SOSI, and a disclaimer of opinion on the 2011 Statement of Changes in Social Insurance Amounts (SCSIA). The 2011 and 2010 SOSI and 2011 SCSIA disclaimers stem from significant uncertainties (discussed in note 26), primarily related to the achievement of projected reductions in Medicare cost growth reflected in the 2011 and 2010 SOSI.

Twenty-one of the 24 agencies required to issue audited financial statements under the Chief Financial Officers (CFO) Act received unqualified audit opinions, as did 11 of 11 additional significant reporting agencies, (see Table 2 and Appendix A for a list of these agencies)[7].

Table 2: FY 2011 Financial Statement Audit Results by Agency

Chief Financial Officers (CFO) Act Agency	Audit Opinion
Department of Agriculture (USDA)	Unqualified
Department of Commerce (DOC)	Unqualified
Department of Defense (DOD)	Disclaimer
Department of Education (Education)	Unqualified
Department of Energy (DOE)	Unqualified
Department of Health and Human Services (HHS)[1]	Unqualified
Department of Homeland Security (DHS)[2]	Qualified
Department of Housing and Urban Development (HUD)	Unqualified
Department of the Interior (DOI)	Unqualified
Department of Labor (DOL)	Unqualified
Department of Justice (DOJ)	Unqualified
Department of State (State)[3]	Qualified
Department of Transportation (DOT)	Unqualified
Department of the Treasury (Treasury)	Unqualified
Department of Veterans Affairs (VA)	Unqualified
Agency for International Development (USAID)	Unqualified
Environmental Protection Agency (EPA)	Unqualified
General Services Administration (GSA)	Unqualified
National Aeronautics and Space Administration (NASA)	Unqualified
National Science Foundation (NSF)	Unqualified
Nuclear Regulatory Commission (NRC)	Unqualified
Office of Personnel Management (OPM)	Unqualified
Small Business Administration (SBA)	Unqualified
Social Security Administration (SSA)	Unqualified
Other Significant Reporting Entities	**Audit Opinion**
Export-Import Bank of the United States	Unqualified
Farm Credit System Insurance Corportation (FCSIC)[4]	Unqualified
Federal Communications Commission (FCC)	Unqualified
Federal Deposit Insurance Corporation (FDIC)[4]	Unqualified
National Credit Union Administration (NCUA)[4]	Unqualified
Pension Benefit Guaranty Corporation (PBGC)	Unqualified
Railroad Retirement Board (RRB)	Unqualified
Securities and Exchange Commission (SEC)	Unqualified
Smithsonian Institution[5]	Unqualified
Tennessee Valley Authority (TVA)	Unqualified
U.S. Postal Service (USPS)	Unqualified

[1] Recieved disclaimer of opinion on Statement of Social Insurance and Statement of Changes in Social Insurance Amounts.

[2] Balance Sheet and Custodial Statement Audit Only.

[3] Received unqualified opinion on Statement of Budgetary Resources and Consolidated Statement of Net Cost, and a qualfied opinion on the Consolidated Balance Sheet and Statement of Changes in Net Position.

[4] Entities operate under calendar year (CY)-end. Opinions reflect CY 2010 audit results.

[5] Opinion on the most recent annual report, covering FY 2010.

The Government-wide Reporting Entity

These financial statements cover the three branches of the Government (legislative, executive, and judicial). Legislative and judicial branch reporting focuses primarily on budgetary activity. Executive branch entities, as well as certain legislative branch agencies are required, by law, to prepare audited financial statements. Some other legislative branch entities voluntarily produce audited financial reports.

A number of entities and organizations are excluded due to the nature of their operations, including the Federal Reserve System (considered to be an independent central bank under the general oversight of Congress), all fiduciary funds, and Government-Sponsored Enterprises, including the Federal Home Loan Banks, the Federal National Mortgage Association (Fannie Mae), and the Federal Home Loan Mortgage Corporation (Freddie Mac). The Emergency Economic Stabilization Act (EESA) of 2008 gave the Secretary of the Treasury temporary authority to purchase and guarantee assets from a wide range of financial institutions. Following U.S. Generally Accepted Accounting Principles (U.S. GAAP) for Federal entities, the Government has not consolidated into its financial statements the assets, liabilities, or results of operations of any financial organization or commercial entity in which Treasury holds either a direct, indirect, or beneficial majority equity investment. Even though some of the equity investments are

[7] The Department of Health and Human Services received a disclaimer of opinions on its 2011 SOSI and SCSIA.

significant, the entities in which the Federal Government holds equity investments meet the criteria under paragraph 50 of the Statement of Federal Financial Accounting Concepts (SFFAC) No. 2, which directs that the financial results of such entities should not be consolidated into the financial reports of the Federal Government, either in part or as a whole. However, the investments in these entities and any related liabilities are recorded in the financial statements. Appendix A includes a list of the agencies and entities contributing to this report.[8]

The following pages contain a more detailed discussion of the Government's financial results for FY 2011, the budget, the economy, the debt, the Government's ongoing economic recovery efforts, and a long-term perspective about fiscal sustainability, including the Government's ability to meet its social insurance benefits obligations. The information in this Report, when combined with the President's Budget, collectively provides a valuable tool to the Nation's leaders for managing current operations and planning future initiatives.

Limitations of the Financial Statements

The principal financial statements have been prepared to report the financial position and results of operations of the Federal Government, and the financial condition and changes in financial condition of its social insurance programs, pursuant to the requirements of 31 U.S.C. § 331(e)(1). These statements are in addition to the financial reports used to monitor and control budgetary resources that are prepared from the same books and records.

The President's Budget and The Financial Report

Each year, the Administration issues two reports that detail financial results for the Federal Government: the *President's Budget*, which provides a plan for future initiatives and the resources needed to support them, as well as prior year fiscal and performance results; and this *Financial Report*, which provides the President, Congress, and the American people a broad, comprehensive overview of the cost on an accrual basis of the Government's operations, the sources used to finance them, its balance sheet, and the overall financial outlook.

Treasury generally prepares the financial statements in this Report on an "accrual basis" of accounting as prescribed by U.S. GAAP for Federal entities.[9] These principles are tailored to the Government's unique characteristics and circumstances. For example, agencies prepare a uniquely structured "Statement of Net Cost," which is intended to present net Government resources used in its operations. Also, unique to Government is the preparation of separate statements to reconcile differences and articulate the relationship between the budget and financial accounting results.

President's Budget*	**Financial Report of the U.S. Government***
Prepared primarily on a "*cash basis*" • Initiative-based and prospective: focus on current and future initiatives planned and how resources will be used to fund them. • Receipts ("cash in"), taxes and other collections recorded when received. • Outlays ("cash out"), largely recorded when payment is made.	Prepared on an "*accrual and modified cash basis*" • Agency-based and retrospective – prior and present resources used to implement initiatives. • Revenue: Tax revenue (more than 90 percent of total revenue) recognized on modified cash basis (see Financial Statement Note 1.B). Remainder recognized when earned, but not necessarily received. • Costs: recognized when owed, but not necessarily paid.

*See Statements of Changes in Cash Balance from Unified Budget and Other Activities and Reconciliations of Net Operating Cost and Unified Budget Deficits.

[8] Since programs are not administered at the government-wide level, performance goals and measures for the Federal Government, as a whole, are not reported here. The outcomes and results of those programs are addressed at the individual agency level and can be found in each agency's financial report.

[9] Under U.S. GAAP, most U.S. Government revenues are recognized on a 'modified cash' basis, or when they become measurable. The Statement of Social Insurance presents the present value of the estimated future revenues and expenditures for scheduled benefits over the next 75 years for the Social Security, Medicare, Railroad Retirement programs; and through September 30, 2040 for the Black Lung program.

Budget Deficit vs. Net Operating Cost

As the economy continues along a path of gradual recovery, the Government's primarily cash-based[10] budget deficit remained relatively flat at about $1.3 trillion, compared to FY 2010, following significant increases during FY 2008 and especially FY 2009 due to the impacts of the financial crisis, the recession, and the policy actions responding to both. These increases were attributable in part to Government programs that act as "automatic stabilizers," which help to support the economy during a downturn by increasing spending and reducing tax collections. This support is "automatic" because increased spending on programs like unemployment benefits, Social Security, and Medicaid, and a reduction in tax receipts happen even without any legislative changes in policies. These "automatic stabilizers," in addition to recent economic recovery efforts, caused the deficit to increase in recent years. However, the deficit decreased during FY 2010 and remained largely unchanged in 2011.

The Government's largely accrual-based net operating cost (which decreased from a record high of nearly $2.1 trillion in FY 2010 to $1.3 trillion in FY 2011) typically exceeds the deficit due largely to the inclusion of cost accruals or changes in future estimated liabilities for the Government's postemployment benefit programs for its military and civilian employees, as well as its veterans. The longer-term actuarial costs of these programs are included in the Government's net operating cost, calculated on an accrual basis as described above, but are not included in the largely cash-based budget deficit. Agencies and their actuaries estimate the liability for these benefits over the long-term, but funds have yet to actually be spent. Similarly, changes in estimated long-term liabilities associated with economic recovery programs supporting Fannie Mae and Freddie Mac also result in costs that are reflected in the Government's financial statements, but not in the Budget.

Table 3 shows that, for FY 2011, the $14 billion net difference between the Government's budget deficit and net operating cost is minimal, especially when compared to FY 2010 net difference of $786.2 billion. As indicated in Table 3, this is largely due to agencies recording large increases in liabilities for employee and veterans benefits, and support for Government-Sponsored Enterprises (GSEs) – Fannie Mae and Freddie Mac in FY 2010 ($503.1 billion and $268 billion, respectively) and significantly smaller changes for these same amounts in FY 2011 ($71.9 billion increase and $43.7 billion decrease, respectively). As discussed in greater detail later, the smaller estimates of the increase in future employee and veterans benefits relative to FY 2010 stems from changes in experience and economic and demographic assumptions, as well as the implementation of a new Federal accounting standard during FY 2010 that provided for greater consistency in these estimates. GSE estimated liabilities decreased due to payments to the GSEs and lower loss projections. As discussed later and as indicated in the "change" column of Table 3, the difference in the changes of these estimates resulted in significant actuarial and total cost reductions for the Federal Government during FY 2011.

Table 3: Budget Deficit vs. Net Operating Cost

Dollars in Billions	2011	2010	Increase / (Decrease)
Net Operating Cost	**$ (1,312.6)**	**$ (2,080.3)**	**$ (767.7)**
Change in:			
Federal Employee and Veterans Benefits Payable	$ 71.9	$ 503.1	$ (431.2)
Liabilities for Government Sponsored Enterprises	$ (43.7)	$ 268.0	$ (311.7)
Other, Net	$ (14.2)	$ 15.1	$ (29.3)
Subtotal - Net Difference:	$ 14.0	$ 786.2	$ (772.2)
Budget Deficit	**$ (1,298.6)**	**$ (1,294.1)**	**$ 4.5**

[10] Interest outlays on Treasury debt held by the public are recorded in the budget when interest accrues, not when the interest payment is made. For Federal credit programs, outlays are recorded when loans are disbursed, in an amount representing the present value cost to the Government (excluding administrative costs), or the credit subsidy cost. Credit programs record cash payments to and from the public in nonbudgetary financing accounts.

The Government's Net Position: "Where We Are"

The Government's financial position and condition have traditionally been expressed through the Budget, focusing on surpluses, deficits, and debt. However, this primarily cash-based discussion of the Government's net outlays (deficit) or net receipts (surplus) tells only part of the story. The Government's accrual-based net position, (the difference between its assets and liabilities), and its "bottom line" net operating cost (the difference between its revenues and costs) are also key financial indicators.

Revenues and Costs: "What Came In & What Went Out"

The Government's ***Statement of Operations and Change in Net Position***, much like a corporation's income statement, shows the Government's "bottom line" and its impact on net position (i.e., assets net of liabilities). The Government nets its costs against both: (1) earned revenues from Government programs (e.g., Medicare premiums, National Park entry fees, and postal service fees) to derive net cost; and (2) taxes and other revenue to arrive at the Government's "bottom line" net operating cost.

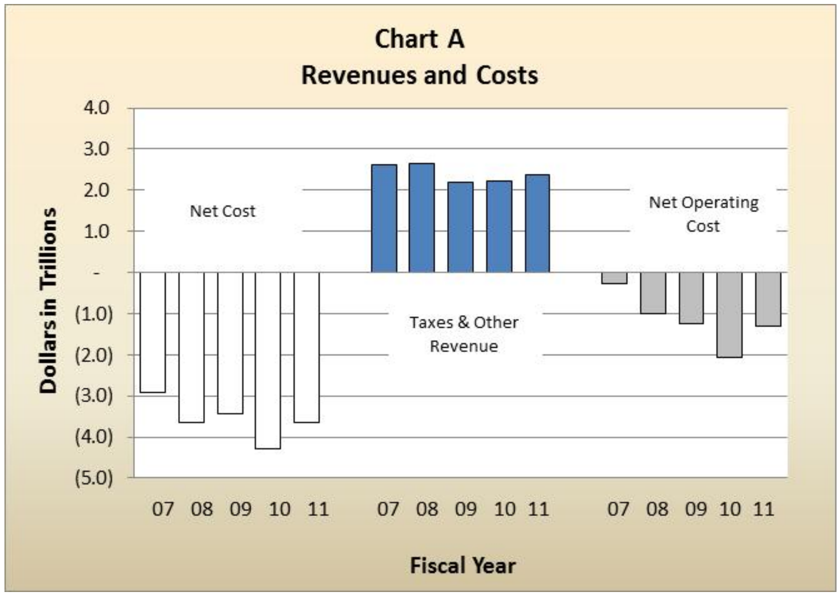


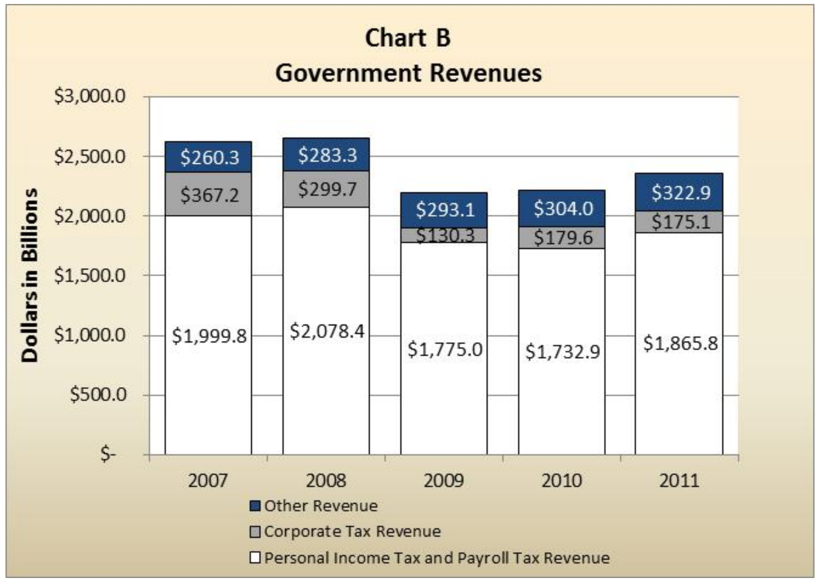
Chart A and Table 4 show that the Government has incurred a total net operating cost (i.e., costs have exceeded its revenues) over the past several years, causing net position to decline. In summary, Table 4 shows that during FY 2011, the Government's "bottom line" net operating cost of $1,312.6 billion decreased by 37 percent or $768 billion, compared to 2010's net operating cost of $2,080.3 billion. As summarized in Table 4 and as will be discussed below, the net decrease in net operating cost in FY 2011 was caused by both a slight revenue increase and a significant net cost decrease.

Table 4: Gross Cost, Revenues, and Net Cost							
Dollars in Billions		2011		2010	Increase / (Decrease)		
						$	%
Gross Cost	**$**	**(3,998.3)**	**$**	**(4,472.3)**	**$**	**(474.0)**	**(10.6%)**
Less: Earned Revenue	$	365.6	$	309.2	$	56.4	18.2%
Subtotal	**$**	**(3,632.7)**	**$**	**(4,163.1)**	**$**	**(530.4)**	**(12.7%)**
Gain/(Loss) from Changes in Assumptions	$	(28.1)	$	(132.9)	$	(104.8)	78.9%
Net Cost	**$**	**(3,660.8)**	**$**	**(4,296.0)**	**$**	**(635.2)**	**(14.8%)**
Less: Taxes and Other Revenue	$	2,363.8	$	2,216.5	$	147.3	6.6%
Unmatched Transactions and Balances	$	(15.6)	$	(0.8)	$	14.8	1850.0%
Net Operating Cost	**$**	**(1,312.6)**	**$**	**(2,080.3)**	**$**	**(767.7)**	**(36.9%)**

The ***Reconciliation of Net Operating Cost and Unified Budget Deficit Statement*** shows how the Government's net operating cost from the primarily accrual-based financial statements relates to the more widely-known and primarily cash-based budget deficit. As summarized in Table 3 on the previous page, most of this difference is attributable to cost related to changes in the estimated present value of the Federal Government's net liabilities for Federal Employee and Veterans' Benefits. The impact of these accrual costs on the Government's total net costs is shown in Chart E.

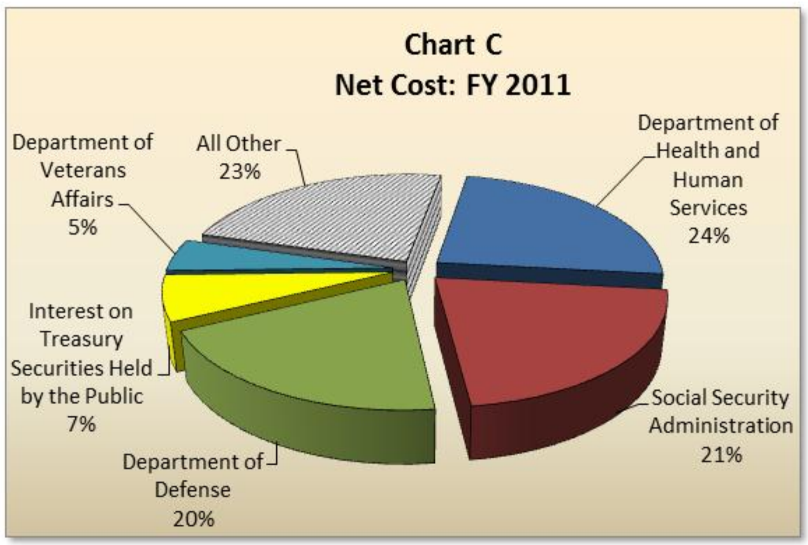
Revenue: "What Came In"

The ***Statement of Net Cost*** reports "earned" revenue generated by Federal programs, including Medicare premiums paid by program participants and postal service fees. The ***Statement of Operations and Changes in Net Position*** shows the Government's taxes and other revenues (i.e., revenues other than "earned"). As shown in Chart B, a slight increase in personal income tax and other revenues, partially offset by a slight decrease in corporate tax revenues combined to increase total Government revenues by $147 billion (6.6 percent) to about $2.4 trillion for FY 2011. Together, personal and corporate income taxes accounted for 86 percent of total revenues in FY 2011. The remaining 14 percent consists of various other taxes and receipts, including excise taxes, unemployment taxes, and customs duties.

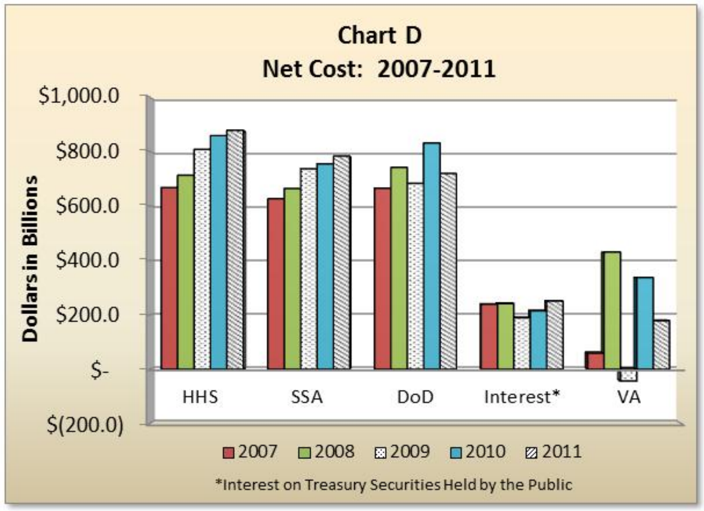


Cost: "What Went Out"

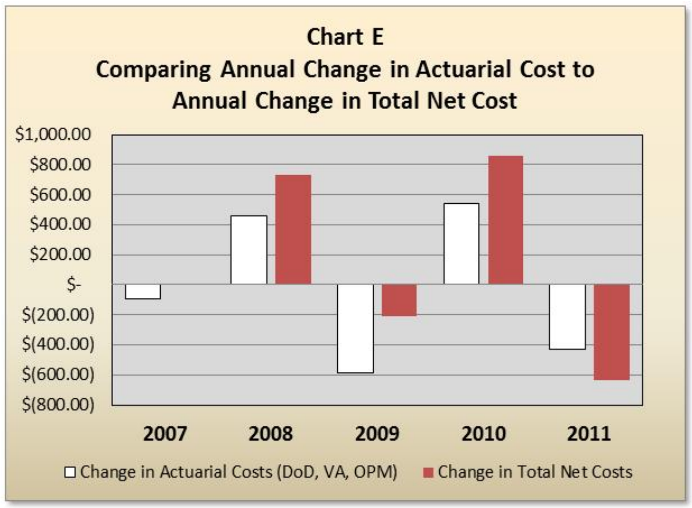
The ***Statement of Net Cost*** also shows how much it costs to operate the Federal Government, recognizing expenses when they happen, regardless of when payment is made (accrual basis). It shows the derivation of the Government's <u>net cost</u> or the net of: (1) the costs of goods produced and services rendered by the Government, (2) the earned revenues generated by those goods and services during the fiscal year, and (3) gains or losses from changes in assumptions impacting longer-term estimated costs. This amount, in turn, is offset against the Government's taxes and other revenue in the ***Statement of Operations and Changes in Net Position*** to calculate the "bottom line" or <u>*net operating cost*</u>. Chart C shows the composition of the Government's net cost (gross cost less earned revenue and gain/loss from changes in assumptions) of $3,660.8 billion in FY 2011, which decreased about 15 percent or $635.2 billion compared to FY 2010. In FY 2011, about two-thirds of total net cost came from the Department of Defense (DOD), the Social Security Administration (SSA), and the Department of Health and Human Services (HHS), which have consistently incurred the largest agency shares of the Government's total net cost in recent years, as shown in Charts C and D. The bulk of HHS and SSA costs (which totaled $877.1 billion and $782.5 billion in FY 2011, respectively) are attributable to major social insurance programs administered by these agencies, e.g., Medicare and Social Security. The ***Statement of Social Insurance*** (SOSI) and the related information in this report, including the broader discussion of the Government's long-term fiscal projections, discuss the projected future revenues, expenditures, and sustainability of these programs in greater detail. DOD net costs of $718.7 billion relate primarily to operational activities and the longer-term costs of military retirement and health benefits. Charts C and D show that the Department of Veterans Affairs (VA) as well as interest on debt held by the public were also significant contributors to the Government's net cost during FY 2011. The combined other agencies included in the Government's Statement of Net Cost accounted for 23 percent of the Government's total net cost.



In recent years, the changes in the Government's net cost have been significantly impacted by changes in the current costs of and especially the actuarial and other estimated costs associated with the Government's postemployment benefits programs for its military and civilian employees reported primarily by the Office of Personnel Management (OPM), DOD, and VA:



- OPM recorded a total agency cost decrease of $126 billion due primarily to actual cost of living adjustment (COLA) and salary increases being lower than expected and actuarial estimate changes.[11]
- DOD cost decreased $131 billion due to changes in the discount rate and demographic assumptions used to calculate military retiree health benefits.[12]
- VA recorded a cost decrease of $152.7 billion in FY 2011, compared to a significant increase in FY 2010 due to the recognition of the initial cost for three new presumptive disability benefits in FY 2010 (subsequent adjustments each year are comparatively smaller) and the implementation of revised projection and calculation methods under a new Federal accounting standard.[13]



In the aggregate, the combined decrease of $431.2 billion from Table 3 in actuarial and other estimated costs associated with the change in estimated liabilities for the Government's three largest postemployment benefits programs, including veterans' benefits, accounted for more than two-thirds of the $635.2 billion total net decrease in the Government's total net cost for FY 2011 (see Chart E).

By comparison and to illustrate the volatility of the changes in these costs, during FY 2010, increases in actuarial costs of more than $538 billion accounted for 65 percent of the total $826.6 billion increase in the Government's 2010 net cost.

These agencies employ a complex series of assumptions, including but not limited to interest rates, beneficiary eligibility, life expectancy, medical cost levels, compensation levels, and cost of living to make annual actuarial projections of their long-term benefits liabilities and the related costs. Annual changes in these assumptions can cause those projections, and consequently total costs, to fluctuate, sometimes significantly, from year to year. Table 4 shows that the losses associated with these changes in assumptions totaled only $28.1 billion in FY 2011, but reflected a decrease of $105 billion compared to losses incurred in FY 2010. DOD, VA, and OPM each attributed significant decreases in their respective agency total net costs largely to changes in these assumptions.

In addition, a decline in net costs at the Department of the Treasury of $288 billion (77 percent) during FY 2011 was another significant contributor to the decline in the Government's total net costs. Last year, Treasury recorded a $268 billion increase in net cost related to the expense associated with recording a contingent liability for

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[11] OPM FY 2011 Agency Financial Report (AFR), p. 16. Cost reduction reflects amounts reported in OPM's annual AFR. Agency costs reported in their AFRs are adjusted at the government-wide level in this Report for consolidation and allocation of inter-agency costs.

[12] DOD FY 2011 AFR, p. 29. Cost reduction reflects amounts reported in DOD's annual AFR. Agency costs reported in their AFRs are adjusted at the government-wide level in this Report for consolidation and allocation of inter-agency costs.

[13] VA FY 2011 Performance and Accountability Report (PAR) p. I-95. Cost reduction reflects amounts reported in VA's PAR. Agency costs reported in their PARs are adjusted at the government-wide level for consolidation and allocation of inter-agency costs.

projected total costs payable to the Government Sponsored Enterprises (GSEs) under the Senior Preferred Stock Purchase Agreement (SPSPA) program. Payments to and revised loss projections for the GSEs resulted in a $43.7 billion reduction of the estimated liability for FY 2011, which, when compared to the $268 billion liability increase (cost) in 2010, yields a combined decrease of $311.7 billion (see Table 3).

As noted earlier, taxes and other revenues of $2,363.8 billion are deducted from the Government's total net cost of $3,660.8 billion (including actuarial costs) to derive a "bottom line" net operating cost[14]. As previously shown in Table 4, a slight increase in taxes and other revenues, combined with the nearly 15 percent decrease in net costs, resulted in a "bottom line" net operating cost of about $1.3 trillion ($1,312.6 billion) for FY 2011, a decrease of 37 percent or $767.7 billion, compared to the FY 2010 net operating cost of about $2.1 trillion ($2,080.3 billion).

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

The Federal Government's net position at the end of the year is derived by netting the Government's assets against its liabilities, as presented in the ***Balance Sheet*** (summarized in Table 5). It is important to note that the balance sheet does not include the financial value of the Government's sovereign powers to tax, regulate commerce, and set monetary policy. It also excludes its control over nonoperational resources, including national and natural resources, for which the Government is a steward. In addition, as is the case with the ***Statement of Operations and Changes in Net Position***, the ***Balance Sheet*** includes a separate presentation of the portion of net position earmarked for specific funds and programs. Moreover, the Government's exposures are broader than the liabilities presented on the balance sheet, when such items as the Government's future social insurance exposures (namely, Medicare and Social Security), as well as other fiscal projections, commitments and contingencies, are taken into account. These exposures are discussed later in this Management Discussion and Analysis (MD&A) section as well as in the supplemental disclosures of this Report.

Table 5: Assets and Liabilities

Net Position Dollars in Billions	2011	2010	Increase (Decrease) $	Increase (Decrease) %
Assets				
Cash & Other Monetary Assets	$ 177.0	$ 428.6	$ (251.6)	(58.7%)
Loans Receivable and Investments, Net*	$ 985.2	$ 942.5	$ 42.7	4.5%
Inventories	$ 296.1	$ 286.2	$ 9.9	3.5%
Property, Plant & Equipment, Net	$ 852.8	$ 828.9	$ 23.9	2.9%
Other	$ 396.2	$ 397.6	$ (1.4)	(0.4%)
Total Assets	**$ 2,707.3**	**$ 2,883.8**	**$ (176.5)**	**(6.1%)**
Less: Liabilities, comprised of:				
Federal Debt Held by the Public & Accrued Interest	$ (10,174.1)	$ (9,060.0)	$ 1,114.1	12.3%
Federal Employee & Veterans Benefits	$ (5,792.2)	$ (5,720.3)	$ 71.9	1.3%
Other	$ (1,526.4)	$ (1,576.3)	$ (49.9)	(3.2%)
Total Liabilities	**$ (17,492.7)**	**$ (16,356.6)**	**$ 1,136.1**	**6.9%**
Net Position (Assets Minus Liabilities)	**$ (14,785.4)**	**$ (13,472.8)**	**$ (1,312.6)**	**(9.7%)**

*Includes Net Loans Receivable and Mortgage-Backed Securities, Troubled Asset Relief Program (TARP) Investments, and Investments in Government-Sponsored Enterprises (GSEs).

Assets – "What We Own"

As of September 30, 2011, the Government held about $2.7 trillion in assets, comprised mostly of net property, plant, and equipment ($852.8 billion in FY 2011) and a combined total of $985.2 billion in net loans receivable and mortgage-backed securities, and investments, including amounts associated with the Troubled Asset Relief Program (TARP) and the GSEs as discussed later. During FY 2011, the Government's total assets decreased by $176.5 billion, due in large part to the elimination of cash deposits with the Federal Reserve held under the Supplementary Financing Program (SFP). Under the SFP, the Treasury issued special bills, which provided cash that the Federal Reserve used to manage its authorized lending and liquidity initiatives. As of September 30, 2011, there were no outstanding cash management bills earmarked for SFP as compared to $200 billion as of September 30, 2010. In addition to assets recorded on the balance sheet, the Government discloses that it also owns certain other

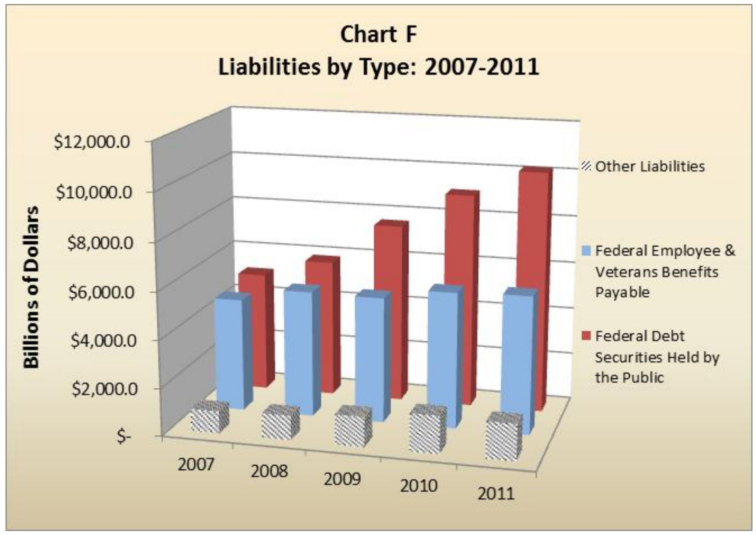
[14] As shown in Table 4, net operating cost includes a slight adjustment for unmatched transactions and balances. These amounts are described in greater detail in the Required Supplementary Information section of this Report.

stewardship assets such as land (e.g., national parks and forests) and heritage assets (e.g., national memorials and historic structures).

Liabilities – "What We Owe"

As indicated in Table 5 and Chart F, the Government's largest liability is Federal debt held by the public and accrued interest, the balance of which increased to $10.2 trillion as of September 30, 2011.

The other major component of the Government's liabilities is Federal employee postemployment and veterans benefits payable (i.e., the Government's pension and other benefit plans for its military and civilian employees), which increased only $71.9 billion or just over 1 percent during FY 2011, from $5,720.3 billion to $5,792.2 billion. OPM administers the largest civilian pension plan, covering nearly 2.8 million current employees[15] and 2.5 million annuitants.[16] The military pension plan covers more than three million current military personnel (including active service, reserve, and National Guard) and approximately 2.2 million retirees and annuitants.[17]



Federal Debt

The unified budget surplus or deficit is the difference between total Federal spending and receipts (e.g., taxes) in a given year. The Government borrows from the public (increases Federal debt levels) to finance deficits. During a budget surplus (i.e., when receipts exceed spending), the Government typically uses those excess funds to reduce the debt held by the public. ***The Statements of Changes in Cash Balance from Unified Budget and Other Activities*** reports how the annual unified budget surplus or deficit relates to the Federal Government's borrowing and changes in cash and other monetary assets. It also explains how a budget surplus or deficit normally affects changes in debt balances.

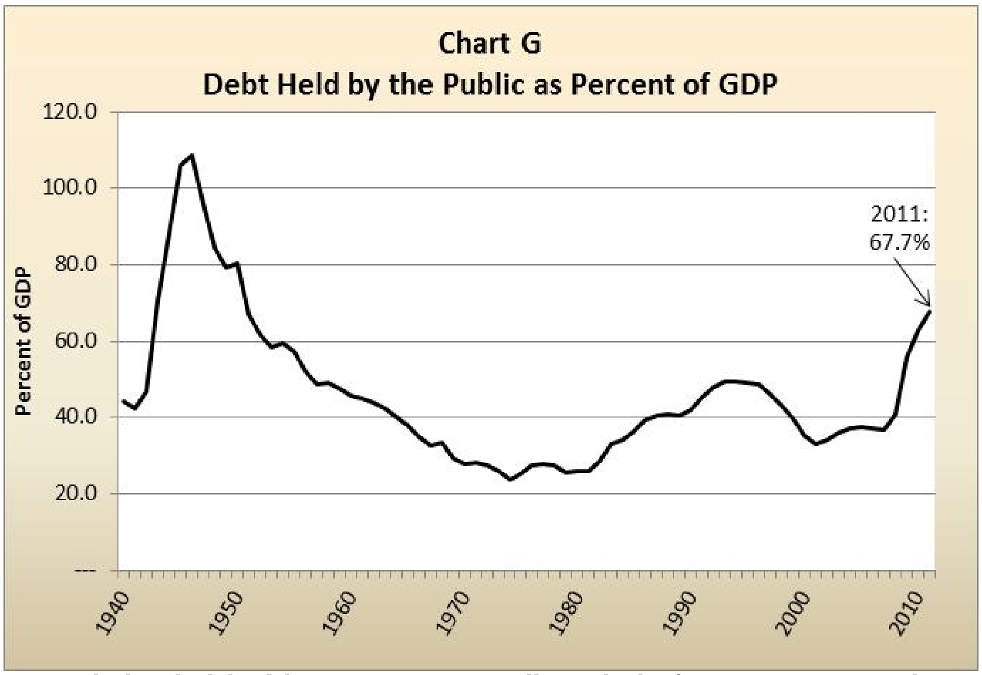
The Government's publicly held debt, or debt held by the public, and accrued interest, as reported on the Government's balance sheet, is comprised of Treasury securities, such as bills, notes, and bonds, net of unamortized discounts and premiums; and accrued interest payable. The "public" consists of individuals, corporations, state and local governments, Federal Reserve Banks, foreign governments, and other entities outside the Federal Government. Debt held by the public and accrued interest is a balance sheet liability and totaled approximately $10.2 trillion at the end of FY 2011 – an increase of about $1.1 trillion. As indicated above, budget surpluses have typically resulted in borrowing reductions, and budget deficits have conversely yielded borrowing increases. However, the Government's debt operations are generally much more complex than this would imply. Each year, trillions of dollars of debt matures and new debt is issued to take its place. In FY 2011, new borrowings were $8.0 trillion and repayments of maturing debt held by the public were $6.9 trillion. Both represented slight decreases over new borrowings and debt repayments as compared to FY 2010.

In addition to debt held by the public, the Government has about $4.7 trillion in intragovernmental debt outstanding, which arises when one part of the Government borrows from another. It represents debt issued by the Treasury and held by Government accounts, including the Social Security ($2.7 trillion) and Medicare ($316.3 billion) trust funds. Intragovernmental debt is primarily held in Government trust funds in the form of special nonmarketable securities by various parts of the Government. Laws establishing Government trust funds generally require excess trust fund receipts (including interest earnings) to be invested in these special securities. Because these amounts are both liabilities of the Treasury and assets of the Government trust funds, they are eliminated as part of the consolidation process for the government-wide financial statements (see Note 14 of the Report). When

[15] As of 9/30/2010 OPM Office of Actuaries
[16] OPM FY 2011 Annual Financial Report, p. 12.
[17] DOD FY 2011 Agency Financial Report, p.12; DOD Military Retirement Fund (MRF) financial statements, p. 14.

those securities are redeemed, e.g., to pay future Social Security benefits, the Government will need to obtain the resources necessary to reimburse the trust funds. 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). At the end of FY 2011, debt subject to the statutory limit was $14.747 trillion, nearly $450 billion under the current limit of $15.194 trillion.

Prior to 1917, the Congress approved each debt issuance. In 1917, to facilitate planning in World War I, Congress established a dollar ceiling for Federal borrowing. Since 1960, Congress has passed 79 separate acts to raise the debt limit, extend the duration of a temporary increase, or revise the definition. The debt limit has been raised multiple times in recent years – most recently by $400 billion in August 2011 to $14.694 trillion and by $500 billion in September 2011 to $15.194 trillion, pursuant to the Budget Control Act (BCA) of 2011. The BCA provides for one additional increase to the debt limit, which will occur fifteen days after the President certifies that the outstanding debt subject to limit is within $100 billion of the debt limit, unless Congress enacts a joint resolution of disapproval. The amount of the next increase will be $1.2 trillion, unless a balanced budget amendment to the Constitution has been submitted to the states for ratification, in which case the amount of the increase will be $1.5 trillion.



The Federal debt held by the public measured as a percent of GDP compares the country's debt to the size of its economy, making this measure sensitive to changes in both. Over time, the ratio of Federal debt-to-GDP has varied widely. For most of the Nation's history, the debt to GDP ratio has tended to increase during wartime and decline during peacetime. That pattern continued to hold following World War II until the 1970s. As shown in Chart G, wartime spending and borrowing had pushed the debt to GDP ratio to an all-time high of 109 percent in 1946, but it decreased rapidly in the post-war years, falling to 80 percent by 1950, 46 percent in 1960, and the postwar low point of 24 percent in 1974. Since then, the ratio has increased, growing rapidly from the mid-1970s until the early 1990s. In the 1990s, strong economic growth and fundamental fiscal decisions, including measures to reduce the Federal deficit and implementation of binding "Pay As You Go" ("PAYGO") rules, generated a significant decline in the debt-to-GDP ratio over the course of the 1990s, from a peak of 49 percent in 1993-1994, to 33 percent in 2001. During the last decade, much of this progress was undone as PAYGO rules were allowed to lapse, significant tax cuts were implemented, entitlements were expanded, and spending related to defense and homeland security increased. By September 2008, the debt-to-GDP ratio was 40 percent of GDP. The extraordinary demands of the recent economic and fiscal crisis and the consequent actions taken by the Federal Government, combined with slower economic growth in the wake of the crisis, have pushed the debt/GDP ratio up to almost 68 percent in 2011.

The preceding section has focused on the Federal Government's financial results for FY 2011. The following sections discuss the Government's economic recovery efforts and provide a perspective on the issue of fiscal sustainability.

Economic Recovery Efforts

This section provides an overview of the economy at the end of FY 2011 and discusses the many important recovery efforts that have been initiated by the Department of the Treasury and across the Government.

The Economy in Fiscal Year 2011

A review of the Nation's key macroeconomic indicators can help place the discussion of the Government's financial results in a broader context. As summarized in Table 6, the economy continued to grow, albeit at a slower rate during FY 2011. Job growth accelerated, with private non-farm payrolls rising by almost 1.9 million after a gain of nearly 350,000 the previous fiscal year. The unemployment rate declined during FY 2011 but remained relatively high.

Table 6: National Economic Indicators*

	FY 2011	FY 2010
Real GDP Growth	1.5%	3.5%
Residential Investment Growth	1.4%	-7.8%
Average monthly payroll job change (thousands)	158	29
Unemployment rate (percent, end of period)	9.1%	9.6%
Consumer Price Index (CPI)	3.9%	1.1%
CPI, excluding food and energy	2.0%	0.8%
Treasury constant maturity 10-year rate (end of period)	1.9%	2.5%
Moody's Baa bond rate (end of period)	5.2%	5.6%

* Some FY2010 data may differ from the FY2010 Report due to update and revision.

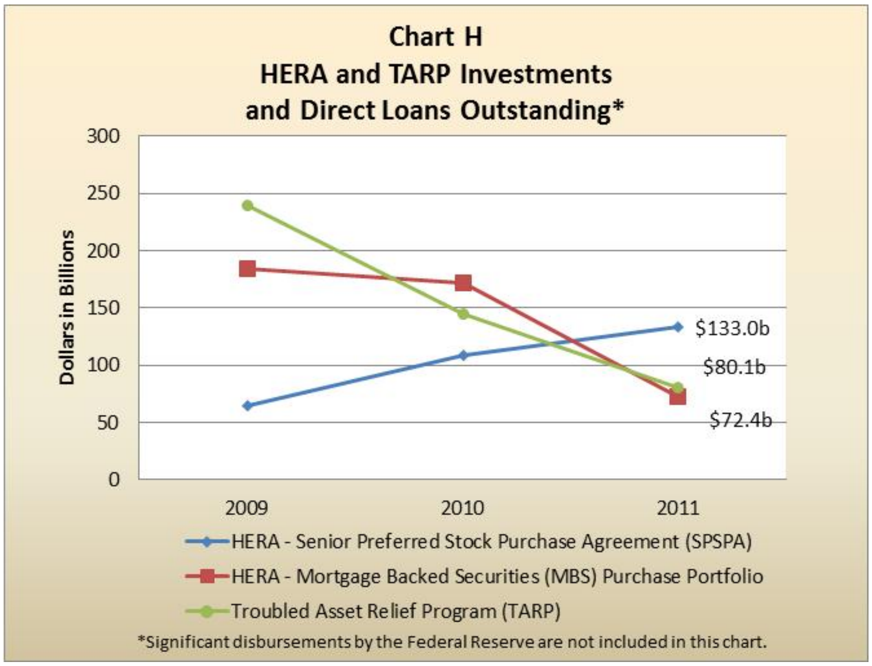
After rising by 3.5 percent during FY 2010, real GDP grew at an annual average rate of 1.5 percent over the four quarters of FY 2011. Quarterly performance was mixed, with real GDP rising 2.3 percent during the first quarter of FY 2011, 0.8 percent on average in the second and third quarters, and 2.0 percent in the fourth quarter of the fiscal year. The economy added 1.6 million total nonfarm payroll jobs during FY 2011, a substantial improvement on the 118,000 nonfarm payroll jobs added during FY 2010. In the private sector, nonfarm payrolls rose by about 1.9 million, after increasing by nearly 350,000 during the previous fiscal year. Nonetheless, the unemployment rate remained elevated in the aftermath of the financial crisis during FY 2011, declining from 9.6 percent in September 2010 to 9.1 percent in September 2011. Inflation increased for the second straight year, mainly reflecting increases in energy and food prices, but still remained contained. Underlying inflation (the core rate, excluding food and energy) also increased but was still low by historical standards. Real wages declined, reflecting the combination of slower nominal wage growth and rising consumer prices. The level of corporate profits increased in FY 2011, but at a slower pace than in the previous fiscal year. Growth of Federal spending and receipts accelerated in FY 2011. As a result, the Federal unified budget deficit was little-changed at $1.3 trillion but narrowed as a share of GDP to 8.7 percent of GDP from 9.0 percent in FY 2010.

The following key points summarize economic performance in FY 2011:

- Consumer spending rose 2.2 percent for a second straight fiscal year during FY 2011. Nonetheless, quarterly performance ranged from a solid 3.6 percent annualized increase in the first quarter of FY 2011 to a more tepid 0.7 percent annualized increase in the third quarter.
- Residential fixed investment started to recover in the latest fiscal year, growing by 1.4 percent over the four quarters of FY 2011, with growth recorded in all but one quarter. Nonresidential fixed investment grew 8.9 percent, after rising by 7.7 percent during the previous fiscal year.
- Labor market conditions improved noticeably during FY 2011, despite a moderation in the pace of job growth towards the end of the fiscal year. Over the entire fiscal year, private nonfarm payroll employment advanced at an average rate of 158,000 jobs per month, compared with an average monthly increase of 29,000 in FY 2010. During FY 2011, the number of unemployed persons fell from 14.7 million to 14.0 million. The unemployment rate stood at 9.1 percent in September 2011, down from 9.6 percent at the end of FY 2010, or 0.5 percentage point lower. At the end of FY 2011, the unemployment rate was a full percentage point lower than the recent peak of 10.1 percent, reached in October 2009.

- The overall price level, as measured by the consumer price index (CPI), rose 3.9 percent during FY 2011, boosted by rising energy and food prices. In FY 2010, the CPI had increased by 1.1 percent. Core inflation (which excludes food and energy) was 2.0 percent in FY 2011, compared with 0.8 percent the previous fiscal year.
- Financial markets conditions and measures of financial risk generally remained stable in FY 2011:
    - Corporate debt yields on bonds of moderate risk stood at about 305 basis points above the rate on 10-year Treasury securities at the end of FY 2010. After narrowing through much of the following fiscal year, the spread widened somewhat during the final quarter of FY 2011 and ended the fiscal year at 330 basis points.
    - The difference between the 3-month London Interbank Offered Rate (LIBOR) and the 3-month Treasury rate stood at 13 basis points at the end of FY 2010. This spread widened over the course of the latest fiscal year, ending FY 2011at 43 basis points.

Review of the Government's Stabilization Efforts



Three years ago, the U.S. financial system was on the verge of collapse and many major financial institutions were at risk of failure. Markets had ceased to function. Without immediate and forceful government action, our country faced the possibility of a second Great Depression. The Department of the Treasury, the Federal Reserve, the Federal Deposit Insurance Corporation (FDIC), and other U.S. Government bodies undertook an array of unprecedented steps at that time to avert a potential collapse and continue to administer a number of programs to help pave the way for sustained economic recovery. Three years later, substantial progress continues to be made in stabilizing the financial system as the Government continues to wind down the extraordinary assistance that was provided during the crisis. Chart H summarizes the outstanding balances of investments and direct loans related to key economic recovery programs.

HERA

The Housing and Economic Recovery Act of 2008 (HERA) established a new regulatory agency, the Federal Housing Finance Agency (FHFA), to regulate the housing Government-Sponsored Enterprises (GSEs),[18] Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. FHFA placed Fannie Mae and Freddie Mac under conservatorship in September 2008 in order to preserve GSE assets and restore those GSEs to a sound and solvent financial condition. Pursuant to HERA, the Treasury Department undertook certain efforts to help ensure the solvency and liquidity of the GSEs, including:

- entering into senior preferred stock purchase arrangements (SPSPAs) with Fannie Mae and Freddie Mac;
- establishing a GSE mortgage-backed securities (MBS) purchase program (expired on December 31, 2009).

[18] The housing GSEs (Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System) are chartered by the Federal Government and pursue a federally mandated mission to support housing finance. Some GSEs are distinctly established as corporate entities - owned by shareholders. The obligations of the housing GSEs are not guaranteed by the Federal Government, however, Treasury's actions under HERA provided significant financial support to Fannie Mae and Freddie Mac.

The SPSPAs are intended to maintain the solvency of the GSEs so they can continue to fulfill their vital roles in the mortgage market while the Administration and Congress determine what structural changes should be made. These agreements provide that the Government will make funding advances to the GSEs if, at the end of any quarter, the FHFA, acting as the conservator, determines that the liabilities of either GSE exceeds its respective assets. GSE funding is subject to a formulaic cap that adjusts upwards quarterly by the cumulative amount of any losses realized by either GSE and downward by the cumulative amount of any gains, but not below $200 billion per GSE, and will become fixed on December 31, 2012. At that time, the remaining commitment will then be fixed and available to be drawn per the terms of the agreements. As of September 30, 2011, Treasury had made total actual cumulative combined payments to Fannie Mae and Freddie Mac of $169.0 billion, reflected on the Government's balance sheet at fair value of $133.0 billion (see Chart H). In addition, a combined $316.2 billion has been accrued as a contingent liability for future SPSPA investments in the GSEs, a $44 billion decrease from FY 2010, following a $268 billion increase between 2009 and 2010. The significant increase in this liability in FY 2010 was due primarily to the increased availability of GSE projection data, coupled with the effect of the 2009 amendment to the liquidity cap for each GSE. The decrease in FY 2011 was attributable to payments to the GSEs and updated projections reflecting lower expected future losses at the GSEs.

The GSE Mortgage-Backed Securities (MBS) Purchase Program was created to broaden access to mortgage funding for current and prospective homeowners and to promote stability in the mortgage market. Between October 2008 and December 31, 2009, Treasury purchased $225 billion in agency MBS. In March 2011, Treasury announced its plans to sell up to $10 billion of its MBS portfolio per month, subject to market conditions. As a result of these sales and prepayments, the outstanding MBS portfolio decreased by more than half from $172.2 billion at the end of FY 2010 to $72.4 billion at the end of FY 2011 (see Chart H) and by more than two-thirds when compared to Treasury's initial purchases. Treasury's efforts combined with purchases by the Federal Reserve, has helped bring down mortgage rates to historically low levels and provide liquidity and stability to housing markets.

EESA, TARP, and the Office of Financial Stability

The Emergency Economic Stabilization Act of 2008 (EESA) provided authority and facilities that the Secretary of the Treasury could use to restore liquidity and stability to the financial system of the United States and ensured that such authority and facilities have been used in a manner that protected home values, college funds, retirement accounts, and life savings; preserved home ownership; promoted jobs and economic growth; maximized overall returns to the taxpayers of the United States; and provided public accountability for the exercise of such authority. The EESA authorized the establishment of the Office of Financial Stability (OFS) within the Treasury Department to implement the Troubled Asset Relief Program (TARP). TARP, in conjunction with other Federal Government actions, helped to prevent a collapse of the financial system and unfreeze capital and credit markets, bringing down the cost of borrowing for businesses, individuals, and state and local governments, restoring confidence in the financial system, and restarting economic growth. TARP did so faster and at a much lower cost than many anticipated.

The EESA originally provided authority for the TARP to purchase or guarantee up to $700 billion in troubled assets. The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 reduced the cumulative TARP authority to $475 billion. On October 3, 2010, OFS' authority to make new commitments under TARP expired. During FY 2011, OFS focused principally on exiting remaining investments in a timely and orderly manner, maximizing return for taxpayers, and continuing to help homeowners avoid preventable foreclosures:

- The TARP programs launched to help stabilize the nation's banking institutions are now producing a profit to taxpayers. A total of $245 billion was invested in banking institutions pursuant to several TARP initiatives, compared to approximately $258 billion that OFS has recovered through repayments, dividends, interest, and other income since TARP's inception through September 30, 2011.
- OFS reduced its stake in General Motors Company by 50 percent through General Motors' highly successful Initial Public Offering and fully exited its investment in Chrysler Group, as Chrysler Group repaid its loans six years earlier than the loans' maturity dates.
- OFS, working with other Federal Government entities, closed a major restructuring plan for American International Group (AIG), marking a major milestone in the company's turnaround and putting OFS in a better position to recover their investment in AIG. In May 2011, Treasury completed the sale of 132 million shares of AIG common stock held by OFS and 68 million shares held by the General Fund. As of September 30, 2011, OFS held 960 million shares and the General Fund held an additional 495 million

shares of AIG common stock, resulting in a combined percentage ownership of AIG's outstanding shares of approximately 77 percent.

As a result of improved financial conditions of TARP participants, earlier than expected asset repurchases, lower utilization of the program, and careful stewardship, the estimated cost of TARP over its lifetime continues to decline on a budget basis, from $341 billion in August 2009 (assuming the full $700 billion of TARP authority was utilized), to $117 billion in February 2010 (assuming $546 billion of the $700 billion TARP authority was utilized). The most recent estimates as of September 30, 2011, reflect a lifetime cost of $70.2 billion on $470 billion of TARP authority that was obligated. These budget-basis estimates, which assume that all planned expenditures are made, differ from the cost reported in the financial statements, which are based on transactions through September 30, 2011, and thus, do not include committed but undisbursed funds for housing programs as well as other programs all of which are included in the expected lifetime cost for budget purposes. TARP's costs from inception (October 3, 2008), through September 30, 2011, as reported in the OFS financial statements, were $28.0 billion.

Since its inception through September 30, 2011, OFS has disbursed $413.4 billion in direct loans and investments and for the Treasury Housing programs under TARP, collected $276.9 billion from repayments and sales, and reported nearly $40 billion from cash received through interest and dividends, as well as from proceeds from the sale and repurchase of assets in excess of cost. As of September 30, 2011, TARP had $122.4 billion in gross outstanding direct loans and equity investments, valued at $80.1 billion (see Chart H).

It should be noted that TARP cost estimates are based on current market prices, where available. The ultimate cost of the outstanding TARP investments is, therefore, subject to significant uncertainty and will depend on, among other things, how the economy, financial markets, and particular companies perform. Additional information concerning the TARP program and other related initiatives can be found at www.financialstability.gov.

The Recovery Act

Improvement in the economic and financial outlook since the spring of 2009 reflects a broad and aggressive policy response that has included the initiatives and programs under HERA and TARP as discussed above, other financial stability policies implemented by the FDIC and the Board of Governors of the Federal Reserve, accommodative monetary policy, and the American Recovery and Reinvestment Act of 2009 (ARRA or the Recovery Act). The purpose of the original $787 billion ARRA package was to jump-start the economy and to create and save jobs, with one-third of ARRA dedicated to tax provisions to help businesses and working families, another third for emergency relief for those who have borne the brunt of the recession, and the final third devoted to investments to create jobs, spur economic activity, and lay the foundation for future sustained growth. Cumulative ARRA amounts paid out by Federal agencies as of September 30, 2011 totaled $421.4 billion, as compared to $307.9 billion as of September 30, 2010.[19] It is important to note that amounts spent by the Federal, State, and Local government agencies, as well as by the private sector are constantly changing. Readers may find the most up-to-date information on where and how these funds are being used at www.recovery.gov.

[19] Agency Financial & Activity Reports as of September 30, 2011 and 2010. For more information, see the Recovery Act website at www.Recovery.gov.

The Long-Term Fiscal Outlook: "Where We Are Headed"

While the Government's immediate priority is to continue to foster economic recovery, there are longer term fiscal challenges that must ultimately be addressed. Persistent growth of health care costs and the aging of the population due to the retirement of the "baby boom" generation and increasing longevity will make it increasingly difficult to fund critical social programs, including Medicare, Medicaid, and Social Security.

Fiscal Sustainability

An important purpose of the Financial Report is to help citizens and policymakers assess whether current fiscal policy is sustainable and, if it is not, to highlight the urgency and magnitude of policy reforms necessary to make it sustainable. A sustainable policy is one where the ratio of debt held by the public (publicly-held debt) to Gross Domestic Product (the debt–to-GDP ratio) is stable in the long run. Sustainability concerns only whether long-run revenues and expenditures are in balance; it does not concern fairness or efficiency implications of the reforms necessary to achieve sustainability.

To determine if current fiscal policies are sustainable, the projections discussed here assume current policies will be sustained indefinitely and draw out the implications for the growth of debt held by the public as a share of GDP.[20] The projections are therefore neither forecasts nor predictions. If policy changes are enacted, then actual financial outcomes will of course be different than those projected.

The projections in this Report indicate that the trajectory of current policy is not sustainable. The debt-to-GDP ratio is projected to reach 287 percent in 2086 and to rise continuously thereafter. Closing the gap between spending and receipts over the next 75 years (the "75-year fiscal gap") is estimated to require some combination of spending reductions and revenue increases that amount to 1.8 percent of GDP over the period. While the precise size of the fiscal gap is highly uncertain, there is little question that current fiscal policies cannot be sustained indefinitely.

It is important to address the Nation's fiscal imbalances soon. Delaying action increases the magnitude of spending reductions and/or revenue increases necessary to stabilize the debt-to-GDP ratio. For example, it is estimated that the magnitude of reforms necessary to close the 75-year fiscal gap is 60 percent larger if reforms are concentrated into the last 55 years of the 75-year period than if they are spread over the entire 75 years.

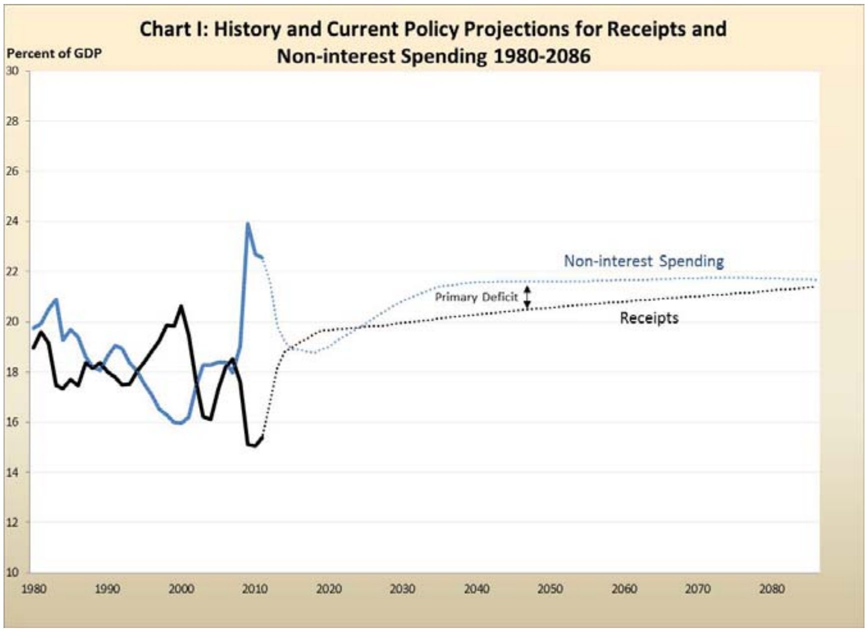
The estimates of the cost of policy delay in this Report assume policy does not affect GDP (or interest rates). Reducing deficits too abruptly would be counterproductive if it slows the economy's recovery. In the near term, it is crucial to strike the proper balance between deficit reduction and economic growth.

The Primary Deficit, Interest, and Debt

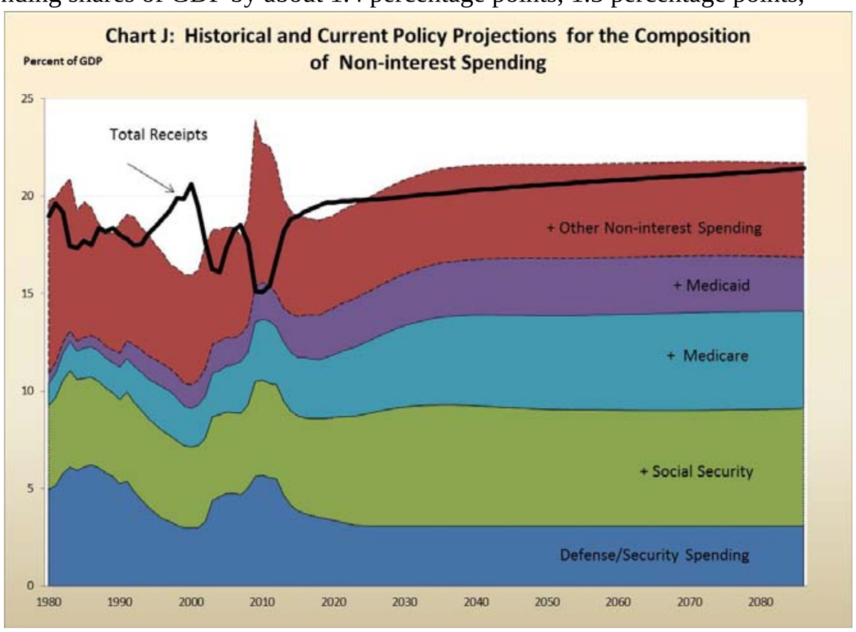
The primary deficit - the difference between non-interest spending and receipts – is the only determinant of the ratio of publicly-held debt to GDP that the Government controls directly. (The other determinants are interest rates and growth in GDP). Chart I shows receipts, non-interest spending, and the difference – the primary deficit – expressed as a share of GDP. The primary deficit-to-GDP ratio grew rapidly in 2009 and stayed large in 2010 and 2011 due to the financial crisis and the recession and the policies pursued to combat both. The primary deficit-to-GDP ratio is projected to fall rapidly between 2012 and 2019 (turning to surplus in 2015) as spending reductions called for in the Budget Control Act (BCA) of 2011 take effect and the economy recovers. Between 2019 and 2035, however, increased spending for Social Security and health programs due to continued aging of the population is expected to cause the primary balance to steadily deteriorate. A primary deficit is expected to reappear in 2025 that reaches 1.3 percent of GDP in 2035. After 2035, the projected primary deficit-to-GDP ratio slowly declines as the impact of the baby boom generation retiring dissipates. Between 2035 and 2086, the projected primary deficit averages 0.9 percent of GDP.

[20] 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).

The revenue share of GDP fell substantially in 2009 and 2010 and increased only modestly in 2011 because of the recession and tax reductions enacted as part of the ARRA and the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, and is projected to return to near its long-run average as the economy recovers and these temporary tax cuts expire. After the economy is fully recovered, receipts are projected to grow slightly more rapidly than GDP as increases in real incomes cause more taxpayers and a larger share of income to fall into the higher individual income tax brackets. These projections assume that Congress and the President will continue to enact legislation to prevent the share of income subject to the Alternative Minimum Tax from rising.

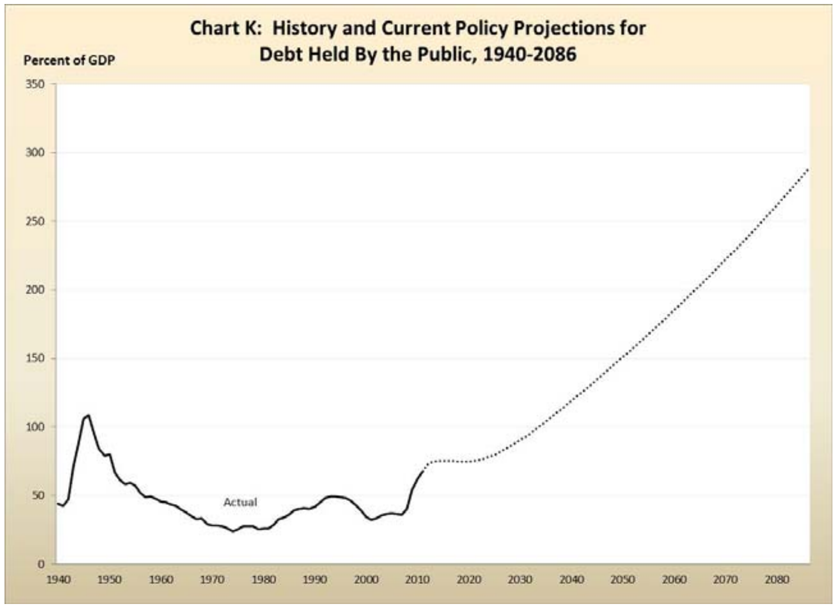


Non-interest spending share of GDP is projected to fall from its current level of 22.6 percent to about 20 percent in 2013, to stay at or below that level until 2026, and then to rise gradually and plateau at about 22 percent beginning in about 2040. The reduction in the non-interest spending share of GDP over the next two years is mostly due to caps on discretionary spending and further automatic spending reductions enacted in the BCA, and the subsequent increase is principally due to growth in Medicare, Medicaid, and Social Security spending. (See Chart J.) The retirement of the baby boom generation over the next 25 years is projected to increase the Social Security, Medicare, and Medicaid spending shares of GDP by about 1.4 percentage points, 1.3 percentage points, and 1.0 percentage points, respectively. After 2035, the Social Security spending share of GDP is relatively steady, while the Medicare and Medicaid spending share of GDP continues to increase, albeit at a slower rate, due to projected increases in health care costs. The Affordable Care Act (ACA)[21] significantly reduces projected Medicare and Medicaid cost growth from the levels projected in the 2009 Financial Report. However, there is uncertainty about whether the projected cost savings, productivity improvements, and reductions in physician payment rates will be sustained in a manner consistent with the projected cost growth over time.

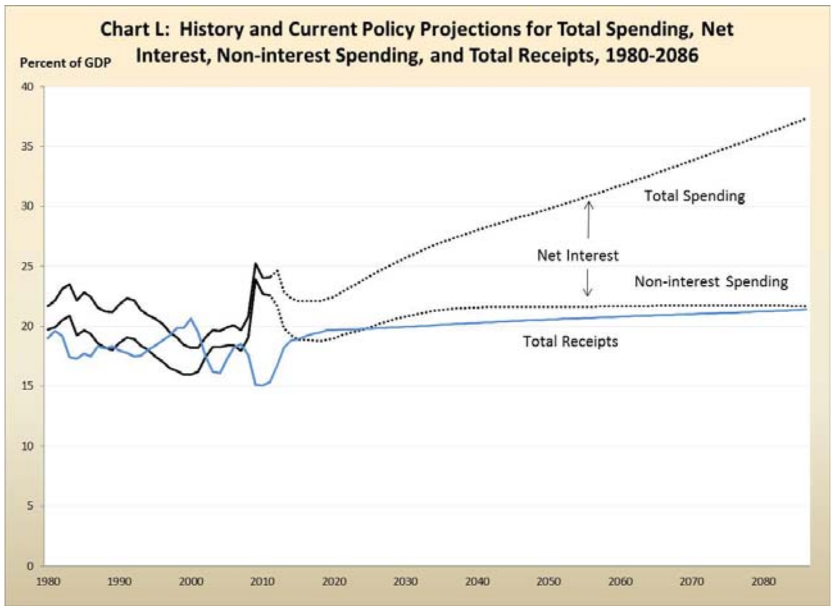


[21] P.L. 111-148 as amended by P.L. 111-152.

The primary deficit projections in Chart I, along with those for interest rates and GDP, determine the projections for the ratio of publicly-held debt to GDP that are shown in Chart K. That ratio was 68 percent at the end of fiscal year 2011 and under current policy is projected to exceed 76 percent in 2022, 125 percent in 2042, and 287 percent in 2086. This continuous rise of the debt-to-GDP ratio illustrates that current policy is unsustainable.



The change in debt held by the public from one year to the next is essentially equal to the unified budget deficit, the difference between total spending (which consists of non-interest spending plus interest spending) and total receipts. Chart L shows that the rapid rise in total spending and the unified deficit is almost entirely due to projected interest payments on the debt. Interest spending was 1.5 percent of GDP in 2011 and under current policies is projected to reach 5 percent in 2031 and nearly 16 percent in 2086.



This year's projections are somewhat more favorable than were the projections in the 2010 Financial Report. Last year's report projected a debt-to-GDP ratio to reach 352 percent in 2085, which compares with 283 percent projected in this year's report. The more favorable outlook is mainly due to spending reductions called for in the BCA that are partly offset by somewhat less favorable economic and technical assumptions.

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 running primary surpluses over the period that average 1.1 percent of GDP. This compares with an average primary deficit of 0.7 percent of GDP under current policy. The difference, the "75-year fiscal gap," is 1.8 percent of GDP, which is about 9 percent of the 75-year present value of projected receipts and non-interest spending.

Table 7: Costs of Delaying Fiscal Consolidation	
Period of Delay	**Change in Average Primary Surplus**
No Delay: Reform in 2012	1.8 percent of GDP between 2012 and 2086
Ten Years: Reform in 2022	2.2 percent of GDP between 2022 and 2086
Thirty Years: Reform in 2032	2.8 percent of GDP between 2032 and 2086

Note: Reforms taking place in 2011, 2021, and 2031 from the 2010 Report were 2.4, 2.9, and 3.7 percent of GDP.

Table 7 illustrates the cost of delaying policy to close the fiscal gap by comparing three policies closing the fiscal gap that begin on different dates. The first policy begins immediately; it increases the primary surplus by 1.8 percent of GDP in every year between 2012 and 2086.

This is accomplished by invoking some combination of spending reductions and revenue increases that amounts to an average of 1.8 percent of GDP in every year. The second policy shown in Table 7 begins in 2022. Because debt grows unabated between 2011 and 2021 and the same fiscal consolidation must be compressed into 10 fewer years, the primary surplus must increase by 2.2 percent of GDP in every year between 2022 and 2086 in order to close the 75-year fiscal gap. Similarly, beginning the policy change in 2032 requires that the primary surplus increase by 2.8 percent of GDP in every year between 2032 and 2086 in order to close the 75-year fiscal gap. The difference between the primary surplus boost starting in 2022 and 2032 (2.2 and 2.8 percent of GDP, respectively) and the primary surplus boost starting in 2012 (1.8 percent of GDP) is a measure of the additional burden policy delay would impose on future generations. Future generations are harmed by policy delay because the higher the primary surplus is during their lifetimes the greater the difference is between the taxes they pay and the programmatic spending they benefit from.

Conclusion

The United States took potentially significant steps towards fiscal sustainability by enacting the ACA in 2010 and the BCA in 2011. The ACA holds the prospect of lowering the long-term growth trend for Medicare and Medicaid spending, and the BCA significantly curtails discretionary spending. Together, these two laws substantially reduce the estimated long-term fiscal gap. But even with the new law, the debt-to-GDP ratio is projected to increase continually over the next 75 years and beyond if current policies are kept in place, which means current policies are not sustainable. Subject to the important caveat that policy changes are not so abrupt that they slow the economy's recovery, the sooner policies are put in place to avert these trends, the smaller are the revenue increases and/or spending decreases necessary to return the Nation to a sustainable fiscal path.

While this Report's projections of expenditures and receipts under current policies are highly uncertain, there is little question that current policies cannot be sustained indefinitely. These and other issues concerning fiscal sustainability are discussed in further detail in the Supplemental Information section of this Report.

Statement of Social Insurance – Challenges Continue

The preceding analysis of the Government's long-term fiscal projections considered Government receipts and spending as a whole. A more focused perspective can be achieved through analysis of the Government's "social insurance" programs: Social Security, Medicare, Railroad Retirement, and Black Lung. For these programs, the Statement of Social Insurance (SOSI) reports: (1) the actuarial present value of all future program revenue (mainly taxes and premiums) - excluding interest - to be received from or on behalf of current and future participants; (2) the estimated future scheduled expenditures to be paid to or on behalf of current and future participants; and (3) the difference between (1) and (2). Amounts reported in the SOSI and in the supplemental

Table 8: Social Insurance Future Expenditures in Excess of Future Revenues

Dollars in Billions	2011	2010	Increase / (Decrease) $	Increase / (Decrease) %
Open Group (Net):				
Social Security (OASDI)	$ (9,157)	$ (7,947)	$ 1,210	15%
Medicare (Parts A, B, & D)	$ (24,572)	$ (22,813)	$ 1,759	8%
Other	$ (101)	$ (97)	$ 4	4%
Total Social Insurance Expenditures, Net (Open Group)	**$ (33,830)**	**$ (30,857)**	$ 2,974	10%
Total Social Insurance Expenditures, Net (Closed Group)	**$ (46,273)**	**$ (43,057)**	$ 3,217	7%

Social Insurance Net Expenditures as a % of Gross Domestic Product (GDP)*

Open Group	**2011**	**2010**
Social Security (OASDI)	-1.0%	-0.9%
Medicare (Parts A, B, & D)	-2.8%	-2.7%
Other	0.0%	0.0%
Total (Open Group)	**-3.8%**	**-3.7%**
Total (Closed Group)	**-5.3%**	**-5.1%**

Source: Statement of Social Insurance (SOSI). Amounts equal estimated present value of projected revenues and expenditures for scheduled benefits over the next 75 years of certain 'Social Insurance' programs (e.g., Social Security, Medicare). 'Open Group' totals reflect all curent and projected program participants during the 75-year projection period. 'Closed Group' totals reflect only current participants.

* GDP values from the 2011 & 2010 Social Security and Medicare Trustees Reports represent the present value of GDP over the 75 years. As the GDP used for Social Security and Medicare differ slightly in the Trust Fund Reports, the two values are averaged to estimate the 'Other' and Total Net Social Insurance Expenditures as % of GDP.

Note - some totals may not equal sum of components due to rounding.

information in this Report are based on each program's official actuarial calculations. By accounting convention, the transfers of general revenues are eliminated in the consolidation of the financial statements at the government-wide level and as such, the general revenues that are used to finance Medicare Parts B and D are not included in these calculations even though the expenditures on these programs are included. SOSI programs and amounts are included in the broader fiscal sustainability analysis in the previous section, although on a slightly different basis (as described in the Supplemental Section of this Report).

The SOSI provides perspective on the Government's long-term estimated exposures and costs for social insurance programs. While these expenditures are not considered Government liabilities, they do have the potential to become expenses and liabilities in the future, based on the continuation of the social insurance programs' provisions contained in current law. The social insurance trust funds account for all related program income and expenses. Medicare and Social Security taxes, premiums, and other income are credited to the funds; fund disbursements may only be made for benefit payments and program administrative costs. Any excess revenues are invested in special non-marketable U.S. Government securities at a market rate of interest. The trust funds represent the accumulated value, including interest, of all prior program surpluses, and provide automatic funding authority to pay for future benefits.

Table 8 on the previous page, which summarizes amounts reported in the SOSI, shows that net social insurance expenditures are projected to be approximately $34 trillion as of January 1, 2011 for the "Open Group," an increase of approximately $3 trillion over net expenditures of $31 trillion projected in the 2010 Report.[22] Table 9 summarizes the principal reasons for the changes in projected social insurance amounts during FY 2011. Most of the change from the past year is attributable to the change in valuation period. For a 75-year projection period, the change in valuation period measures the effect of replacing the first projection year from the prior year with a new 75th year in the current reporting year. Another significant variable was changes in demographic (e.g., birth, mortality, and immigration) and economic (e.g., taxable earnings, unemployment, and interest rates) assumptions. For the Old-Age, Survivors, and Disability Insurance (OASDI) programs administered by the Social Security Administration, the largest component for change was the change in demographic assumptions. For the Medicare programs (Parts A, B, and D) the most significant components of change were the changes in valuation period and in economic assumptions.

Table 9: Changes in Social Insurance Projections

Dollars in Billions		
Net Present Value (NPV) - Open Group (FY 2010)		(30,857)
Change In:		
Valuation Period	$	(1,518)
Demographic data and assumptions	$	(859)
Economic data and assumptions	$	(145)
Law or policy	$	(14)
Methodology and programmatic data	$	56
Economic and other healthcare assumptions	$	(463)
Change in projection base	$	(31)
Net Change in Open Group measure	$	(2,974)
NPV - Open Group (FY 2011)		(33,830)

As was reported in the FY 2010 Financial Report of the U.S. Government, projected Medicare costs declined significantly reflecting provisions of the ACA. As reported last year and again this year in Note 26, there continues to be uncertainty about whether the projected reductions in health care cost growth will be fully achieved. Note 26 includes an alternative projection to illustrate the uncertainty of projected Medicare costs. As indicated earlier, GAO disclaimed opinions on the 2011 and 2010 SOSI, because of these significant uncertainties.

The retirement of the "baby boom generation" and increases in health care costs are still anticipated to have a prolonged impact on the long-run financial condition of Medicare and Social Security, which is analyzed annually in the Medicare and Social Security Trustees' Reports. According to the Medicare Trustees' Report, under current law, including the assumption of the full implementation of ACA program changes, spending on Medicare is projected to rise from 3.7 percent of GDP in 2011 to 5.6 percent in 2035 and 6.2 percent in 2085. The Hospital Insurance (HI) Trust Fund is now expected to remain solvent until 2024, five years earlier than estimated in last year's report, after which point tax income is estimated to be sufficient to pay 90 percent of benefits, declining to 76 percent in 2050 and then increasing to 88 percent by 2085.

As for Social Security (the Old-Age, Survivors, and Disability Insurance Trust Funds or OASDI), combined spending is projected to increase gradually from its current level of 4.8 percent of GDP to 6.2 percent in 2035, declining to about 6.0 percent by 2050 and remaining at about that level through 2085. The Social Security

[22] 'Closed' Group and 'Open' Group differ by the population included in each calculation. From the SOSI, the 'Closed' Group includes: (1) participants who have attained eligibility and (2) participants who have not attained eligibility. The 'Open' Group adds future participants to the 'Closed' Group. See 'Social Insurance' in the Supplemental Information section in this report for more information.

Trustees' Report indicates that annual OASDI income, including interest on trust fund assets, will exceed annual cost and trust fund assets will increase every year until 2023, at which time it will be necessary to begin drawing down on trust fund assets to cover part of expenditures until assets are exhausted in 2036, one year earlier than estimated in the prior year's Trustees' Report. After trust fund exhaustion, continuing tax income would be sufficient to pay 77 percent of scheduled benefits in 2036 and 74 percent in 2085.[23]

As noted earlier, it is apparent that these programs are on a fiscally unsustainable path (as was previously discussed and as noted in the Trustees' Reports). Additional information from the Trustees Reports may be found in the Supplemental Information section of this Report.

Systems, Controls, and Legal Compliance

Systems

As Federal agencies demonstrate success in obtaining opinions on their audited financial statements, the Federal Government continues to face challenges in implementing financial systems that meet Federal requirements, but progress has been made. The number of agencies reporting compliance with the Federal Financial Management Improvement Act (FFMIA) in FY 2011 remains at 17, and the number of auditors reporting compliance with FFMIA reduced to 13, compared to 14 in FY 2010. The annual compliances reported each year underscores the importance of current initiatives to standardize the financial management practices across the Federal Government.

Controls

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

The OMB Circular No. A-123, *Management's Responsibility for Internal Control,* is the policy document that implements the requirements of 31 U.S.C. 3512 (c), (d) (commonly known as the Federal Managers' Financial Integrity Act or FMFIA). Circular No. A-123 primarily focuses on providing agencies with a framework for assessing and managing risks more strategically and effectively. The Circular contains multiple appendices that address, at a more detailed level, one or more of the objectives of effective internal control. Appendix A provides a methodology for agency management to assess, document, test, and report on internal controls over financial reporting. Appendix B requires agencies to maintain internal controls that reduce the risk of fraud, waste, and error in Government charge card programs. Appendix C implements the requirements of the Improper Payments Information Act, as amended by the Improper Payments Elimination and Recovery Act, which includes the measurement, reporting, recovery, and remediation of improper payments.

In addition to the FY 2011 agency financial statement audit results, the total number of material weaknesses for Chief Financial Officers (CFO) Act agencies remained steady at 31. Effective internal controls are a challenge not only at the agency level, but also at the government-wide level. GAO reported that at the government-wide level, material weaknesses resulted in ineffective internal control over financial reporting. While progress is being made at many agencies and across the Government in identifying and resolving internal control deficiencies, continued diligence and commitment are needed.

Legal Compliance

Federal agencies are required to comply with a wide range of laws and regulations, including appropriations, employment, health and safety, and others. Responsibility for compliance primarily rests with agency management. Compliance is addressed as part of agency financial statement audits. Agency auditors test for compliance with selected laws and regulations related to financial reporting. Certain individual agency audit reports contain instances of noncompliance. None of these instances were material to the government-wide financial statements. However, GAO reported that its work on compliance with laws and regulations was limited by the material weaknesses and scope limitations discussed in its report.

[23] A Summary of the 2011 Annual Social Security and Medicare Trust Fund Reports, p. 10.

Financial Management Progress and Priorities

The Office of Federal Financial Management (OFFM) within the Office of Management and Budget (OMB) is responsible for the Federal Government's financial management policy and manages government-wide financial management priorities. This section summarizes recent progress and outlines several key initiatives intended to achieve improved results moving forward.

Progress To Date

Since the passage of the CFO Act of 1990, the Federal financial community has made important strides in instilling strong accounting and financial reporting practices. This year, for the first time since the passage of the CFO Act over 20 years ago, 23 of the 24 CFO Act agencies obtained an opinion from the independent auditors on their financial statements.[24] Over the past 20 years, an increasing number of Federal agencies have initiated and sustained disciplined and consistent financial reporting operations, implemented effective internal controls around financial reporting, and have successfully integrated transaction processing and accounting records. These efforts have resulted in improved results on financial statement audits. Out of the 24 major "CFO Act" agencies, there were 21 clean opinions, 2 qualified opinions, and only one remaining disclaimer in FY 2011. In addition, the number of auditor-identified material weaknesses stands at 31, an approximate 50 percent decline from the 61 material weaknesses that were identified at the start of this past decade.

The foundations for the accomplishments achieved over the past 20 years are numerous. In particular, and as envisioned by OMB Circular No. A-123, *Management's Responsibility for Internal Control*, the Federal financial management community approached these reporting challenges holistically, integrating both programmatic and financial management disciplines in building successful financial reporting programs. Given the size and complexity of the programs and transactions involved, these results would not have been possible without the advances in Federal financial management.

Ongoing Challenges

Despite the progress identified above, critical gaps in financial management performance remain. Weaknesses in basic financial management practices and other limitations continue to prevent one major agency, and the Government as a whole, from achieving an audit opinion. The cost of maintaining effective financial operations is increasing, driven largely by the growing and high costs agencies are incurring to modernize agency financial systems. While Federal agencies have mobilized resources to meet the new and growing demand for real-time transparency into where Federal dollars are going, more work is necessary to sustain these solutions in a cost-effective manner over the long term. Federal agencies reported approximately $115 billion in improper payments in FY 2011 and continue to maintain thousands of unneeded real property assets on their books. These instances of Government waste compromise the integrity of Federal programs, lead to damaging inefficiencies, and erode citizens' trust in Government. However, initiatives as outlined below are resulting in progress with these issues and are putting the Government in a better position.

Improvement Initiatives

It has never been more vital that the Government's financial managers are performing at high levels to meet these challenges and are maximizing the return on every dollar invested in financial management activities. To do so, three areas emerge as the optimal priority areas for the Federal financial management community:

- **Eliminating Waste –** The President launched the Campaign to Cut Waste last summer to reduce costs, identify and implement efficiencies, and root out wasteful expenditures across government. Building on this effort, the

[24] The Department of Homeland Security had the Balance Sheet and the Statement of Custodial Activity audited and received a qualified opinion on these statements. The Department of State received a clean opinion on the Statements of Net Costs and the Statement of Budgetary Resources, and a qualified opinion on the Balance Sheet and Statement of Changes in Net Position. HHS received a clean opinion on all statements except the Statement of Social Insurance and the Statement of Changes in Social Insurance, both of which received a disclaimer of opinion. The Department of Defense received a disclaimed opinion on all statements subject to audit.

Federal Government will continue to focus on removing unneeded real property from the Government's books and eliminating improper payments.

- **Closing the Efficiency and Technology Gap in Financial Operations** – The Federal Government are working to simplify the governance structure in an effort to unify the grants community and strengthen the audit framework for Federally-funded State and local activities. In February, the President issued a memorandum directing OMB to work with stakeholders to improve Federal grants management. In addition, expensive and long-term investments in technology solutions to support financial reporting and accounting must be reconsidered in favor of shorter-term, lower cost, and easier to manage solutions that meet critical business needs, drive operational efficiency, and leverage shared service solutions where cost-effective.
- **Promoting Accountability and Innovation through Open Government** – Efforts should be directed towards improving the content and quality of currently reported information to provide better value to taxpayers and Government decision-makers. Further, solutions must be developed and deployed in partnerships that extend beyond the borders of the Federal financial management community, to involve Federal and State stakeholders, and most critically, members of the public.

Eliminating Waste

- *Campaign to Cut Waste.* In an effort to reduce costs, identify and implement efficiencies, eliminate practices that are antiquated and unnecessary, and root out waste across government, the President launched the Campaign to Cut Waste in June of 2011. Executive Order 13576 "*Delivering an Efficient, Effective, and Accountable Government,*" which established the Campaign to Cut Waste, called upon all agencies to reinforce the performance and management reform gains already achieved; systematically identify additional reforms necessary to eliminate wasteful, duplicative or otherwise inefficient programs; and publicize these reforms so that they may serve as a model across the Federal Government. Building on this effort, the President issued an Executive Order on "Promoting Efficient Spending" that requires agencies to cut certain administrative costs in FY 2013 by not less than 20 percent below FY 2010 levels. The Chief Financial Officers at each of the agencies are largely responsible for achieving these savings. The CFO Council is responsible for reporting the result of these efforts to the President's Management Council. These efforts under the Campaign to Cut Waste are expected to result in billions of dollars in savings by FY 2013.
- *Accelerating Efforts to Better Manage Federal Real Property.* The Administration is focused on improving the management of real property assets. The Federal Government is the largest property owner in the country, but it is not using some of those assets productively. The Administration supports efforts to remove unneeded real property from the Government's books and reduce operating costs related to real property., On June 10, 2010, the President signed a memorandum on *Disposing of Unneeded Federal Real Estate—Increasing Sales Proceeds, Cutting Operating Costs, and Improving Energy Efficiency*, which directed Federal agencies to accelerate efforts to remove excess and surplus property and to realize $3 billion in savings from the Government's properties by September 30, 2012. To date, Federal agencies have identified $1.5 billion of the President's $3 billion goal through actions including reducing annual operating costs, reducing square footage through consolidating space within owned and leased buildings, increasing the impact of telework, selling owned properties, and improving energy efficiencies. To build on this effort and work in achieving more long-term savings, the President introduced the Civilian Property Realignment Act in the FY 2012 budget. The proposal would create an independent Board to reduce and realign the Federal civilian property inventory. The Board would cut bureaucratic red tape, resolve longstanding competing stakeholder interests, and help address the financial challenges that hinder efforts to dispose and consolidate Federal real property. Expanding on the work toward the passage of the President's proposal, the Administration has continued to make progress on achieving savings in real property by working with the Federal Real Property Council and the Real Property Advisory Committee to encourage greater collaboration across agencies.
- *Addressing Improper Payments.* The Improper Payments Information Act of 2002 (IPIA) as amended by the Improper Payments Elimination and Recovery Act of 2010 (IPERA), created a framework for assessing every Federal program and dollar for risk of improper payments, annually measuring the accuracy of payments, and initiating improvements to ensure that errors are reduced and eliminated and overpayment recoveries are pursued. Addressing improper payments is a central component of Administration efforts to eliminate waste. Over the past two years, the President has issued Executive Order 13520 on Reducing Improper Payments, a Presidential memorandum on intensifying and expanding agency efforts to recapture improper payments, and a Presidential memorandum directing that a Do Not Pay List be established to help prevent improper payments from being made to ineligible recipients. In addition, the President also signed into law the Improper Payments Elimination and Recovery Act of 2010 (IPERA), which amends IPIA. While agencies are continuing to

implement these initiatives, we are already seeing real results. Based on information submitted by agencies in FY 2011, the reported government-wide error rate is 4.69 percent, a decrease from the FY 2010 rate of 5.29 percent. The estimated improper payments reported for FY 2011 are $18 billion lower than if the error rate had remained at the higher rate of 5.42 percent reported for FY 2009, the first year of improper payment reporting under the Administration. In addition, agencies reported recapturing more than $1.2 billion in improper payments to contractors and vendors in FY 2011, almost twice as much as was recaptured in FY 2010. More information on agency improper payments and the Administration's improper payment initiatives can be found at PaymentAccuracy.gov.

Closing the Efficiency and Technology Gap in Financial Operations

- *Improving Grants Management*. Each year, the Federal Government provides over $500 billion in grants to State, local and tribal governments, colleges and universities, and other non-profit organizations –roughly one-sixth of the Federal budget. OFFM is committed to working with the grants community to make the grant process efficient and citizen-friendly through streamlining grant applications and reports and modernizing the grants system, Grants.gov. On February 28, 2011, the President issued a Memorandum instructing OMB to work with Federal and non-Federal stakeholders to review OMB Circulars and look for ways to reduce administrative burden for recipients while improving program outcomes for Federal grants. OFFM convened two working groups, one focusing on Cost Principles and Audit Requirements for States, Localities, and Tribes, and another to look at the same policies for universities. The recommendations of these two groups were submitted to OMB at the end of August. On October 27, 2011, OMB issued M-12-01, creating the Council on Financial Assistance Reform (COFAR) to provide policy level leadership for the grants community to implement much needed reforms to improve effectiveness and efficiency in Federal grants. The COFAR is working to develop these reforms based on the recommendations received from the grants community.
- *Decreasing the Cost of Financial System Modernizations*. Complexity and inefficiency in the Federal Government's financial management operations has led to an increasingly expensive environment for modernizing financial systems. Also, once deployed, the Federal Government's modern systems do not consistently meet our business needs or produce the right information to support decision-making. In June 2010, OMB froze activity on CFO Act agency financial system plans pending their immediate review and approval. To date, a total of 21 agencies have been reviewed and, where appropriate, the agencies have realigned their financial system plans through splitting projects into smaller, simpler segments with clear deliverables; focusing on the most critical business needs first; and ensuring ongoing, transparent project oversight. These realignments have resulted in cost reductions for some of the projects reviewed. Review of the agency financial system projects continues according to the risk associated with the projects. In addition, Customer Control Boards were established to organize agencies that are leveraging similar solutions. This will allow the agencies to pool resources, share strategies, and organize solutions across the Government in an effort to support the combined interests of agencies to modernize at a pace and scope that fits their individual business needs.

Promoting Accountability and Innovation through Open Government

- *Improving Data Quality for Federal Spending Information.* Ensuring the quality of Federal spending information has been central to OMB's efforts in implementing the Federal Funding Accountability and Transparency Act. Under the Administration's Campaign to Cut Waste, the President's June 13, 2011 Executive Order (EO), "Delivering an Efficient, Effective, and Accountable Government" established the Government Accountability and Transparency Board (GATB). Under the EO, the Board is charged with providing recommendations to the President on enhancing the transparency of Federal spending and advance fraud detection efforts, data quality and fraud detection. These recommendations will leverage the experience and lessons learned from the implementation of the Recovery Act and the Recovery Accountability and Transparency Board (RATB). In December 2009, the Administration established the Open Government Directive (M-10-06), which required each agency take specific steps to ensure that data is reported quickly, efficiently, and accurately. The Open Government Directive was quickly followed by the Data Quality Framework in February, which provides specific guidance on data quality plans as they relate to Federal spending data. Pursuant to this guidance, Federal agencies developed these specific data quality plans that outline a governance structure, risk assessment process, governing principles and controls, communications, and monitoring of Federal spending information. In April and August 2010, OMB issued guidance to Federal agencies on improving information quality and required the reporting of grants and contracts sub-award information. Access to both prime and now sub-award data offers the public unprecedented amounts of information on Federal spending. This increased transparency will ensure that the Federal Government is held fully accountable for the administration of Federal programs. Notwithstanding these accomplishments, efforts must continue to address existing and burgeoning data quality concerns. Informed by stakeholder input and recommendations, OMB and Federal agencies will work to ensure that high quality Federal spending information is available to promote accountability and ultimately be used to improve the performance of our Federal programs.

- *Strengthening the Reporting Model*. The Federal Government's "reporting model" defines the information that is included in federal entity financial statements and other required supplemental information (e.g., Management's Discussion and Analysis) and the scope of internal controls related to financial reporting. Inclusion in the financial statements or required supplemental information also affects the nature and extent of the auditor's responsibilities. The overall goal of this initiative is to maintain public faith and confidence in Federal financial management by proposing improvements to the usefulness of financial reports to decision makers and the public and strengthening audit requirements in areas where financial risks are the most significant. Particular emphasis is being placed on obtaining improved information on the cost of Government activities and the results achieved. OMB, working with the CFO Council, developed a new statement of spending that focused on how and where Federal money was spent. This new statement is currently being piloted and will establish reliable reporting of how taxpayer dollars are being spent.
- *Partnering For Solutions*. The Partnership Fund for Program Integrity Innovation (Partnership Fund) was established by the Consolidated Appropriations Act of 2010 (P.L. 111-117) to fund pilot projects to improve delivery of Federal assistance programs administered through state and local governments or where Federal-state cooperation could be beneficial. Funding supports pilots and evaluations of promising innovations that confront these challenges in Federal, state and/or local administration. Partnership Fund pilots advance four goals: (1) improve payment accuracy; (2) improve administrative efficiency; (3) improve service delivery; and (4) reduce access barriers for eligible beneficiaries. OMB is actively working with a Collaborative Forum of Federal agencies, state and local administrators, industry and other stakeholders to identify pilot opportunities that could inform the expansion of innovations to other state or local agencies as well as further potential administrative or legislative action to facilitate these goals. In aggregate, pilots must save at least as much as they cost. So far, six pilots have been funded and are being implemented by lead Federal agencies in cooperation with state partners. These pilots address multiple programs, including the Supplemental Nutrition Assistance Program (SNAP), Unemployment Insurance, Medicaid, the Earned Income Tax Credit (EITC), and the Treasury Offset Program.

The sweeping challenges we face in the Government today require our financial managers to move beyond the status quo and to generate a higher return on investment for our financial management activities. The Financial Management Community has made critical progress – decreasing the reported government-wide improper payment rate, from 5.29 percent in FY 2010 to 4.69 percent in FY 2011 and increasing the amount of recaptured improper payments by approximately 80 percent. In addition, the agencies are on target to exceed the goal of $3 billion in savings from real property by September 30, 2012. The steps outlined above leverage the tools and capacities in place today, and refocus energies on critical and emerging priorities – cutting wasteful spending, improving the efficiency of our operations and information technology, and laying a foundation for data quality and collaboration as we enter a new era of transparency and open Government.

Additional Information

This *Financial Report's* Appendix contains the names and websites of the significant Government entities included in the Report's financial statements. Details about the information in this *Financial Report* can be found in these entities' financial statements included in their Performance and Accountability and Annual Financial Reports. This *Financial Report*, as well as those from previous years, is also available at the Treasury, OMB, and GAO websites at: http://www.fms.treas.gov/fr/index.html; http://www.whitehouse.gov/omb/financial/index.html; and http://www.gao.gov/financial.html, respectively. Other related Government publications include, but are not limited to the:

- *Budget of the United States Government*,
- *Treasury Bulletin*,
- *Monthly Treasury Statement of Receipts and Outlays of the United States Government*,
- *Monthly Statement of the Public Debt of the United States*,
- *Economic Report of the President*, and
- *Trustees' Reports* for the Social Security and Medicare Programs.

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GAO
Accountability * Integrity * Reliability

Comptroller General
of the United States

United States Government Accountability Office
Washington, DC 20548

December 23, 2011

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

During fiscal year 2011, the federal government continued to face economic and fiscal challenges in a slow growth economy with high unemployment. Dealing with the government's longer-term fiscal challenge will, as discussed below, require sustained attention and difficult decisions to address serious deficit and debt issues. These fiscal issues further highlight the need for the federal government to operate as effectively and efficiently as possible. Therefore, the Congress, the administration, and federal managers must have ready access to reliable and complete financial and performance information for individual federal entities and the federal government as a whole. Even though significant progress has been made in federal financial management since the enactment of key reforms in the 1990s, our report on the U.S. government's consolidated financial statements illustrates that much work remains to improve federal financial management.

Our report on the U.S. government's consolidated financial statements is enclosed. In summary, we found the following:

- Certain material weaknesses in internal control over financial reporting and other limitations on the scope of our work resulted in conditions that prevented us from expressing an opinion on the fiscal years 2011 and 2010 accrual-based consolidated financial statements.[1] About 35 percent of the federal government's reported total assets as of September 30, 2011, and approximately 21 percent of the federal government's reported net cost for fiscal year 2011 relate to the Department of Defense (DOD), which received a disclaimer on its consolidated financial statements, and the Department of Homeland Security (DHS), which received a qualified opinion on its Balance Sheet and Statement of Custodial Activity for fiscal year 2011 with the remainder of its financial statements being unaudited.

[1]The accrual-based consolidated financial statements for the fiscal years ended September 30, 2011, and 2010, consist of the (1) Statements of Net Cost, (2) Statements of Operations and Changes in Net Position, (3) Reconciliations of Net Operating Cost and Unified Budget Deficit, (4) Statements of Changes in Cash Balance from Unified Budget and Other Activities, and (5) Balance Sheets, including the related notes to these financial statements. Most revenues are recorded on a modified cash basis. Two additional statements that do not interrelate with the accrual-based consolidated financial statements are also included: the Statements of Social Insurance, and the Statement of Changes in Social Insurance Amounts, and related notes.

- Because of significant uncertainties, primarily related to the achievement of projected reductions in Medicare cost growth reflected in the 2011 and 2010 Statements of Social Insurance, we are unable to, and we do not, express an opinion on the 2011 and 2010 Statements of Social Insurance, as well as on the 2011 Statement of Changes in Social Insurance Amounts. About $24.6 trillion, or 72.6 percent, of the federal government's reported total present value of future expenditures in excess of future revenue for 2011 relate to the Department of Health and Human Service's 2011 Statement of Social Insurance, which received a disclaimer of opinion.[2]

- Material weaknesses resulted in ineffective internal control over financial reporting.

- Our work to test compliance with selected provisions of laws and regulations in fiscal year 2011 was limited by the material weaknesses and other scope limitations discussed in our report.

While significant progress has been made in improving federal financial management since the federal government began preparing consolidated financial statements 15 years ago, three major impediments continued to prevent us from rendering an opinion on the federal government's accrual-based consolidated financial statements over this period: (1) serious financial management problems at the DOD that have prevented its financial statements from being auditable, (2) the federal government's inability to adequately account for and reconcile intragovernmental activity and balances between federal agencies, and (3) the federal government's ineffective process for preparing the consolidated financial statements.

It is important to emphasize that while the vast majority of the 24 CFO Act agencies received unqualified opinions, DOD and DHS have consistently been unable to receive such audit opinions. Efforts are underway at both agencies to address this situation. At DOD, following years of unsuccessful financial improvement efforts, the Comptroller established the Financial Improvement and Audit Readiness (FIAR) Directorate to develop, manage, and implement a strategic approach for addressing weaknesses and for achieving auditability, and to integrate those efforts with other improvement activities, such as the department's business system modernization efforts. DOD's current FIAR strategy and methodology is to focus on two priorities—budgetary information and asset accountability—with an overall goal of preparing auditable financial statements by September 30, 2017.[3] Because budgetary information is widely and regularly used for management, the Comptroller designated as one of DOD's highest interim priorities the improvement of its budgetary information and processes underlying its Statement of Budgetary Resources (SBR). On October 13, 2011, the Secretary of Defense directed the department to accelerate its audit readiness timelines to achieve audit readiness on DOD components' SBR by fiscal year 2014, and planning for this accelerated goal is underway.

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[2]We issued an unqualified opinion on the Statements of Social Insurance for 2009, 2008, and 2007.
[3]Section 1003 of the National Defense Authorization Act for Fiscal Year 2010 (Pub. L. No. 111-84) made the development and maintenance of the FIAR Plan into a statutory requirement. Under the act, the FIAR Plan must ensure that DOD's financial statements are validated as ready for audit by September 30, 2017.

DHS was able to attain a qualified audit opinion on its fiscal year 2011 Balance Sheet and Statement of Custodial Activity. This is a significant achievement for DHS. However, the remaining statements are unaudited. The auditor was unable to form an opinion on DHS's internal control over financial reporting due to pervasive material internal control weaknesses over key financial reporting processes. It is important that DHS continue to remediate its internal control deficiencies and build upon the progress it has accomplished as it moves forward to expand the audit to all the financial statements and achieve its ultimate goal of obtaining a clean audit opinion on the full set of financial statements and on internal control over financial reporting.

In addition to the material weaknesses underlying the three aforementioned major impediments, we identified three other material weaknesses. These entail the federal government's inability to (1) determine the full extent to which improper payments occur and reasonably assure that appropriate actions are taken to reduce improper payments, (2) identify and resolve information security control deficiencies and manage information security risks on an ongoing basis, and (3) effectively manage its tax collection activities. Additional details concerning these material weaknesses and their effect on the accrual-based consolidated financial statements and on the management of federal government operations are presented in our report. Until the problems outlined in our report are adequately addressed, they will continue to have adverse implications for the federal government and American taxpayers.

The last economic recession and the federal government's actions to stabilize financial markets and promote economic recovery, among other factors, continued to significantly affect the federal government's financial condition. The federal government reported a net operating cost of about $1.3 trillion and a unified budget deficit of approximately $1.3 trillion for fiscal year 2011, and as of September 30, 2011, debt held by the public increased to 68 percent of gross domestic product (GDP). As of September 30, 2011, the federal government's actions to stabilize the financial markets and to promote economic recovery also resulted in reported federal government assets of over $295 billion, which is net of about $95 billion in valuation losses. In addition, the federal government reported incurring significant liabilities resulting from these actions. Because the valuation of these assets and liabilities is based on assumptions and estimates that are inherently subject to substantial uncertainty arising from the uniqueness of certain transactions and the likelihood of future changes in general economic, regulatory, and market conditions, actual results may be materially different from the reported amounts. For example, assets and liabilities reported by the federal government that are subject to substantial uncertainty include the following:

- The federal government's consolidated financial statements for fiscal year 2011 include approximately $133 billion of investments in Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac) (net of about $43 billion in valuation losses), and approximately $316 billion of liabilities for future payments to these entities. The notes to these financial statements also discuss an estimated additional $60 billion of future payments that could be incurred under an "extreme case" scenario, based on the estimates as of September 30, 2011. Challenges in the housing market have continued and the future structures of these government-sponsored enterprises and the roles they will serve in the mortgage markets must still be determined.

- The federal government reported Troubled Asset Relief Program direct loans and equity investments of approximately $80 billion as of September 30, 2011 (net of about $42 billion in valuation losses, including about $21 billion related to the American International Group, Inc. Investment Program, and approximately $19 billion related to loans to and equity investments in certain entities in the automotive industry, including General Motors Company).

- The federal government reported Federal Deposit Insurance Corporation liabilities of approximately $47 billion as of September 30, 2011, related to estimated failures of insured financial institutions, guarantees, and bank resolutions. Additional losses could occur if economic and market conditions deteriorate in the future.

- Further deterioration in the residential real-estate market could result in additional losses for the Federal Housing Administration beyond the reported loan guarantee liability of approximately $36 billion as of September 30, 2011.

- The federal government reported that the Pension Benefit Guaranty Corporation's (PBGC) liabilities exceeded its assets by about $26 billion as of September 30, 2011. PBGC is subject to further losses if plan terminations that are reasonably possible occur.

The ultimate cost of the federal government's actions to stabilize the financial markets and promote economic recovery will not be known for some time as these uncertainties are resolved and further federal government actions are taken in fiscal year 2012 and later. Looking ahead, the federal government will face the challenge of determining the most expeditious manner in which to bring closure to its financial stabilization initiatives while optimizing its investment returns.

The comprehensive long-term fiscal projections presented in this *2011 Financial Report of the United States Government* (*2011 Financial Report*) show that—absent policy changes—the federal government continues to face an unsustainable fiscal path. Largely as a result of the provisions in the Budget Control Act of 2011,[4] the fiscal outlook has improved. However, rising health care costs and the aging of the U.S. population continue to create budgetary pressure. The oldest members of the baby boom generation are now eligible for early Social Security retirement benefits and for Medicare benefits. In addition, debt held by the public continues to grow as a share of the economy; this means the current structure of the federal budget is unsustainable over the longer term. These projections, with regard to Social Security and Medicare, are based on the same assumptions underlying the information presented in the Statement of Social Insurance and assume that the provisions in law designed to slow the growth of Medicare costs are sustained and remain effective throughout the projection period. GAO also prepares long-term fiscal simulations for the U.S. government.[5] Under GAO's Alternative simulation, which modifies the revenue assumptions used in the above noted projections and uses the Centers for Medicare and Medicaid Services (CMS) actuary's alternative health care cost projections, projected spending in excess of receipts would be greater and debt held by the public as a share of GDP would grow more quickly than the projections in the *2011 Financial Report*. For example, under GAO's Alternative simulation, debt held by the public as a share of GDP would exceed the historical

[4]Pub. L. No. 112-25, 125 Stat. 240 (Aug. 2, 2011).
[5]GAO, *The Federal Government's Long-Term Fiscal Outlook: Fall 2011 Update*, GAO-12-28SP (Washington, D.C.: Oct. 24, 2011).

high reached in the aftermath of World War II by 2027,[6] 10 years earlier than the projections in the *2011 Financial Report*.

Our report on the U.S. government's consolidated financial statements would not be possible without the commitment and professionalism of inspectors general throughout the federal government who are responsible for annually auditing the financial statements of individual federal entities. We also appreciate the cooperation and assistance of Department of the Treasury and Office of Management and Budget officials as well as the federal entities' chief financial officers. We look forward to continuing to work with these individuals, the administration, and the Congress to achieve the goals and objectives of federal financial management reform.

Our report begins on page 211. Our guide[7] to the *Financial Report of the United States Government* is intended to help those who seek to obtain a better understanding of the *Financial Report* and is available on GAO's website at www.gao.gov. In addition, the website includes a guide[8] to understanding the differences between accrual and cash measures of the deficit and provides a useful perspective on the different purposes cash and accrual measures serve in providing a comprehensive picture of the federal government's fiscal condition today and over time.

[6]GAO's Alternative simulation incorporates the CMS Office of the Actuary's alternative projections for health care cost growth, which assume physician payments are not reduced as specified under current law and certain cost controls are not maintained over the long term. Also in this simulation, expiring tax provisions other than the Social Security payroll tax reductions are extended to 2021 and the alternative minimum tax exemption amount is indexed to inflation through 2021; revenues are then brought back to the 40-year historical average as a share of GDP. Discretionary spending follows the Congressional Budget Office's baseline for the first 10 years, which reflect the discretionary spending caps in the Budget Control Act of 2011, and thereafter gradually increases to the historical average share of GDP. Automatic procedures in the Budget Control Act of 2011 that reduce spending by $1.2 trillion are applied to total annual deficits evenly from 2013 to 2021 and remain a constant share of GDP thereafter.
[7]GAO, *Understanding the Primary Components of the Annual Financial Report of the United States Government*, GAO-09-946SP (Washington, D.C.: September 2009).
[8]See http://www.gao.gov/special.pubs/longterm/deficit/, which is based on information in GAO, *Understanding Similarities and Differences between Accrual and Cash Deficits*, and GAO-07-117SP (Washington, D.C.: December 2006). In January 2007 and 2008, we issued updates to this guide for fiscal years 2006 and 2007; see GAO-07-341SP (Washington, D.C.: January 2007) and GAO-08-410SP (Washington, D.C.: January 2008).

Our report was prepared under the direction of Robert F. Dacey, Chief Accountant, 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) 512-3406.

Gene L. Dodaro
Comptroller General
of the United States

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

(198663)

Financial Statements of the United States Government for the Years Ended September 30, 2011, and 2010

Statements of Net Cost

These statements present the net cost of fiscal years 2011 and 2010 Government [1] operations, including the operations related to earmarked funds (funds financed by specifically identified revenues, often supplemented by other financing sources, which remain available over time). The Government's fiscal year begins October 1 and ends September 30. Costs and earned revenues are categorized on the Statement of Net Cost by significant entity, providing greater accountability by showing the relationship of the agencies' net cost to the Governmentwide net cost. Costs and earned revenues are presented in this report by department on an accrual basis, while the budget presents costs and revenues by obligations and receipts, generally on a cash basis. 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 controls of the Government.

These statements contain the following four components:

- Gross cost—is the full cost of all the departments and entities excluding (gain)/loss from changes in assumptions. These costs are assigned on a cause-and-effect basis, or reasonably allocated to the corresponding departments and entities.
- Earned revenue—is exchange revenue resulting from the Government providing goods and services to the public at a price.
- (Gain)/loss from changes in assumptions—is the loss or gain from changes in long-term assumptions used to measure the liabilities reported for Federal civilian and military employee pensions, other post-employment benefits and other retirement benefits, including veterans' compensation.
- Net cost—is computed by subtracting earned revenue from gross cost, plus/minus the (gain)/loss from changes in assumptions.

Net cost for Governmentwide reporting purposes includes the General Services Administration (GSA) and the Office of Personnel Management (OPM) agency allocations, and is net of intragovernmental eliminations. For this reason, individual agency net cost amounts will not agree with the agency's financial statements. Because of their specific functions, most of the costs originally associated with GSA and OPM have been allocated to their user agencies for Governmentwide reporting purposes. 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, if applicable. The interest on securities issued by the Department of the Treasury (Treasury) and held by the public is reported on Treasury's financial statements, but because of its importance, and the dollar amounts involved, it is reported separately in these statements.

Statements of Operations and Changes in Net Position

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

[1] For purposes of this document, "Government" refers to the U.S. Government.

Revenue

Individual income tax and tax withholdings include Federal Insurance Contributions Act (FICA)/Self-Employment Contributions Act (SECA) taxes and other taxes. These taxes are characterized as non-exchange revenue.

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

Other taxes and receipts include Federal Reserve banks (FRBs) earnings, tax related fines, penalties and interest, and railroad retirement taxes.

Miscellaneous earned revenues consist of earned revenues received from the public with virtually no associated cost. These revenues include rents and royalties on the Outer Continental Shelf Lands resulting from the leasing and development of mineral resources on public lands.

Earmarked revenues are required by statute to be used for designated activities, benefits or purposes and must be accounted for separately from the rest of the Government's non-earmarked revenues. See Note 24—Earmarked Funds for detailed information.

Intragovernmental interest represents interest earned from the investment of surplus earmarked revenues, which finance the deficit spending of non-earmarked operations. These investments are recorded as intragovernmental debt holdings and are included in Note 14—Federal Debt Securities Held by the Public and Accrued Interest, in the table titled Intragovernmental Debt Holdings: Federal Debt Securities Held as Investments by Government Accounts. These interest payments and the associated investments are eliminated in the consolidation process.

Net Cost of Government Operations

The net cost of Government operations (gross cost [including (gains)/losses from changes in assumptions] less earned revenue) flows through from the Statements of Net Cost. The net cost associated with earmarked activities is separately reported.

Intragovernmental Transfers

Intragovernmental transfers reflect amounts required by statute to be transferred from the General Fund of the Treasury to earmarked funds (an example is the annual transfer to the Department of Health and Human Services' (HHS) Supplementary Medical Insurance Trust Fund (Medicare Parts B and D) which receives approximately 76 percent and 80 percent, respectively, of its funding from the General Fund.

Unmatched Transactions and Balances

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

Net Position, Beginning of Period

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

Prior-period adjustments are revisions to adjust the beginning net position and balances presented on the prior year financial statements due to corrections of errors or changes in accounting principles. See Note 1.B—Basis of Accounting and Revenue Recognition and Note 21—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. The net position for earmarked funds is separately shown.

Reconciliations of Net Operating Cost and Unified Budget Deficit

These statements reconcile the results of operations (net operating cost) on the Statements of Operations and Changes in Net Position to the unified budget deficit. The premise of the reconciliation is that the accrual and budgetary accounting bases share transaction data.

Receipts and outlays in the budget are measured primarily on a cash basis and differ from the accrual basis of accounting used in the *Financial Report*. Refer to Note 1.B—Basis of Accounting and Revenue Recognition for details. These statements begin with the net results of operations (net operating cost), where operating revenues are reported on a modified cash basis of accounting and the net cost of Government operations on an accrual basis of accounting and reports activities where the bases of accounting for the components of net operating cost and the unified budget deficit differ.

Components of Net Operating Cost Not Part of the Budget Deficit

This information includes the operating components, such as the changes in benefits payable for veterans, military and civilian employees, 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 which are recorded as outlays in the budget when purchased, and reflected in net operating cost through depreciation expense over the useful life of the asset and increases in other assets that are not included in 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 cash and other monetary assets 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 cash and other monetary assets.

These statements reconcile the unified budget deficit to the change in cash and other monetary assets during the fiscal year and explain how the budget deficits (fiscal years 2011 and 2010) were financed. A budget deficit is the result of outlays (expenditures) exceeding receipts (revenue) during a particular fiscal year.

The budget deficit is financed through borrowings from the public. Other transactions also require cash disbursements and are not part of the deficit. These other transactions, such as the payment of interest on debt held by the public, contributed to the use of cash. The budget deficit also includes certain amounts that are recognized in the budget and will be disbursed in a future period or are adjustments that did not affect the cash balance. These amounts include interest accrued on debt issued by Treasury and held by the public and subsidy expense related to direct and guaranteed loans as well as equity investment activity and did not contribute to the change in the cash balance.

These statements show the adjustments for noncash outlays included in the budget and items affecting the cash balance not included in the budget to explain the change in cash and other monetary assets.

Balance Sheets

The balance sheets show the Government's assets, liabilities, and net position. When combined with stewardship information, this information presents a more comprehensive understanding of the Government's financial position. The net position for earmarked funds is shown separately.

Assets

Assets included on the balance sheets are resources of the Government that remain available to meet future needs. The most significant assets that are reported on the balance sheets are property, plant, and equipment (PP&E), net; inventories and related property, net; cash and other monetary assets; loans receivable and mortgage-backed securities, net; and Troubled Asset Relief Program (TARP) direct loans and equity investments, net. There are, however, other significant resources available to the Government that extend beyond the assets presented in these financial statements. Those resources include stewardship assets, including natural resources, and the Government's sovereign powers to tax, regulate commerce, set monetary policy, and the power to print additional currency.

Liabilities and Net Position

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

As with reported assets, the Government's responsibilities, policy commitments, and contingencies are much broader than these reported balance sheet liabilities. They include the social insurance programs in the Statements of Social Insurance disclosed in the Supplemental Information—Social Insurance section, the fiscal long-term projections of non-interest spending disclosed in the Supplemental Information—Statement of Fiscal Projections for the U.S. Government 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 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 22—Contingencies and Note 23—Commitments.

The collection of earmarked taxes and other earmarked revenue is credited to the corresponding Earmarked Fund that will use these funds to meet a particular Government purpose. If the collections from taxes and other sources exceed the payments to the beneficiaries, the excess revenue is invested in Treasury securities or "loaned" to 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 24—Earmarked Funds. That note also contains information about trust fund receipts, disbursements, and assets.

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.

Net position is the residual difference between assets and liabilities and is the cumulative results of operations since inception. For detailed components that comprise the net position, refer to the section "Statement of Operations and Changes in Net Position."

Statements of Social Insurance and Changes in Social Insurance Amounts

The Statements of Social Insurance provide estimates of the status of the most significant social insurance programs: Social Security, Medicare, Railroad Retirement, and Black Lung social insurance programs, which are administered by the Social Security Administration (SSA), HHS, the Railroad Retirement Board (RRB), and the Department of Labor (DOL), respectively. The estimates are actuarial present values [2] of the projections and are based on the economic and demographic assumptions representing the trustees' reasonable estimates as set forth in the relevant Social Security and Medicare trustees' reports and in the agency financial report of HHS and DOL (Black Lung) and in the relevant agency performance and accountability reports for the SSA and RRB. The projections are based on the continuation of program provisions contained in current law.

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. In preparing the Statements of Social Insurance, Government management considers and selects assumptions and data that it believes provide a reasonable basis for the assertions in the statement. However, because of the large number of factors that affect the Statements of Social Insurance and the fact that such assumptions are inherently subject to substantial uncertainty (arising from the likelihood of future events, significant uncertainties, and contingencies), there will be differences between the estimates in the Statements of Social Insurance and the actual results, and those differences may be material. Note 26—Social Insurance describes the social insurance programs, reports long-range estimates that can be used to assess the financial condition of the programs, and explains some of the factors that impact the various programs. Using this information, readers can apply their own judgment as to the condition and sustainability of the individual programs. The Statement of Changes in Social Insurance Amount reconciles the change between the current valuation period and the prior valuation period.

[2] Present values recognize that a dollar paid or collected in the future is worth less than a dollar today, because a dollar today could be invested and earn interest. To calculate a present value, future amounts are thus reduced using an assumed interest rate, and those reduced amounts are summed.

United States Government
Statement of Net Cost
for the Year Ended September 30, 2011

(In billions of dollars)	Gross Cost	Earned Revenue	Subtotal	(Gain)/Loss from Changes in Assumptions	Net Cost
Department of Health and Human Services	943.4	66.4	877.0	0.1	877.1
Social Security Administration	782.9	0.4	782.5	-	782.5
Department of Defense	828.7	78.0	750.7	(32.0)	718.7
Interest on Treasury Securities Held by the Public	250.9	-	250.9	-	250.9
Department of Veterans Affairs	124.3	4.7	119.6	58.9	178.5
Department of Agriculture	154.2	9.4	144.8	-	144.8
Department of Labor	132.8	-	132.8	-	132.8
Department of the Treasury	115.2	30.6	84.6	-	84.6
Department of Transportation	77.9	0.7	77.2	-	77.2
Department of Housing and Urban Development	60.8	1.2	59.6	-	59.6
Department of Education	69.7	15.0	54.7	-	54.7
Department of Homeland Security	58.9	9.4	49.5	0.4	49.9
Department of Energy	52.5	7.9	44.6	-	44.6
Department of Justice	31.3	1.3	30.0	-	30.0
Office of Personnel Management	43.7	19.1	24.6	0.3	24.9
Department of State	27.0	3.4	23.6	0.4	24.0
Department of the Interior	23.8	2.7	21.1	-	21.1
National Aeronautics and Space Administration	18.8	0.1	18.7	-	18.7
Agency for International Development	12.1	0.7	11.4	-	11.4
Railroad Retirement Board	17.0	5.9	11.1	-	11.1
Environmental Protection Agency	11.3	0.5	10.8	-	10.8
Federal Communications Commission	9.3	0.4	8.9	-	8.9
Department of Commerce	11.3	2.5	8.8	-	8.8
National Science Foundation	7.1	-	7.1	-	7.1
Pension Benefit Guaranty Corporation	12.8	7.4	5.4	-	5.4
Small Business Administration	3.6	0.4	3.2	-	3.2
Smithsonian Institution	0.7	-	0.7	-	0.7
U.S. Nuclear Regulatory Commission	1.0	0.8	0.2	-	0.2
Farm Credit System Insurance Corporation	-	0.1	(0.1)	-	(0.1)
Export-Import Bank of the United States	0.6	0.7	(0.1)	-	(0.1)
General Services Administration	0.4	0.6	(0.2)	-	(0.2)
Tennessee Valley Authority	11.5	11.8	(0.3)	-	(0.3)
Securities and Exchange Commission	1.1	1.6	(0.5)	-	(0.5)
National Credit Union Administration	0.2	3.1	(2.9)	-	(2.9)
U.S. Postal Service	56.2	64.6	(8.4)	-	(8.4)
Federal Deposit Insurance Corporation	(2.1)	13.7	(15.8)	-	(15.8)
All other entities	47.4	0.5	46.9	-	46.9
Total	3,998.3	365.6	3,632.7	28.1	3,660.8

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

United States Government
Statement of Net Cost
for the Year Ended September 30, 2010

(In billions of dollars)	Gross Cost	Earned Revenue	Subtotal	(Gain)/Loss from Changes in Assumptions	Net Cost
Department of Health and Human Services	920.4	62.7	857.7	(0.1)	857.6
Social Security Administration	754.2	0.3	753.9	-	753.9
Department of Defense	929.0	39.8	889.2	(58.8)	830.4
Interest on Treasury Securities Held by the Public	214.8	-	214.8	-	214.8
Department of Veterans Affairs	240.2	4.7	235.5	101.4	336.9
Department of Agriculture	136.6	6.0	130.6	-	130.6
Department of Labor	179.0	-	179.0	-	179.0
Department of the Treasury	402.3	29.4	372.9	-	372.9
Department of Transportation	80.4	0.6	79.8	-	79.8
Department of Housing and Urban Development	56.7	1.3	55.4	-	55.4
Department of Education	100.8	11.3	89.5	-	89.5
Department of Homeland Security	58.9	8.9	50.0	5.7	55.7
Department of Energy	28.9	3.8	25.1	-	25.1
Department of Justice	32.7	1.2	31.5	-	31.5
Office of Personnel Management	43.5	18.0	25.5	84.1	109.6
Department of State	24.5	2.8	21.7	0.6	22.3
Department of the Interior	20.7	2.4	18.3	-	18.3
National Aeronautics and Space Administration	22.1	0.1	22.0	-	22.0
Agency for International Development	10.7	0.2	10.5	-	10.5
Railroad Retirement Board	14.6	5.8	8.8	-	8.8
Environmental Protection Agency	12.7	0.5	12.2	-	12.2
Federal Communications Commission	9.5	0.5	9.0	-	9.0
Department of Commerce	16.5	2.3	14.2	-	14.2
National Science Foundation	6.9	-	6.9	-	6.9
Pension Benefit Guaranty Corporation	11.9	8.1	3.8	-	3.8
Small Business Administration	5.4	0.4	5.0	-	5.0
Smithsonian Institution	0.8	-	0.8	-	0.8
U.S. Nuclear Regulatory Commission	1.2	0.9	0.3	-	0.3
Farm Credit System Insurance Corporation	-	0.1	(0.1)	-	(0.1)
Export-Import Bank of the United States	0.4	0.7	(0.3)	-	(0.3)
General Services Administration	0.6	0.6	-	-	-
Tennessee Valley Authority	9.7	10.8	(1.1)	-	(1.1)
Securities and Exchange Commission	1.1	1.4	(0.3)	-	(0.3)
National Credit Union Administration	3.2	1.1	2.1	-	2.1
U.S. Postal Service	57.3	65.7	(8.4)	-	(8.4)
Federal Deposit Insurance Corporation	16.8	16.1	0.7	-	0.7
All other entities	47.3	0.7	46.6	-	46.6
Total	4,472.3	309.2	4,163.1	132.9	4,296.0

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, 2011, and 2010

(In billions of dollars)	Non-Earmarked Funds 2011	Earmarked Funds 2011	Consolidated 2011	Non-Earmarked Funds 2010	Earmarked Funds 2010	Consolidated 2010
Revenue:						
Individual income tax and tax withholdings	1,092.9	772.9	1,865.8	902.6	830.3	1,732.9
Corporation income taxes	175.1		175.1	179.6		179.6
Unemployment taxes		56.1	56.1		45.2	45.2
Excise taxes	21.3	52.2	73.5	22.6	49.0	71.6
Estate and gift taxes	7.3		7.3	18.8		18.8
Customs duties	28.5		28.5	25.1		25.1
Other taxes and receipts	120.4	20.9	141.3	96.9	30.6	127.5
Miscellaneous earned revenues	11.3	4.9	16.2	11.3	4.5	15.8
Intragovernmental interest		202.0	202.0		195.0	195.0
Total revenue	1,456.8	1,109.0	2,565.8	1,256.9	1,154.6	2,411.5
Eliminations			(202.0)			(195.0)
Consolidated revenue			2,363.8			2,216.5
Net Cost of Government Operations:						
Net cost	2,110.6	1,550.2	3,660.8	2,553.5	1,742.5	4,296.0
Intragovernmental interest	202.0		202.0	195.0		195.0
Total net cost	2,312.6	1,550.2	3,862.8	2,748.5	1,742.5	4,491.0
Eliminations			(202.0)			(195.0)
Consolidated net cost			3,660.8			4,296.0
Intragovernmental transfers	(540.5)	540.5		(482.1)	482.1	
Unmatched transactions and balances (Note 1.T)	(15.6)		(15.6)	(0.8)		(0.8)
Net operating (cost)/revenue	(1,411.9)	99.3	(1,312.6)	(1,974.5)	(105.8)	(2,080.3)
Net position, beginning of period	(14,119.7)	646.9	(13,472.8)	(12,208.6)	752.7	(11,455.9)
Prior period adjustments–changes in accounting principles (Note 21)	(2.0)	2.0	-	63.4	-	63.4
Net operating (cost)/revenue	(1,411.9)	99.3	(1,312.6)	(1,974.5)	(105.8)	(2,080.3)
Net position, end of period	(15,533.6)	748.2	(14,785.4)	(14,119.7)	646.9	(13,472.8)

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, 2011, and 2010

(In billions of dollars)	2011	2010
Net operating cost	(1,312.6)	(2,080.3)
Components of net operating cost not part of the budget deficit:		
Increase in liability for military employee benefits (Note 15):		
Increase in military pension liabilities	98.6	85.6
(Decrease)/increase in military health liabilities	(62.4)	78.9
(Decrease) in other military benefits	(1.2)	(0.3)
Increase in liability for military employee benefits	35.0	164.2
Increase in liability for veteran's compensation (Note 15)	58.9	223.8
(Decrease)/increase in liabilities for civilian employee benefits (Note 15):		
(Decrease)/increase in civilian pension liabilities	(13.2)	103.5
(Decrease)/increase in civilian health liabilities	(13.0)	3.3
Increase in other civilian benefits	4.2	8.3
(Decrease)/increase in liabilities for civilian employee benefits	(22.0)	115.1
Increase/(decrease) in environmental and disposal liabilities (Note 16):		
Increase/(decrease) in Energy's environmental and disposal liabilities	0.4	(17.5)
Increase/(decrease) in all others' environmental and disposal liabilities	2.4	(3.0)
Increase/(decrease) in environmental and disposal liabilities	2.8	(20.5)
Depreciation expense	68.4	57.5
Property, plant, and equipment disposals and revaluations	(4.6)	(9.8)
Increase in benefits due and payable	6.7	3.5
(Decrease)/increase in insurance and guarantee program liabilities	(13.9)	9.4
Increase in other liabilities	10.5	62.4
Seigniorage and sale of gold	-	(0.4)
(Decrease) in accounts payable	(9.5)	(0.3)
(Increase) in net accounts and taxes receivable	(11.7)	(7.1)
TARP yearend upward/(downward) re-estimate	23.3	(23.6)
Decrease in Non-TARP Investments in American International Group, Inc. due to valuation losses	9.9	2.7
(Decrease)/increase in liabilities to Government-sponsored enterprises	(43.7)	268.0
(Decrease)/increase in valuation loss on investments in Government-sponsored enterprises	(3.0)	8.1
Components of the budget deficit that are not part of net operating cost:		
Capitalized fixed assets:		
Department of Defense	(51.3)	(59.4)
All other agencies	(36.4)	(33.1)
Total capitalized fixed assets	(87.7)	(92.5)
Effect of prior year TARP downward re-estimate	23.6	110.0
(Increase) in inventory	(9.9)	(1.6)
(Increase) in investments in Government-sponsored enterprises	(20.8)	(52.6)
(Increase) in debt and equity securities	(0.8)	(5.8)
Decrease/(increase) in other assets	4.0	(24.7)
Credit reform and other loan activities	(10.5)	8.0
All other reconciling items	9.0	(7.6)
Unified budget deficit	(1,298.6)	(1,294.1)

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, 2011, and 2010

(In billions of dollars)	2011		2010	
Unified budget deficit		(1,298.6)		(1,294.1)
Adjustments for noncash outlays included in the budget:				
Interest accrued by Treasury on debt held by the public	244.2		206.8	
TARP yearend re-estimates	(46.9)		(86.4)	
TARP Subsidy expense/(income) (Note 5)	7.2		(24.2)	
Other Federal entity subsidy expense/(income) (Note 4)	(43.9)		(9.4)	
Subtotal		160.6		86.8
Items affecting the cash balance not included in the Budget:				
Net Transactions from financing activity:				
Borrowings from the public	7,962.8		8,525.5	
Repayment of debt held by the public	(6,854.2)		(7,054.5)	
Agency securities	1.0		0.7	
Subtotal		1,109.6		1,471.7
Transactions from monetary and other activity:				
Interest paid by Treasury on debt held by the public	(239.7)		(201.2)	
Net TARP direct loans and equity investments activity	59.0		111.8	
Net GSE—mortgage-backed securities activity	93.7		9.1	
Net loan receivable activity	(157.6)		(160.3)	
Allocations of special drawing rights	0.2		(1.0)	
Other	21.2		12.6	
Subtotal		(223.2)		(229.0)
Cash and other monetary assets (Note 2):				
(Decrease)/increase in cash and other monetary assets		(251.6)		35.4
Balance, beginning of period		428.6		393.2
Balance, end of period		177.0		428.6

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

For budgetary purposes, the effect of the yearend downward re-estimates (reduction of net outlays) and upward re-estimates (increase of net outlays) is not recognized until the subsequent fiscal year. As such, for fiscal year 2011, the budget deficit reflected a reduction of noncash outlays for $23.6 billion relating to the fiscal year 2010 yearend downward re-estimates. Also, for fiscal year 2011, TARP subsidy expense includes $23.3 billion in yearend upward re-estimates, which will be reflected in the fiscal year 2012 budget. For fiscal year 2010, the budget deficit reflected a reduction of noncash outlays for $110 billion relating to the fiscal year 2009 yearend downward re-estimates. Also, for fiscal year 2010, TARP subsidy income includes $23.6 billion in yearend downward re-estimates, which was reflected in the fiscal year 2011 budget.

United States Government Balance Sheets as of September 30

(In billions of dollars)	2011	2010
Assets:		
Cash and other monetary assets (Note 2)	177.0	428.6
Accounts and taxes receivable, net (Note 3)	106.3	94.6
Loans receivable and mortgage-backed securities, net (Note 4)	772.1	688.6
TARP direct loans and equity investments, net (Note 5)	80.1	144.7
Non-TARP Investments in American International Group, Inc. (Note 6)	10.9	20.8
Inventories and related property, net (Note 7)	296.1	286.2
Property, plant, and equipment, net (Note 8)	852.8	828.9
Debt and equity securities (Note 9)	99.7	98.9
Investments in Government-Sponsored Enterprises (Note 11)	133.0	109.2
Other assets (Notes 10 and 12)	179.3	183.3
Total assets	2,707.3	2,883.8
Stewardship land and heritage assets (Note 27)		
Liabilities:		
Accounts payable (Note 13)	63.4	72.9
Federal debt securities held by the public and accrued interest (Note 14)	10,174.1	9,060.0
Federal employee and veteran benefits payable (Note 15)	5,792.2	5,720.3
Environmental and disposal liabilities (Note 16)	324.1	321.3
Benefits due and payable (Note 17)	171.0	164.3
Insurance and guarantee program liabilities (Note 18)	161.7	175.6
Loan guarantee liabilities (Note 4)	63.0	65.8
Liabilities to Government-Sponsored Enterprises (Note 11)	316.2	359.9
Other liabilities (Notes 10 and 19)	427.0	416.5
Total liabilities	17,492.7	16,356.6
Contingencies (Note 22) and Commitments (Note 23)		
Net position:		
Earmarked funds (Note 24)	748.2	646.9
Non-earmarked funds	(15,533.6)	(14,119.7)
Total net position	(14,785.4)	(13,472.8)
Total liabilities and net position	2,707.3	2,883.8

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

United States Government
Statements of Social Insurance (Note 26)
Present Value of Long-Range (75 Years, except Black Lung) Actuarial Projections

(In billions of dollars)	2011	2010	2009	2008	2007
Federal Old-Age, Survivors and Disability Insurance (Social Security): [14]					
Revenue (Contributions and Earmarked Taxes) from:					
Participants who have attained eligibility age (62 and over)	726	672	575	542	477
Participants who have not attained eligibility age	20,734	19,914	18,559	18,249	17,515
Future participants	20,144	19,532	18,082	17,566	16,121
All current and future participants	41,603	40,118	37,217	36,357	34,113
Expenditures for Scheduled Future Benefits for:					
Participants who have attained eligibility age (62 and over)	(8,618)	(8,096)	(7,465)	(6,958)	(6,329)
Participants who have not attained eligibility age	(34,042)	(32,225)	(30,207)	(29,021)	(27,928)
Future participants	(8,100)	(7,744)	(7,223)	(6,933)	(6,619)
All current and future participants	(50,760)	(48,065)	(44,894)	(42,911)	(40,876)
Present value of future expenditures in excess of future revenue	(9,157) [1]	(7,947) [2]	(7,677) [3]	(6,555) [4]	(6,763) [5]
Federal Hospital Insurance (Medicare Part A): [14]					
Revenue (Contributions and Earmarked Taxes) from:					
Participants who have attained eligibility age (65 and over)	262	248	209	202	178
Participants who have not attained eligibility age	7,581	7,216	6,348	6,320	5,975
Future participants	7,260	6,944	5,451	5,361	4,870
All current and future participants	15,104	14,408	12,008	11,883	11,023
Expenditures for Scheduled Future Benefits for:					
Participants who have attained eligibility age (65 and over)	(2,923)	(2,648)	(2,958)	(2,747)	(2,558)
Participants who have not attained eligibility age	(12,887)	(12,032)	(18,147)	(17,365)	(15,639)
Future participants	(2,546)	(2,411)	(4,673)	(4,506)	(5,118)
All current and future participants	(18,356)	(17,091)	(25,778)	(24,619)	(23,315)
Present value of future expenditures in excess of future revenue	(3,252) [1]	(2,683) [2]	(13,770) [3]	(12,736) [4]	(12,292) [5]
Federal Supplementary Medical Insurance (Medicare Part B): [14]					
Revenue (Premiums) from:					
Participants who have attained eligibility age (65 and over)	570	538	498	461	433
Participants who have not attained eligibility age	3,651	3,460	4,224	3,859	3,184
Future participants	865	839	1,270	1,158	1,172
All current and future participants	5,086	4,836	5,992	5,478	4,789
Expenditures for Scheduled Future Benefits for:					
Participants who have attained eligibility age (65 and over)	(2,343)	(2,166)	(2,142)	(1,986)	(1,834)
Participants who have not attained eligibility age	(13,489)	(12,587)	(16,342)	(14,949)	(12,130)
Future participants	(3,108)	(2,984)	(4,672)	(4,262)	(4,257)
All current and future participants	(18,940)	(17,737)	(23,156)	(21,197)	(18,221)
Present value of future expenditures in excess of future revenue [6]	(13,854) [1]	(12,901) [2]	(17,165) [3]	(15,719) [4]	(13,432) [5]

Totals may not equal the sum of components due to rounding.

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

United States Government
Statements of Social Insurance (Note 26), continued
Present Value of Long-Range (75 Years, except Black Lung) Actuarial Projections

(In billions of dollars)	2011	2010	2009	2008	2007
Federal Supplementary Medical Insurance (Medicare Part D): [14]					
Revenue (Premiums and State Transfers) from:					
Participants who have attained eligibility age (65 and over)	173	165	140	123	167
Participants who have not attained eligibility age	1,608	1,626	1,442	1,380	1,627
Future participants	703	694	618	604	611
All current and future participants	2,484	2,486	2,199	2,107	2,405
Expenditures for Scheduled Future Benefits for:					
Participants who have attained eligibility age (65 and over)	(695)	(646)	(595)	(581)	(794)
Participants who have not attained eligibility age	(6,438)	(6,355)	(6,144)	(6,527)	(7,273)
Future participants	(2,817)	(2,714)	(2,632)	(2,856)	(2,699)
All current and future participants	(9,950)	(9,715)	(9,371)	(9,964)	(10,766)
Present value of future expenditures in excess of future revenue [6]	(7,466) [1]	(7,229) [2]	(7,172) [3]	(7,857) [4]	(8,361) [5]
Railroad Retirement:					
Revenue (Contributions and Earmarked Taxes) from:					
Participants who have attained eligibility	6	5	5	5	5
Participants who have not attained eligibility	46	47	48	43	41
Future participants	65	66	70	54	54
All current and future participants	117	118	123	102	100
Expenditures for Scheduled Future Benefits for:					
Participants who have attained eligibility	(109)	(105)	(102)	(97)	(93)
Participants who have not attained eligibility	(86)	(88)	(91)	(88)	(86)
Future participants	(28)	(27)	(30)	(26)	(26)
All current and future participants	(223)	(220)	(223)	(212)	(205)
Present value of future expenditures in excess of future revenue [7]	(106) [1]	(103) [2]	(100) [3]	(109) [4]	(105) [5]
Black Lung (Part C):					
Present value of future revenue in excess of future expenditures [8]	5 [9]	6 [10]	6 [11]	5 [12]	5 [13]
Total present value of future expenditures in excess of future revenue	(33,830)	(30,857)	(45,878)	(42,970)	(40,948)

Totals may not equal the sum of components due to rounding.

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

United States Government
Statements of Social Insurance (Note 26), continued
Present Value of Long-Range (75 Years, except Black Lung) Actuarial Projections

(In billions of dollars)	2011	2010	2009	2008	2007
Social Insurance Summary: [14]					
Participants who have attained eligibility age:					
Revenue (e.g., Contributions and earmarked taxes)	1,737	1,628	1,427	1,333	1,260
Expenditures for scheduled future benefits	(14,688)	(13,661)	(13,262)	(12,369)	(11,608)
Present value of future expenditures in excess of future revenue	(12,951)	(12,033)	(11,835)	(11,036)	(10,348)
Participants who have not attained eligibility age:					
Revenue (e.g., Contributions and earmarked taxes)	33,620	32,263	30,621	29,851	28,342
Expenditures for scheduled future benefits	(66,942)	(63,287)	(70,931)	(67,950)	(63,056)
Present value of future expenditures in excess of future revenue	(33,322)	(31,024)	(40,310)	(38,099)	(34,714)
Closed-group – Total present value of future expenditures in excess of future revenue	(46,272)	(43,057)	(52,145)	(49,135)	(45,062)
Future participants:					
Revenue (e.g., Contributions and earmarked taxes)	29,037	28,075	25,491	24,743	22,828
Expenditures for scheduled future benefits	(16,594)	(15,875)	(19,224)	(18,578)	(18,714)
Present value of future revenue in excess of future expenditures	12,443	12,200	6,267	6,165	4,114
Open-group – Total present value of future expenditures in excess of future revenue	(33,830)	(30,857)	(45,878)	(42,970)	(40,948)

[1] The projection period is 1/1/2011 -12/31/2085 and the valuation date is 1/1/2011.
[2] The projection period is 1/1/2010 -12/31/2084 and the valuation date is 1/1/2010.
[3] The projection period is 1/1/2009 -12/31/2083 and the valuation date is 1/1/2009.
[4] The projection period is 1/1/2008 -12/31/2082 and the valuation date is 1/1/2008.
[5] The projection period is 1/1/2007 -12/31/2081 and the valuation date is 1/1/2007.
[6] These amounts represent the present value of the future transfers from the General Fund of the Treasury to the Supplementary Medical Insurance Trust Fund. These future intragovernmental transfers are included as income in both HHS' and the Centers for Medicare & Medicaid Services' Financial Reports but are not income from the Governmentwide perspective of this report.
[7] These amounts approximate the present value of the future financial interchange and the future transfers from the General Fund of the Treasury to the Social Security Equivalent Benefit Account (see discussion of Railroad Retirement Program in the unaudited supplemental information section of this report). They are included as income in the Railroad Retirement Financial Report but are not income from the Governmentwide perspective of this report.
[8] Does not include interest expense accruing on the outstanding debt.
[9] The projection period is 9/30/2011 -9/30/2040 and the valuation date is 9/30/2011.
[10] The projection period is 9/30/2010 -9/30/2040 and the valuation date is 9/30/2010.
[11] The projection period is 9/30/2009 -9/30/2040 and the valuation date is 9/30/2009.
[12] The projection period is 9/30/2008 -9/30/2040 and the valuation date is 9/30/2008.
[13] The projection period is 9/30/2007 -9/30/2040 and the valuation date is 9/30/2007.
[14] Participants for the Social Security and Medicare programs are assumed to be the "closed-group" of individuals who are at least 15 years of age at the start of the projection period, and are participating as either taxpayers, beneficiaries, or both, except for the 2007 Medicare programs for which current participants are assumed to be at least 18 instead of 15 years of age.

Totals may not equal the sum of components due to rounding.

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

United States Government
Statement of Changes in Social Insurance Amounts
for the Year Ended September 30, 2011 (Note 26)

(In billions of dollars)	Social Security	Medicare HI	Medicare SMI	Other (e.g. Railroad Retirement)	Total
Net present value (NPV) of future revenue less future expenditures for current and future participants (the “open group”) over the next 75 years, beginning of the year	(7,947)	(2,683)	(20,130)	(97)	(30,857)
Reasons for changes in the NPV during the year:					
Changes in valuation period	(436)	(112)	(968)	(2)	(1,518)
Changes in demographic data and assumptions	(688)	(112)	(59)	(0)	(859)
Changes in economic data and assumptions	(143)	0	-	(2)	(145)
Changes in law or policy	-	-	(14)	-	(14)
Changes in methodology and programmatic data	56	-	-	-	56
Changes in economic and other healthcare assumptions	-	185	(648)	-	(463)
Change in projection base	-	(531)	500	-	(31)
Net change in open group measure	(1,211)	(570)	(1,189)	(4)	(2,974)
Open group measure, end of year	(9,157)	(3,252)	(21,320)	(101)	(33,830)

Totals may not equal the sum of components due to rounding.

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

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United States Government Notes to the Financial Statements for the Years Ended September 30, 2011, and 2010

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 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 and is not required by law to submit financial statement information to Treasury. Appendix A of this report contains a list of significant Government entities included and excluded in the *Financial Report*. Certain entities are excluded from the *Financial Report* because they are Government-Sponsored Enterprises (GSE), such as the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), or their activities are not included in the Federal budget, such as the Thrift Savings Fund and the Board of Governors of the Federal Reserve System.

During fiscal year 2008, the Government began a number of additional emergency economic measures relating to the economy that involved various financing programs. Key initiatives effective for fiscal year 2008 involved programs concerning Fannie Mae and Freddie Mac (GSEs), provision of a credit facility for GSEs and Federal Home Loan Banks, purchase of Mortgage-Backed Securities (MBS), and setup of a Money Market Guarantee Program (see Note 1.J—Investments in and Liabilities to Government Sponsored Enterprises and Note 11—Investments in and Liabilities to Government-Sponsored Enterprises). The Emergency Economic Stabilization Act of 2008 (EESA) gave the Secretary of the Treasury temporary authority to purchase and guarantee assets in a wide range of financial institutions and markets (see Note 5—TARP Direct Loans and Equity Investments, Net).

Following U.S. Generally Accepted Accounting Principles for Federal entities (U.S. GAAP), the Government has not consolidated into its financial statements the assets, liabilities, or results of operations of any financial organization or commercial entity in which Treasury holds either a direct, indirect, or beneficial equity investment. Even though some of the equity investments are significant, under Statement of Federal Financial Accounting Concepts (SFFAC) No. 2, these entities meet the criteria of paragraph 50 and do not appear in the Federal budget section “Federal Programs by Agency and Account.” As such, these entities are not consolidated into the financial reports of the Government. However, the values of the investment in such entities are presented on the balance sheet.

Material intragovernmental transactions are eliminated in consolidation, except as described below in this note and in the Supplemental Information—Unmatched Transactions and Balances (see Note 1.T). The financial reporting period ends September 30 and is the same as used for the annual budget.

B. Basis of Accounting and Revenue Recognition

These financial statements were prepared using U.S. GAAP, primarily based on SFFAS. Under these principles:

- Expenses are generally recognized when incurred.
- Nonexchange revenues, including taxes, duties, fines, and penalties, are recognized when collected and adjusted to the change in net measurable and legally collectable amounts receivable. Related refunds and other offsets, including those that are measurable and legally payable, are netted against nonexchange revenue.
- Exchange (earned) revenues are recognized when the Government provides goods and services to the public for a price. Exchange revenues include user charges such as admission to Federal parks and premiums for certain Federal insurance.

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

The basis of accounting used and the detail of the basis for the Statement of Social Insurance (SOSI) and the new Statement of Changes in Social Insurance Amounts (SCSIA) are covered in Note 26—Social Insurance.

Beginning in fiscal year 2011, the Government has implemented the requirements of SFFAS No. 37. [1] As required by SFFAS No 37, the Government is now required to present a new SCSIA that: (1) reconciles beginning and ending open group measures and presents the components of the changes in the open group measures from the end of the previous reporting period; and (2) presents significant components of the change, e.g., the difference due to the change in valuation period; the changes in demographic, economic, and health care assumptions; and the changes in law and policy.

Beginning in fiscal year 2010, the Government implemented the requirements of new standards related to: pensions, other retirement benefits, and other postemployment benefits; long-term fiscal projections; and subsequent events.

- Pensions, other retirement benefits (ORB), and other postemployment benefits (OPEB):
  As required by SFFAS, No. 33, [2] the Government statement of net cost is now required to present the amounts reported under the gain/loss from changes in assumptions on pension, other retirement benefits, or other postemployment benefits as a separate component that will provide more transparent information regarding the underlying costs associated with these liabilities. In addition, SFFAS No. 33 also provides a standard for selecting the discount rate assumption for present value estimates of Federal Employee Pension, ORB, and OPEB liabilities. For further information on these new requirements, see Note 1.L—Federal Employee and Veteran Benefits Payable.
- Long-term fiscal projections:
  As required by SFFAS No. 36, [3] the Government is now required to include a statement presenting for all its activities (a) the present value of projected receipts and non-interest spending under current policy without change, (b) the relationship of these amounts to projected Gross Domestic Product (GDP) and (c) changes in the present value of projected receipts and non-interest spending from the prior year (not effective for fiscal year 2010). The Government is also required to provide supplementary information that explains and illustrates projected trends in the relationship between receipts and spending, deficits (or surpluses), debt held by the public as a share of GDP, possible results using alternative scenarios, and the likely impact of delaying corrective action when a fiscal gap exists. Finally, the Government is also required to disclose the assumptions underlying the projections, the factors influencing trends, and significant changes in the projections from period to period. Refer to the *Fiscal Projections for the U.S. Government–Fiscal Year 2011* segment in the Supplementary Information for these required disclosures.

[1] SFFAS No. 37, *Social Insurance: Additional Requirements for Management's Discussion and Analysis and Basic Financial Statements*.
[2] SFFAS No. 33, *Pensions, Other Retirement Benefits, and Other Postemployment Benefits: Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates.*
[3] SFFAS No. 36, *Reporting Comprehensive Long-Term Fiscal Projections for the U.S. Government*.

- Subsequent events:
  The objective of SSFAS No. 39, [4] is to incorporate the accounting and financial reporting guidance regarding subsequent events that have been included in the Statements of Auditing Standards of the American Institute of Certified Public Accountants (AICPA) into SFFAS. Accordingly, SFFAS No. 39 does not establish new accounting guidance with regard to subsequent events.

C. Loans Receivable, Mortgage-Backed Securities, and Loan Guarantee Liabilities, Net

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 fiscal 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 fiscal 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.

The MBS are similarly treated to direct loans, and the value of the Government's position and the associated credit subsidy requirements are determined based on the net present value of the securities' forecasted future cashflows. For more details on MBS, see Note 4—Loans Receivable, Mortgage-Backed Securities, and Loan Guarantee Liabilities, Net.

D. Accounts and Taxes Receivable

Accounts receivable represent 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. Accounts receivable are reported net of an allowance for uncollectible accounts. An allowance 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 and is re-estimated periodically as needed. 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.

Taxes receivable consist 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. The allowance for doubtful accounts is based on projections of collectibles from a statistical sample of unpaid tax assessments.

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[4] SFFAS No. 39, *Subsequent Events: Codification of Accounting and Financial Reporting Standards Contained in the AICPA Statements on Auditing Standards.*

E. TARP Direct Loans and Equity Investments, Net

TARP equity investments are accounted for at fair value which, is defined as the estimated amount of proceeds that would be received if the equity investments were sold to a market participant. Consistent with the present value accounting concepts embedded in SFFAS No. 2, *Accounting for Direct Loans and Loan Guarantees*, TARP Direct Loans and Equity Investments, net, disbursed and outstanding are recognized as assets at the net present value of their estimated future cashflows and outstanding asset guarantees are recognized as liabilities or assets at the net present value of their estimated future cashflows. Market risk is considered in the calculation and determination of the estimated net present values.

The subsidy allowance for TARP's direct loans and equity investments, represents the difference between the face value of the outstanding direct loan and equity investment balance and the net present value of the expected future cashflows, and is reported as an adjustment to the face value of the direct loan or equity investment.

The recorded subsidy allowance for a direct loan, equity investment or asset guarantee is based on a set of estimated future cashflows.

The Government used the following methodologies for valuation of the TARP direct loans and equity investments:

- The estimated future cashflows for TARP direct loans were derived using analytical models that estimate the cashflows to and from the Government over the life of the loan. These cashflows include the scheduled principal, interest, and other payments to the Government, including estimated proceeds from equity interest obtained or additional notes. These models also include estimates of default and recoveries, incorporating the value of any collateral provided by the contract. The probability and timing of default and losses relating to a default are estimated by using applicable historical data when available, or publicly available proxy data, including credit rating agency historical performance data. The models include an adjustment for market risk which is intended to capture the risk of unexpected losses, but are not intended to represent fair value, i.e., the proceeds that would be expected to be received if the loans were sold to a market participant.
- TARP preferred stock cashflows are projected using an analytical model developed to incorporate the risk of losses associated with adverse events, such as failure of the institution or increases in market interest rates. The model estimates how cashflows vary depending on: (1) current interest rates, which may affect the decision whether to repay the preferred stock; and (2) the strength of a financial institution's assets. Inputs to the model include institution specific accounting data obtained from regulatory filings, an institution's stock price volatility, and historical bank failure information, as well as market prices of comparable securities trading in the market. The Government estimates the values and projects the cashflows of warrants using an option-pricing approach based on the current stock price and its volatility. Investments in common stock which are exchange traded are valued at the market price. The result of using market prices, either quoted prices for the identical asset or quoted prices for comparable assets, is that the equity investments are recorded at estimated fair value.

For more details on TARP, see Note 5—TARP Direct Loans and Equity Investments, Net.

F. Non-TARP Investments in American International Group, Inc.

The Non-TARP investments in American International Group (AIG), Inc. are recorded at fair value and represent the Government's non-TARP holdings of AIG common stock. On September 30, 2010, the Government, the Federal Reserve Bank of New York (FRBNY) and AIG entered into an AIG Recapitalization Agreement for the purpose of restructuring the Government's holdings in AIG. The value of the non-TARP investments in AIG is based on the market value of the Government's holdings of AIG common stock as of the reporting date. (See Note 6—Non-TARP Investments in American International Group, Inc., for further details.)

G. Inventories and Related Property

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. SFFAS No. 3, *Accounting for Inventory and Related Property*, requires inventories held for sale and held in reserve for future sale within the Government to be valued using either historical cost or latest acquisition cost (LAC). Historical cost methods include first-in-first-out, weighted average, and moving average. When LAC methods are used, the inventory is revalued periodically and an allowance account should be established for unrealized holding gains and losses.

The Department of Defense (DOD) holds the majority of the inventories within the Government and uses moving average cost methods for valuing most of its inventory. To a lesser degree, DOD also uses LAC methods adjusted for holding gains and losses to approximate the historical cost of resale inventory items remaining in its legacy system. DOD is continuing to transition inventories from these legacy systems to new inventory systems, using moving average cost methods, however, most of DOD's inventory value for its activities remain non-compliant with SFFAS No. 3.

When using historical cost valuation, 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.

Related property includes commodities, seized and monetary instruments, forfeited and foreclosed property, raw materials and work in process. 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.

H. Property, Plant, and Equipment

Property, plant, and equipment consists of tangible assets including equipment, buildings, construction in progress, internal use software, assets acquired through capital leases, including leasehold improvements, and other assets used to provide goods and services.

Property, plant, and equipment used in Government operations are carried at acquisition cost, with the exception of DOD military equipment (e.g., ships, aircraft, combat vehicles, and weapons) and some National Aeronautics and Space Administration (NASA) equipment. DOD military equipment is valued at estimated historical costs, which are calculated using internal DOD records. DOD identified the universe of military equipment by accumulating information relating to program funding and associated military equipment, equipment useful life, and program acquisitions and disposals to create a baseline. The equipment baseline is updated using expenditure information and information related to acquisition and logistics to identify acquisitions and disposals. NASA also uses estimates of historical cost to value some of its equipment for which historical cost information is not readily available, such as components of the International Space Station.

All property, plant, and equipment is capitalized if the acquisition costs (or estimated acquisition cost for DOD) are in excess of capitalization thresholds that vary considerably between the Federal entities. Depreciation and amortization expense applies to property, plant, and equipment reported on the balance sheets except for land, unlimited duration land rights and construction in progress. Depreciation and amortization are recognized using the straight-line method over the estimated useful lives of the assets. All property, plant, and equipment are assigned useful lives depending on their category and vary considerably between the Federal entities. The cost of acquisition, betterment, or reconstruction of all multi-use heritage assets is capitalized as general property, plant, and equipment and is depreciated. Construction in progress is used for the accumulation of the cost of construction or major renovation of fixed assets during the construction period. The assets are transferred out of construction in progress when the project is substantially completed. Internal use software includes purchased commercial off-the-shelf software, contractor-developed software, and software internally developed.

I. Debt and Equity Securities

Debt and equity securities are classified as held-to-maturity, available-for-sale, and trading. Held-to-maturity debt and equity securities are reported at amortized cost, net of unamortized premiums and discounts. Available-for-sale debt and equity securities are reported at fair value. Trading debt and equity securities are reported at fair value.

J. Investments in and Liabilities to Government-Sponsored Enterprises

The senior preferred stock liquidity preference (preferred stock) and associated common stock warrant (warrant(s)) in GSEs are presented at their fair value as permitted by Office of Management and Budget (OMB) Circular No. A-136. This Circular includes language that generally requires agencies to value non-Federal investments at acquisition cost, and also permits the use of other measurement basis, such as fair value, in certain situations. Treasury performs annual valuations, as of September 30th, to provide a "sufficiently reliable" estimate of the outstanding commitments in order for Treasury to record the remaining liability in accordance with SFFAS No. 5, *Accounting for Liabilities of the Federal Government*. The valuations incorporated various forecasts, projections, and cashflow analyses to develop an estimate of the potential liability. Annual valuations are performed, as of September 30, of the preferred stock and warrants and any changes in valuation, including impairment, are recorded and disclosed in accordance with SFFAS No. 7, *Accounting for Revenue and Other Financing Sources*. Since the valuation is an annual process, the changes in valuation of the preferred stock and warrants are deemed usual and recurring. Accordingly, changes in valuation are recorded as an exchange transaction which is either an expense or revenue. Since the costs of preferred stock and warrants are exchange transactions, any change in valuation is also recorded as an exchange transaction.

The GSE Senior Preferred Stock Purchase Agreements (SPSPAs) provide that Treasury will increase its investment in the GSEs' senior preferred stock if at the end of any quarter the Federal Housing Finance Agency (FHFA), acting as the conservator, determines the liabilities of either GSE, individually, exceed its respective assets. Based on U.S. GAAP, these contingent liquidity commitments, predicated on the future occurrence of any shareholders' deficits of the GSEs at the end of any reporting quarter, are potential liabilities of Treasury. The potential liabilities to the GSEs are assessed annually and recorded at the gross amount, without considering the increase in preferred stock liquidity preference, future divided payments, or future commitment fees, due to the uncertainties involved. The Government currently accounts for the GSE MBS purchase program and the two programs of the state and local Housing Finance Agency (HFA) Initiative (the New Issue Bond Program (NIBP) and Temporary Credit and Liquidity Program (TCLP)) under the provisions of credit reform and the use of estimates is dictated by the SFFAS No. 2. See Note 11—Investments in and Liabilities to Government-Sponsored Enterprises for further details.

K. Federal Debt

Accrued interest on Treasury securities held by the public is recorded as an expense when incurred, instead of when paid. Certain Treasury securities are issued at a discount or premium. These discounts and premiums are amortized over the term of the security using an interest method for all long-term securities and the straight line method for short-term securities. Treasury also issues Treasury Inflation-Protected Securities (TIPS). The principal for TIPS is adjusted daily over the life of the security based on the Consumer Price Index (CPI) for all Urban Consumers.

L. Federal Employee and Veteran Benefits Payable

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

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

Gains and losses from changes in long-term assumptions used to estimate Federal employee pensions, ORB, and OPEB liabilities are reflected separately on the Statement of Net Cost and the components of the expense related to Federal employee pension, ORB, and OPEB liabilities are disclosed in Note 15—Federal Employee and Veteran Benefits Payable as prescribed by SFFAS No. 33. In addition, SFFAS No. 33 also provides a standard for selecting the discount rate assumption for present value estimates of Federal employee pension, ORB, and OPEB liabilities.

M. Environmental and Disposal Liabilities

Environmental and disposal liabilities are recorded at the estimated current cost of removing, containing, treating, and/or disposing of radioactive waste, hazardous waste, chemical and nuclear weapons, and other environmental contaminations, 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 radioactive or hazardous waste, only the estimable portion of the liability, typically monitoring and safe containment is recorded.

N. Insurance and Guarantee Program Liabilities

Insurance and guarantee programs provide protection to individuals or entities against specified risks except for those specifically covered by Federal employee and veteran benefits, social insurance, and loan guarantee programs. Insurance and guarantee program funds are commonly held in revolving funds in the Government and losses sustained by participants are paid from these funds. Many of these programs receive appropriations to pay excess claims and/or have authority to borrow from the Treasury. The values of insurance and guarantee program liabilities are particularly sensitive to changes in underlying estimates and assumptions. Insurance and guarantee programs with recognized liabilities in future periods (i.e., liabilities that extend beyond one year) are reported at their actuarial present value.

O. 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 Unaudited Supplemental Information section of this report.

P. Contingent Liabilities

Liabilities for contingencies are recognized on the Balance Sheets when both:

- A past transaction or event has occurred, and
- 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 and the range is disclosed.

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 22—Contingencies.

Q. 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 23—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.

R. Social Insurance

A liability for social insurance programs (Social Security, Medicare, Railroad Retirement, Black Lung, and Unemployment) is recognized for any unpaid amounts currently due as of the reporting date. No liability is recognized for future benefit payments not yet due. For further information, see the Unaudited Supplemental Information—Social Insurance section, and Note 26—Social Insurance.

S. 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 agents. They process Federal payments and deposits to the Treasury General Account (which functions as the Government's checking account for deposits and disbursements) and service Treasury securities. The FRBs had total holdings of $1,665.4 billion and $813.6 billion, including a net of $0.8 billion and $1.9 billion in Treasury securities held by the FRB as collateral for securities lending activities, as of September 30, 2011 and 2010, respectively. These securities are held in the FRBs' System Open Market Account (SOMA) for the purpose of conducting monetary policy. Additionally, under the Supplementary Financing Program (SFP), the Government had no deposit with the Federal Reserve as of September 30, 2011, as compared to $200 billion as of September 30, 2010, to support Federal Reserve initiatives (see Note 2—Cash and Other Monetary Assets). FRBs earnings that exceed statutory amounts of surplus established for FRBs are paid to the Government and are recognized as nonexchange revenue. Those earnings totaled $82.5 billion and $75.8 billion for the years ended September 30, 2011, and 2010, respectively and reflect the increase in securities held by the FRB. Also, the FRBs hold Special Drawing Rights Certificates (SDRCs) (see Note 19—Other Liabilities, international monetary liabilities and gold certificates). For further details on the coordinated activities of the U.S. Government—primarily Treasury and the Federal Deposit Insurance Corporation—and the Board of Governors of the Federal Reserve System and the FRBs to help stabilize the financial system and the housing market, see Note 5—TARP Direct Loans and Equity Investments, Net, Note 6—Non-TARP Investments in American International Group, Inc., and Note 11—Investments in and Liabilities to Government-Sponsored Enterprises.

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 generally does not guarantee payment of the liabilities of GSEs such as Fannie Mae, Freddie Mac, or the Federal Home Loan Banks, which are privately owned. Fannie Mae and Freddie Mac have been placed under conservatorship as of September 7, 2008. On December 24, 2009, Treasury amended the SPSPAs to replace the existing fixed $200 billion cap per the GSEs on Treasury advances, with a formulaic cap for the next 3 years that will adjust upwards quarterly by the cumulative amount of any losses realized by either Fannie Mae or Freddie Mac and downwards by the cumulative amount of any gains, but not below $200 billion per GSE. At the conclusion of the 3-year period, the remaining commitment will then be fixed and available to be drawn per the terms of the agreements (referred to as the "Adjusted Cap"). These entities also are excluded from the reporting entity.

The Department of Transportation (DOT) has possession of two long term notes with the National Railroad Passenger Service Corporation (more commonly referred to as Amtrak). The first note is for $4 billion and matures in 2975 and; the second note is for $1.1 billion and matures in 2082 with renewable 99 year terms. Interest is not accruing on these notes as long as the current financial structure of Amtrak remains unchanged. If the financial structure of Amtrak changes, both principal and accrued interest are due and payable. DOT does not record the notes in its financial statements because the present value of the notes was immaterial at September 30, 2011. These notes were discounted according to rates published in OMB M-10-07, Appendix C, and the maturity dates of 2975 and 2082.

In addition, DOT has possession of all the preferred stock shares (109.4 million) of Amtrak. Congress through the DOT continues to fund Amtrak since 1981; originally through the purchase of preferred stock, notes receivable and then through grants after 1997. The Amtrak Reform and Accountability Act of 1997 changed the structure of the preferred stock by rescinding the voting rights and eliminating the preferred stock's liquidation preference over the common stock. This Act also eliminated further issuance of preferred stock to the DOT. DOT does not record the Amtrak stock in its financial statements because it is not publicly traded and no fair market value can be placed on it.

Amtrak is not a department, agency or instrumentality of the Government or the DOT. The nine members of Amtrak's Board of Directors are appointed by the President of the United States and are subject to confirmation by the U.S. Senate. Once appointed, Board Members, as a whole, act independently without the consent of the Government or any of its officers to set Amtrak policy, determine its budget and decide operational issues. The Secretary of Transportation is statutorily appointed to the nine-member Board. Traditionally, the Secretary of Transportation has designated the Administrator of the Federal Rail Administration to represent the Secretary at Board meetings.

The Export-Import Bank of the United States (Ex-Im Bank) has contractual agreements with the Private Export Funding Corporation (PEFCO). PEFCO, which is owned by a consortium of private-sector banks, industrial companies and financial services institutions, makes medium-term and long-term fixed-rate and variable-rate loans to foreign borrowers to purchase U.S.-made equipment when such loans are not available from traditional private sector lenders on competitive terms. Ex-Im Bank's credit and guarantee agreement with PEFCO extends through December 31, 2020. Through its contractual agreements with PEFCO, Ex-Im Bank exercises a broad measure of supervision over PEFCO's major financial management decisions, including approval of both the terms of individual loan commitments and the terms of PEFCO's long-term debt issues, and is entitled to representation at all meetings of PEFCO's board of directors, advisory board and exporters' council.

The contractual agreements provide that Ex-Im Bank will (1) guarantee the due and punctual payment of principal and interest on export loans made by PEFCO and (2) guarantee the due and punctual payment of interest on PEFCO's long-term secured debt obligations when requested by PEFCO. Related to the amounts for Ex-Im Bank as shown in Note 4—Loans Receivable, Mortgage Backed Securities, and Loan Guarantee Liabilities, Net, these guarantees to PEFCO, aggregating $5.3 billion and $5.1 billion at September 30, 2011 and 2010, respectively, are included within the principal amounts guaranteed by the United States. The allowance related to these transactions is included within the guaranteed loan liability. Ex-Im Bank received fees totaling $0.03 billion in both fiscal years 2011 and 2010 for the agreements, which are included as earned revenue on the Statements of Net Costs.

T. Unmatched Transactions and Balances

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

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

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

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

U. Derivatives

A derivative is a financial instrument or other contract with all three of the following characteristics:

- It has (1) one or more underlyings and (2) one or more notional amounts or payment provisions or both. Those terms determine the amount of the settlement or settlements, and, in some cases, whether a settlement is required.
- It requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors.
- Its terms require or permit net settlement, it can readily be settled net by a means outside the contract, or it provides for delivery of an asset that puts the recipient in a position not substantially different from net settlement.

An underlying is a specified interest rate, security price, commodity price, foreign exchange rate, index of prices or rates, or other variable. An underlying may be a price or rate of an asset or liability but is not the asset or liability itself. A notional (or face) amount is a number of currency units, shares, bushels, pounds, or other units specified in the contract. The settlement of a derivative instrument with a notional amount is determined by interaction of that notional amount with the underlying. The interaction may be simple multiplication, or it may involve a formula with leverage factors or other constants. A payment provision specifies a fixed or determinable settlement to be made if the underlying behaves in a specified manner.

The accounting for derivative instruments are governed by FASB Accounting Standards Codification (ASC) Topic 815, *Derivatives and Hedging*, which aims to highlight to financial statement users additional disclosures on an entity's objectives in its use of derivatives and the method of accounting for such financial instruments. This standard requires that entities with derivatives disclose the following:

- How and why an entity uses derivatives,
- How derivatives and related hedged items are accounted for under this accounting standard, and
- How derivatives and related hedged items affect an entity's financial statements.

For further information, see Note 10—Derivatives.

V. Reclassifications

One fund previously reported as an earmarked fund was reclassified to non-earmarked funds and recorded as a prior period adjustment. See Note 21—Prior Period Adjustments.

W. Fiduciary Activities

Fiduciary activities are the collection or receipt, and the management, protection, accounting, investment and disposition by the Government of cash or other assets in which non-Federal individuals or entities have an ownership interest that the Government must uphold. Fiduciary cash and other fiduciary assets are not assets of the Government and are not recognized on the Balance Sheet. See Note 25—Fiduciary Activities, for further information.

X. Use of Estimates

The Government has made certain estimates and assumptions relating to the reporting of assets, liabilities, revenues, expenses, and the disclosure of contingent liabilities to prepare these financial statements. There are a large number of factors that affect these assumptions and estimates, which are inherently subject to substantial uncertainty arising from the likelihood of future changes in general economic, regulatory and market conditions. As such, actual results will differ from these estimates and such differences may be material.

Significant transactions subject to estimates include loans receivable and mortgage-backed securities, net; TARP direct loans and equity investments; investments in other non-Federal securities (including GSEs and foreign and domestic public entities) and related impairment, if any; tax receivables; loan guarantees; depreciation; liability for liquidity commitment (GSEs); actuarial liabilities; contingent legal liabilities; environmental liabilities; credit reform subsidy costs; and insurance and guarantee program liabilities.

The Government recognizes the sensitivity of credit reform modeling to slight changes in some model assumptions and uses regular review of model factors, statistical modeling, and annual reestimates to reflect the most accurate cost of the credit programs to the U.S. Government. Two of the emergency economic programs that the Government implemented in the latter part of September 2008, the purchase program for MBS and the GSE credit line facility, are accounted for pursuant to the provisions of credit reform and the use of estimates as dictated by the *Federal Credit Reform Act of 1990* (FCRA). FCRA loan receivables and loan guarantees are disclosed in Note 4—Loans Receivable, Mortgage Backed Securities, and Loan Guarantee Liabilities, Net. Additionally, all TARP credit activity, including investments in common and preferred stock and loans and asset guarantees, are also subject to credit reform accounting (see Note 5—TARP Direct Loans and Equity Investments, Net).

The forecasted future cashflows used to determine credit reform amounts as of September 30, 2011, and 2010, are sensitive to slight changes in model assumptions, such as general economic conditions, specific stock price volatility of the entities in which the Government has an equity interest, estimates of expected default, and prepayment rates. Forecasts of future financial results have inherent uncertainty and the TARP Direct Loans and Equity Investments, Net line item as of September 30, 2011, and 2010, is reflective of relative illiquid, troubled assets whose values are particularly sensitive to future economic conditions and other assumptions.

The GSE senior preferred stock purchase agreements provide that the Government will make funding advances to the GSEs, if at the end of any quarter, FHFA, acting as the conservator, determines that the liabilities of either GSE, individually, exceed its respective assets. These contingent liquidity commitments predicated on the future occurrence of any shareholders' deficits of the GSEs at the end of any reporting quarter, are potential liabilities of the Government. Valuation analyses were performed to attempt to provide a "sufficiently reliable" estimate of the outstanding commitment which is recorded as a liability in accordance with SFFAS No. 5. The valuation incorporated various forecasts, projections and cashflow analysis to develop an estimate of potential liability. Note 1.J—Investments in and Liabilities to Government-Sponsored Enterprises and Note 11—Investments in and Liabilities to Government-Sponsored Enterprises discusses the results of the valuation and the contingent liability recorded as of September 30, 2011, and 2010.

Y. Credit Risk

Credit risk is the potential, no matter how remote, for financial loss from a failure of a borrower or a counterparty to perform in accordance with underlying contractual obligations. The Government takes on credit risk when it makes direct loans or credits to foreign entities or becomes exposed to institutions which engage in financial transactions with foreign countries.

The Government also takes on credit risk related to committed but undisbursed direct loans, liquidity commitment to GSEs, the MBS portfolio, investments, loans, and asset guarantees of the TARP, guarantee of money market funds, and the Terrorism Risk Insurance Program. Except for the Terrorism Risk Insurance Program, these activities focus on the underlying problems in the credit markets, and the ongoing instability in those markets exposes the Government to potential unknown costs and losses. The extent of the risk assumed is described in more detail in the notes to the financial statements, and where applicable, is factored into credit reform models and reflected in fair value measurements.

Note 2. Cash and Other Monetary Assets

Cash and Other Monetary Assets as of September 30, 2011, and 2010

(In billions of dollars)	2011	2010
Unrestricted cash:		
Cash held by Treasury for Governmentwide operations	49.8	103.6
Other	8.3	9.0
Restricted cash:		
Cash held by Treasury for Governmentwide operations	-	200.0
Other	18.8	19.4
Total cash	76.9	332.0
International monetary assets	76.6	70.4
Gold	11.1	11.1
Foreign currency	12.4	15.1
Total cash and other monetary assets	177.0	428.6

Unrestricted cash includes cash held by Treasury for Governmentwide operations (Operating Cash) and all other unrestricted cash held by the Federal agencies. Operating Cash represents balances from tax collections, other revenue, Federal debt receipts, and other various receipts net of cash outflows for budget outlays and other payments. Operating Cash includes balances invested with commercial depositaries in Treasury Tax and Loan Accounts (including funds invested through the Term Investment Option program and the Repo Pilot program). Treasury checks outstanding are netted against Operating Cash until they are cleared by the Federal Reserve System. Other unrestricted cash not included in Treasury's Operating Cash balance includes balances representing cash, cash equivalents, and other funds held by agencies, such as undeposited collections, deposits in transit, demand deposits, amounts held in trust, imprest funds, and amounts representing the balances of petty cash.

Restricted cash is restricted due to the imposition on cash deposits by law, regulation, or agreement. Restricted cash is primarily composed of the Supplementary Financing Program (SFP) and cash held by the Foreign Military Sales programs. On September 18, 2008, Treasury began issuing specific cash management bills to fund the SFP. The SFP is a temporary program that deposits cash with the Federal Reserve to support Federal Reserve initiatives aimed at addressing the ongoing crisis in financial markets. As of September 30, 2011, there were no outstanding cash management bills earmarked for SFP, as compared to eight outstanding cash management bills totaling $200.0 billion as of September 30, 2010. The Foreign Military Sales program included $18.2 billion and $18.6 billion as of September 30, 2011, and 2010, respectively. International monetary assets include the U.S. reserve position in the International Monetary Fund (IMF) and U.S. holdings of Special Drawing Rights (SDRs).

The U.S. reserve position in the IMF is an interest-bearing claim on the IMF that includes the reserve asset portion of the financial subscription that the United States has paid in as part of its participation in the IMF as well as any amounts drawn by the IMF from a letter of credit made available by the United States as part of its financial subscription to the IMF. The IMF promotes international monetary cooperation and a stable payment 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 $43.0 billion and $45.2 billion as of September 30, 2011, and 2010, respectively. The U.S. reserve position in the IMF has a U.S. dollar equivalent of $22.7 billion and $12.9 billion as of September 30, 2011, and 2010, respectively.

The SDR is an international reserves asset created by the IMF to supplement the existing reserve assets of its members. These interest-bearing assets can be obtained by IMF allocations, transactions with IMF member countries, or in the form of interest earnings on SDR holdings and reserve position in the IMF U.S. SDR holdings are an interest-bearing asset of Treasury's Exchange Stabilization Fund (ESF). The total amount of SDR holdings of the United States was the equivalent of $55.9 billion and $57.4 billion as of September 30, 2011, and 2010, respectively.

The IMF allocates SDRs to its members in proportion to each member's quota in the IMF. The SDR Act, enacted in 1968, authorized the Secretary of the Treasury to issue Special Drawing Right 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 $5.2 billion as of September 30, 2011, and 2010 respectively, and are included in Note 19—Other Liabilities.

As of September 30, 2011, and 2010, other liabilities included $55.1 billion and $55.0 billion 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, 1981, and 2009.

Gold is valued at the statutory price of $42.2222 per fine troy ounce. The number of fine troy ounces was 261,498,900 as of September 30, 2011, and 2010. The market value of gold on the London Fixing was $1,620 and $1,307 per fine troy ounce as of September 30, 2011, and 2010, respectively. Gold totaling $11.1 billion as of September 30, 2011, and 2010, was pledged as collateral for gold certificates issued and authorized to the FRBs by the Secretary of the Treasury. Gold certificates were valued at $11.0 billion as of September 30, 2011, and 2010, which are included in Note 19—Other Liabilities. Treasury may redeem the gold certificates at any time. Foreign currency is translated into U.S. dollars at the exchange rate at fiscal yearend. The foreign currency is maintained by the ESF and various U.S. Federal agencies and foreign banks.

Note 3. Accounts and Taxes Receivable, Net

Accounts and Taxes Receivable as of September 30, 2011, and 2010

(In billions of dollars)	2011	2010
Accounts receivable:		
Gross accounts receivable	89.2	75.1
Allowance for uncollectible accounts	(20.7)	(18.0)
Accounts receivable, net	68.5	57.1
Taxes receivable:		
Gross taxes receivable	151.5	141.9
Allowance for doubtful accounts	(113.7)	(104.4)
Taxes receivable, net	37.8	37.5
Total accounts and taxes receivable, net	106.3	94.6

Accounts receivable includes related interest receivable of $6.6 billion and $6.7 billion as of September 30, 2011, and 2010, respectively.

Note 4. Loans Receivable, Mortgage-Backed Securities, and Loan Guarantee Liabilities, Net

Direct Loan, Mortgage-Backed Securities, and Defaulted Guaranteed Loan Programs as of September 30, 2011, and 2010

(In billions of dollars)	Face Value of Loans Outstanding		Long-term Cost of/(Income From) Direct Loans and Defaulted Guaranteed Loans Outstanding		Loans Receivable and Mortgage-Backed Securities, Net		Subsidy Expense/ (Income) for the Fiscal Year	
	2011	2010	2011	2010	2011	2010	2011	2010
Federal Direct Student Loans - Education	356.1	231.3	(25.3)	2.4	381.5	228.9	(28.6)	(1.6)
Federal Family Education Loans - Education	147.3	138.9	(0.8)	-	148.0	138.9	(4.9)	(1.1)
GSE Mortgage Backed Securities Purchase Program - Treasury	70.6	164.3	(1.8)	(7.9)	72.4	172.2	1.8	(0.6)
Electric Loans - USDA	42.2	40.7	2.1	2.2	40.2	38.5	(0.2)	-
Rural Housing Services - USDA	30.7	29.8	7.1	7.0	23.6	22.8	0.5	0.5
State and Local Housing Finance Agency Initiative - Treasury	15.1	15.3	0.8	1.2	14.3	14.1	-	1.7
Housing and Urban Development Loans	13.9	11.3	1.3	(0.2)	12.6	11.5	0.2	1.3
Water and Environmental Loans - USDA	11.9	11.0	0.7	0.8	11.1	10.3	-	0.1
Farm Loans - USDA	8.6	8.2	0.4	0.3	8.3	7.9	0.2	(0.1)
Export-Import Bank Loans	9.9	8.9	2.8	3.6	7.0	5.3	(0.4)	(0.2)
Disaster Loan Programs - SBA	7.5	7.9	1.5	1.5	6.0	6.5	0.2	0.2
Telecommunications Loans - USDA	4.5	4.3	-	-	4.5	4.3	-	-
U. S. Agency for International Development Loans	4.7	5.3	1.3	1.9	3.4	3.4	-	-
Housing for the Elderly and Disabled - HUD	2.8	3.2	-	-	2.8	3.2	-	-
Food Aid - USDA	5.2	5.6	2.5	2.0	2.7	3.7	-	-
All Other Programs	45.5	26.6	11.8	9.2	33.7	17.1	2.2	0.6
Total Direct Loans and Defaulted Guaranteed Loans	776.5	712.6	4.4	24.0	772.1	688.6	(29.0)	0.8

Loan Guarantees as of September 30, 2011, and 2010

(In billions of dollars)	Principal Amount of Loans under Guarantee		Principal Amount Guaranteed by the United States		Loan Guarantee Liabilities		Subsidy Expense (Income) for the Fiscal Year	
	2011	2010	2011	2010	2011	2010	2011	2010
Federal Housing Administration Loans - HUD	1,167.1	1,025.1	1,096.8	968.0	36.1	35.0	(7.2)	(3.0)
Federal Family Education Loans - Education	327.6	390.5	320.7	382.0	10.0	14.5	(11.2)	(13.3)
Export-Import Bank Guarantees	70.7	61.7	70.7	61.7	1.2	1.4	(0.2)	(0.2)
Small Business Loans - SBA	82.2	76.2	70.0	64.4	4.7	4.5	2.4	4.2
Veterans Housing Benefit Programs - VA	247.7	214.7	66.2	58.1	5.1	4.9	0.6	1.3
Rural Housing Services - USDA	63.3	51.0	56.9	45.8	2.5	1.8	0.3	0.5
Israeli Loan Guarantee Program - AID	11.6	11.9	11.6	11.9	1.3	1.9	-	-
Export Credit Guaranteed Programs - USDA	6.1	6.6	6.0	6.5	0.1	0.2	0.1	-
Business and Industry Loans - USDA	7.0	5.9	5.3	4.4	0.8	0.6	0.4	0.3
Overseas Private Investment Corporation Credit Program	4.9	5.0	4.9	5.0	0.2	0.1	-	-
Federal Ship Financing Fund (Title XI) - DOT	1.8	2.0	1.8	2.0	0.2	0.2	-	-
All Other Guaranteed Loan Programs	22.6	19.8	20.8	18.4	0.8	0.7	(0.1)	-
Total Loan Guarantees	2,012.6	1,870.4	1,731.7	1,628.2	63.0	65.8	(14.9)	(10.2)

The Government has two different types of loans and loan guarantees. One major type of loan is direct loans such as the Department of Education's (Education) Federal Direct Student Loans. Direct Loans includes purchases of asset-backed securities (ABS), such as the Treasury's GSE MBS Purchase Program. The second type is loan guarantee programs, such as the Department of Housing and Urban Development's (HUD's) Federal Housing Administration Loans program.

Direct loans and loan guarantee programs are used to promote the Nation's welfare by making financing available to segments of the population not served adequately by non-Federal institutions, or otherwise providing for certain activities or investments. 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 September 30. 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 September 30. 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.

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

The total subsidy expense/(income) is the cost of direct loans and loan guarantees recognized during the fiscal year. It consists of the subsidy expense/(income) 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 upward or downward re-estimates as of the end of the fiscal year of the cost of loans and guarantees outstanding. This expense/(income) is included in the Statements of Net Cost.

Major Loan Programs

Education has two major education loan programs, authorized by Title IV of the Higher Education Act of 1965 (HEA). The first program, the William D. Ford Federal Direct Student Loan Program, established in fiscal year 1994, offers four types of education loans: Stafford, Unsubsidized Stafford, PLUS for parents and graduate or professional students, 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 program, the Federal Family Education Loan (FFEL) Program, established in fiscal year 1965, is a guaranteed loan program. Like the William D. Ford Federal Direct Student Loan Program, it offered four types of loans: Stafford, Unsubsidized Stafford, PLUS for parents and graduate or professional students, and consolidation loans. Student Aid and Fiscal Responsibility Act (SAFRA), enacted as part of the Health Care Education and Reconciliation Act of 2010 (Public Law 111-152), eliminated the authority to guarantee new FFEL after July 1, 2010. During fiscal year 2010, FFEL loans receivable continued to increase significantly, principally due to amendments made to the HEA by the Ensuring Continued Access to Student Loans Act of 2008 (ECASLA). These amendments gave Education temporary authority to purchase FFEL loans and interests in those loans. This authority was to expire on July 1, 2009; however, Public Law 110-350 extended the authority through July 1, 2010.

The Housing and Economic Recovery Act of 2008 (HERA), Public Law 110-289, authorized the Treasury to enter into the GSE MBS Purchase Program. Under this program, the Treasury, using private sector asset managers, purchased on the open market as a portfolio of mortgage-backed securities issued by the GSEs. By purchasing these credit-guaranteed securities, the Treasury sought to broaden access to mortgage funding for current and prospective homeowners and to promote stability in the mortgage market. The asset managers were also authorized to enter into other trade/sell transactions such as pair offs, turns, assignments, and dollar rolls to further support the market under the HERA provision/mandate. The authority granted by Congress to purchase MBS expired on December 31, 2009, at which point the purchase of new securities ended, though the Treasury still retains its portfolio of previously purchased securities.

The Treasury's GSE MBS Purchase Program portfolio consists of mortgage pass-through securities issued by Freddie Mac and Fannie Mae.

Under HERA, Treasury together with the FHFA, Fannie Mae, Freddie Mac, and HUD announced in October 2009 an initiative to provide support to state and local HFAs. HFAs have historically played a central role in providing a safe, sustainable path to homeownership for working families in all 50 states and many localities across the country. This initiative is designed to support low mortgage rates and expand resources for low and middle income borrowers to purchase or rent homes, making them more affordable over the long term. In December 2009, several transactions closed as part of the HFA Initiative's two separate programs: (1) TCLP and (2) the NIBP. As part of the TCLP, the Treasury has entered into participation agreements with Fannie Mae and Freddie Mac, supporting credit and liquidity facilities that the GSEs are providing to 11 states as part of the program.

HUD's Federal Housing Administration (FHA) provides mortgage insurance to encourage lenders to make credit available to expand home ownership. FHA serves many borrowers that the conventional market does not serve adequately. This includes first-time homebuyers, minorities, low-income, and other underserved households to realize the benefit of home ownership. Borrowers obtain an FHA insured mortgage and pay an upfront premium and an annual premium to FHA. The proceeds from those premiums are used to fund FHA program costs, including claims on defaulted mortgages and holding costs, property management fees, property sales, and other associated costs. The possibility of a sizable volume of delinquencies remains a significant risk for the housing market and for FHA in the near term. The number of FHA mortgages has risen dramatically. HUD decided to raise the annual premium and lower the upfront premium to aid in returning the Mutual Mortgage Insurance Fund to congressionally mandated levels of capital reserves without disruption to the marketplace.

The United States Department of Agriculture (USDA) offers direct and guaranteed loans through credit programs in the Farm and Foreign Agricultural Services (FFAS) mission area through the Farm Service Agency (FSA), and the Commodity Credit Corporation (CCC), and in the Rural Development (RD) mission area.

The FFAS delivers commodity, credit, conservation, disaster and emergency assistance programs that help strengthen and stabilize the agricultural economy. The FSA offers direct and guaranteed loans to farmers who are temporarily unable to obtain private, commercial credit. Through this supervised credit offered by FSA, the goal is to graduate its borrowers to commercial credit. The CCC offers both credit guarantee and direct credit programs for buyers of U.S. exports, suppliers, and sovereign countries in need of food assistance. The RD provides affordable housing and essential community facilities to rural communities through its rural housing loan and grant programs. The Rural Utilities Program helps to improve the quality of life in rural America through a variety of loan programs for electric energy, telecommunications, and water and environmental projects.

The Small Business Administration's (SBA's) Disaster Assistance Loan Program makes direct loans to disaster victims primarily for homes and personal property.

The Export-Import Bank aids in financing and promoting U.S. exports. The average repayment term for these loans is approximately 7 years.

Please refer to the individual financial statements of the agencies listed in the tables for significant detailed information regarding their direct and guaranteed loan programs.

Note 5. TARP Direct Loans and Equity Investments, Net

The TARP was authorized by the Emergency Economic Stabilization Act of 2008 (EESA). This Act gave the Secretary of the Treasury broad flexible authority to establish the TARP to purchase and guarantee mortgages, mortgage related securities, and other troubled assets from financial institutions. This permitted the Secretary of the Treasury to inject capital into, and receive equity interests in, banks and other financial institutions. Treasury established several programs under the TARP to help stabilize the financial system, restore the flow of credit to consumers and businesses, and tackle the foreclosure crisis. Under the TARP programs, Treasury made direct loans and equity investments as well as entered into the asset guarantees program. This authority to make new commitments to purchase or guarantee troubled assets expired on October 3, 2010.

The following table lists the TARP programs and types:

Program	Program Type
Capital Purchase Program	Equity Investment/Subordinated Debentures
American International Group, Inc. Investment Program *	Equity Investment
Targeted Investment Program	Equity Investment
Automotive Industry Financing Program	Equity Investment and Direct Loan
Consumer and Business Lending Initiative	Direct Loan, Subordinated Debentures and Equity Investments
Public-Private Investment Program	Equity Investment and Direct Loan
Asset Guarantee Program	Asset Guarantee
Housing Programs Under TARP **	Expenditure and Loss Sharing

* Formerly known as the Systemically Significant Failing Institutions Program.
** Housing Programs Under TARP are not designed to recoup money spent on loan modifications or payments on the loss sharing agreement. As such, these programs do not include direct loans, equity investments, or asset guarantees.

TARP Direct Loans and Equity Investments, Net and Asset Guarantee Program balances as of September 30, 2011, and 2010 are as follows:

Troubled Asset Relief Program as of September 30, 2011, and 2010

(In billions of dollars)	2011	2010
Direct Loans and Equity Investments, Net	80.1	142.5
Asset Guarantee Program	-	2.2
Total	80.1	144.7

The Direct Loans and Equity Investments, Net represents the estimated net outstanding amount of direct loans and equity investments.

The table below is a summary of TARP loans and equity investments.

Troubled Asset Relief Program Direct Loans and Equity Investments as of September 30, 2011, and 2010

(In billions of dollars)	Direct Loans and Equity Investments		Subsidy Cost Allowance		Net Direct Loans and Equity Investments		Subsidy Expense (Income) for the Fiscal Year	
	2011	2010	2011	2010	2011	2010	2011	2010
American International Group, Inc. Investment Program	51.1	47.5	(20.7)	(21.4)	30.4	26.1	1.6	(7.7)
Public-Private Investment Program	15.9	13.7	2.4	0.7	18.3	14.4	(1.9)	(0.7)
Automotive Industry Financing Program	37.3	67.3	(19.4)	(14.6)	17.9	52.7	9.7	(16.6)
Capital Purchase Program	17.3	49.8	(4.9)	(1.5)	12.4	48.3	(1.8)	3.9
Consumer and Business Lending Initiative	0.8	0.9	0.3	0.1	1.1	1.0	(0.2)	0.3
Targeted Investment Program	-	-	-	-	-	-	(0.2)	(1.9)
Total	122.4	179.2	(42.3)	(36.7)	80.1	142.5	7.2	(22.7)

American International Group, Inc. Investment Program (AIG)

Treasury provided assistance to AIG in order to prevent its disorderly failure as well as to prevent broader disruption to the financial markets. In November 2008, Treasury invested $40.0 billion in AIG's cumulative Series D perpetual cumulative preferred stock with a dividend rate of 10.0 percent compounded quarterly. On April 17, 2009, AIG and Treasury restructured their November 2008 agreement. Under the restructuring, Treasury exchanged $40.0 billion of cumulative Series D preferred stock for $41.6 billion of non-cumulative 10.0 percent Series E preferred stock. In addition to the exchange, Treasury agreed to make available an additional $29.8 billion capital facility to allow AIG to draw additional funds if necessary to assist in AIG's restructuring. As of January 14, 2011, AIG had drawn an aggregate of $27.8 billion from the capital facility. On September 30, 2010, Treasury, FRBNY, and AIG announced plans for a restructuring of the U.S. Government's investments in AIG. The restructuring, which occurred on January 14, 2011, converted Treasury's $27.8 billion investment in Series F preferred stock into $20.3 billion of interest in AIG Special Purpose Vehicles (SPVs), and 168 million shares of AIG common stock. As a result of the restructuring, Treasury under TARP also converted its AIG Series E preferred stock into 925 million shares of AIG common stock.

At the completion of the January 14, 2011, restructuring, Treasury held 1,093 million shares of AIG common stock under TARP and the General Fund held an additional 563 million shares (see Note 6— Non-TARP Investments in American International Group, Inc.) resulting in a combined total of about 1.7 billion shares (or 92.1 percent ownership) of AIG common stock. In fiscal year 2011, Treasury sold 200 million shares of AIG common stock (68 million General Funds shares and 132 million Treasury under TARP shares) for $5.8 billion, of which the General Fund and Treasury under TARP received $2.0 billion and $3.8 billion, respectively. Treasury also received $11.5 billion in distributions from the AIG SPVs in fiscal year 2011. Treasury received no payments from AIG in fiscal year 2010. At September 30, 2011, Treasury held 960 million shares of AIG common stock under TARP, and the General Fund held an additional 495 million shares, resulting in a combined total of about 1.5 billion shares of AIG common stock with a market value totaling approximately $31.9 billion, or 76.9 percent of AIG's outstanding common stock on a fully diluted basis, of which TARP owned 50.8 percent. As of September 30, 2011, Treasury also owned preferred units in an AIG SPV with an outstanding balance of $9.3 billion.

According to the terms of the preferred stock, if AIG misses four dividend payments, Treasury may appoint to the AIG Board of Directors, the greater of two members or 20.0 percent of the total number of directors of the Company. On April 1, 2010, Treasury appointed two directors to the Company's Board as a result of non-payments of dividends. The additional two directors increased the total number of AIG directors to 12. The two additional Treasury-appointed directors remained on the Board as of September 30, 2011.

Public Private Investment Program (PPIP)

The PPIP is part of Treasury's efforts to help restart the markets and provide liquidity for legacy assets. Under this program, Treasury makes equity and debt investments in investment vehicles (referred to as Public Private Investment Funds or "PPIFs") established by private investment managers. The equity investment is used to match private capital and will equal not more than 50 percent of the total equity invested. Treasury's debt commitment, at the option of the investment manager, equals to 50 percent or 100 percent of the total equity (including private equity). The PPIFs invest primarily in commercial mortgage-backed securities and non-agency residential MBS. At least 90 percent of the assets underlying any eligible asset must be situated in the United States. During fiscal year 2010, Treasury disbursed $4.9 billion as equity investment and $9.2 billion as loans to these eight PPIFs. During fiscal year 2011, Treasury disbursed $1.1 billion as equity investment and $2.3 billion as loans to these PPIFs. At September 30, 2010, Treasury had equity investment in PPIFs outstanding of $4.8 billion and loans outstanding of $8.9 billion for a total of $13.7 billion. At September 30, 2011, Treasury had equity investment in PPIFs outstanding of $5.5 billion and loans outstanding of $10.4 billion for a total of $15.9 billion. In addition, as of September 30, 2011, Treasury had legal commitments to disburse up to $4.3 billion for additional investments and loans in PPIFs.

Automotive Industry Financing Program (AIFP)

The Automotive Industry Financing Program was designed to help prevent a significant disruption of the American automotive industry, which could have had a negative effect on the economy of the United States. The various activities undertaken by Treasury in the automotive industry include:

General Motors (GM)—In fiscal year 2009, Treasury provided $49.5 billion to Old GM through various loan agreements including the initial loan for general and working capital purposes and the final loan for debtor in possession (DIP) financing while Old GM was in bankruptcy. Treasury assigned its rights in these loans (with the exception of $1.0 billion which remained in Old GM for wind down purposes and $7.1 billion that would be assumed) and previously received common stock warrants to a newly created entity New GM. New GM used the assigned loans and warrants to credit bid for substantially all of the assets of GM in a sale pursuant to Section 363 of the Bankruptcy Code (see 11 U.S.C. 363). Upon closing of the Section 363 sale, the credit bid loans and warrants were extinguished and Treasury received $2.1 billion in 9.0 percent cumulative perpetual preferred stock and 60.8 percent of the common equity interest in New GM. In addition, New GM assumed $7.1 billion of the DIP loan, simultaneously paying $0.4 billion (return of warranty program funds), resulting in a balance of $6.7 billion. The assets received by Treasury as a result of the assignment and Section 363 sale are considered recoveries of the original loans for subsidy cost estimation purposes. During fiscal year 2010, Treasury received the remaining $6.7 billion as full repayment of the DIP loan assumed. During fiscal year 2011, pursuant to a letter agreement between Treasury and New GM, New GM repurchased its preferred stock for 102.0 percent of its liquidation amount, or $2.1 billion. As a result of the New GM initial public offering (IPO), in fiscal year 2011, Treasury sold approximately 412 million shares of its GM common stock. Treasury received approximately $13.5 billion in net proceeds, and its equity stake in General Motors Company decreased from 60.8 percent to 33.3 percent. Market value of the 500 million shares of New GM common stock held (representing 32 percent equity stake in New GM) as of September 30, 2011, was $10.1 billion. On March 31, 2011, the Plan of Liquidation for Old GM became effective and Treasury's $1.0 billion loan was converted to an administrative claim. Treasury retains the right to recover additional proceeds but recoveries are dependent on actual liquidation proceeds and pending litigation. Treasury recovered $0.1 billion in fiscal year 2011 on the administrative claim. Treasury does not expect to recover any significant additional proceeds from this claim.

GMAC LLC Rights Offering—In December 2008, Treasury agreed, in principal, to lend up to $1.0 billion to Old GM for participation in a rights offering by GMAC (now known as Ally Financial, Inc.) in support of GMAC's reorganization as a bank holding company. The loan was secured by the GMAC common interest acquired in the rights offering. The loan was funded for $0.9 billion. In May 2009, Treasury exercised its exchange option under the loan and received 190,921 membership interests, representing approximately 35.36 percent of the voting interest at the time, in GMAC in full satisfaction of the loan.

Ally Financial Inc. (formerly known as GMAC Inc.)—In December 2008, Treasury purchased preferred membership interests for $5.0 billion with an 8 percent annual distribution right (dividends) from GMAC. In May 2009, Treasury had invested $7.5 billion in 9 percent Mandatory Convertible Preferred Stock in GMAC to support its ability to originate new loans to Chrysler dealers and consumers, and help address GMAC's capital needs. As of September 30, 2009, Treasury owned $13.1 billion in preferred shares in GMAC, through purchases and the exercise of warrants, in addition to 35.36 percent of the common equity in GMAC, as described previously under GMAC LLC Rights Offering.

In December 2009, Treasury invested $2.5 billion in 8 percent Trust Preferred Securities and $1.25 billion in GMAC's Series F-2 shares which have a $50 per share liquidation preference and are convertible into GMAC common stock at the option of GMAC or Treasury. Absent an optional conversion, the Series F-2 shares automatically convert to common stock after 7 years from the issuance date. In addition, as part of the December 2009 transactions, Treasury exchanged its preferred membership interests and its 9 percent Mandatory Convertible Preferred Stock for a combination of additional Series F-2 convertible shares and GMAC's common shares. The additional shares in GMAC common stock increased Treasury's ownership in GMAC from 35.36 percent to 56.3 percent.

In May 2010, GMAC changed its corporate name to Ally Financial, Inc. (Ally). As of September 30, 2010, Treasury owned $2.7 billion of Trust Preferred Securities and $11.4 billion of Series F-2 Convertible Securities in Ally, through purchases, exchanges, and the exercise of warrants, in addition to 56.3 percent of common equity in Ally. In December 2010, Treasury converted 110 million shares of the Series F-2 preferred stock into 531,850 shares of Ally's common stock.

In March 2011, Treasury sold its Trust Preferred Securities for $2.7 billion. On March 31, 2011, Treasury announced that it had agreed to be named as a selling shareholder of common stock in Ally's registration statement filed with the Securities and Exchange Commission (SEC) for a proposed initial public offering. Since March 31, 2011, Ally has filed four amendments in response to SEC comments and the public offering has not been made.

At September 30, 2011, Treasury held 981,971 shares of common stock (73.84 percent of Ally's outstanding common stock) and 119 million shares of the Series F-2 preferred securities.

Chrysler Holding LLC (Chrysler)

In January 2009, Treasury provided a $4.0 billion General Purpose Loan to a parent company of Chrysler (Chrysler Holdings). On April 30, 2009, Chrysler filed for Chapter 11 bankruptcy. In May 2009, Treasury provided an additional $1.9 billion to Chrysler under the terms of a DIP credit agreement. On June 10, 2009, substantially all of the assets of Chrysler were sold to a newly-created entity (New Chrysler). Recovery of the DIP loan is subject to the bankruptcy process associated with the Chrysler assets remaining after the sale to New Chrysler.

In June 2009, Treasury entered into a credit agreement to lend an additional $6.6 billion. Also, New Chrysler assumed $0.5 billion of the General Purpose Loan, and the balance of $3.5 billion remained outstanding from the Chrysler Holdings. As of September 30, 2009, Treasury had funded approximately $4.6 billion of the $6.6 billion in new commitments to New Chrysler. Treasury also obtained other consideration relating to these new commitments, including a 9.85 percent equity interest in New Chrysler and additional notes with principal balances of approximately $0.3 billion and $0.1 billion.

In fiscal year 2010, pursuant to the terms of a settlement agreement, Treasury received approximately $1.9 billion and subsequently wrote-off the remaining $1.6 billion of the General Purpose Loan. As of September 30, 2010, Treasury had loans outstanding from New Chrysler of $5.1 billion and owned a 9.85 percent equity interest in New Chrysler and additional notes with principal balances of approximately $0.4 billion. Additionally, as of September 30, 2010, Treasury had an interest in an old Chrysler entity as a result of the $1.9 billion DIP Loan, recovery of which is subject to the bankruptcy process associated with the Chrysler assets remaining after the sale to New Chrysler. In May 2011, New Chrysler repaid $5.1 billion, the additional notes totaling $0.4 billion and all associated interests. New Chrysler's ability to draw the remaining $2.1 billion loan commitment was terminated. In July 2011, Fiat SpA paid Treasury $0.6 billion for all of its remaining equity interest and rights relating to New Chrysler. As a result of the fiscal year 2011 transactions, Treasury has no remaining interest in New Chrysler as of

September 30, 2011. Treasury continues to hold a right to receive proceeds from a bankruptcy liquidation trust but no significant cash flows are expected.

Capital Purchase Program

In October 2008, Treasury began implementation of the TARP with the Capital Purchase Program (CPP), designed to help stabilize the financial system by assisting in building the capital base of certain viable U.S. financial institutions to increase the capacity of those institutions to lend to businesses and consumers and support the economy. Under this program, Treasury purchased senior perpetual preferred stock from qualifying federally- or state-regulated banks, savings associations, and certain bank and savings and loan holding companies (Qualified Financial Institution (QFI)). In addition to the senior preferred stock, Treasury received warrants from public QFIs to purchase shares of common stock. The senior preferred stock has a stated dividend rate of 5.0 percent through year five, increasing to 9.0 percent in subsequent years thereafter. The dividends are cumulative for bank holding companies and subsidiaries of bank holding companies and non-cumulative for others and payable when and if declared by the institution’s board of directors. QFIs that are Sub-chapter S corporations issued subordinated debentures in order to maintain compliance with the Internal Revenue Code. The maturity of the subordinated debentures is 30 years and interest rates are 7.7 percent for the first 5 years and 13.8 percent for the remaining years thereafter. For fiscal years 2011 and 2010, repayments totaled $30.2 billion and $81.4 billion, respectively.

The Consumer and Business Lending Initiative (CBLI)

The Consumer and Business Lending Initiative is intended to help unlock the flow of credit to consumers and small businesses. The following three programs were established to help accomplish this: Term Asset-Backed Securities Loan Facility (TALF), Small Business Administration (SBA) 7(a) Securities Purchase Program, and the Community Development Capital Initiative (CDCI).

TALF, which was created to help jump start the market for securitized consumer and small business loans, was created by the Board of Governors of the Federal Reserve System and Treasury to provide low-cost funding to investors in certain classes of ABS. Treasury participates in the program as part of Treasury’s Consumer and Business Lending Initiative by providing liquidity and credit protection to the FRBNY. As part of the program, the FRBNY has entered into a put agreement with the TALF, LLC, a special purpose vehicle created by the FRBNY. In the event of a TALF borrower default, the FRBNY will seize the collateral and sell it to the TALF, LLC under this agreement. Under the TALF, the FRBNY, as implementer of the TALF program, originates loans on a non-recourse basis to holders of certain AAA rated ABS. The TALF, LLC receives a monthly fee equal to the differences between the TALF loan rate and the FRBNY’s fee (spread) as compensation for entering into the put agreement. The accumulation of this fee will be used to fund purchases. In the event there are insufficient funds to purchase the collateral, Treasury committed to invest up to $20.0 billion in non-recourse subordinate notes issued by the TALF, LLC. On July 19, 2010, the Treasury commitment was reduced to $4.3 billion. Treasury disbursed $0.1 billion upon creation of the TALF, LLC and the remainder can be drawn to purchase collateral in the event the accumulated fees are not sufficient to cover purchases. As of September 30, 2011 and 2010, approximately $11.3 billion and $29.7 billion of loans due to FRBNY remained outstanding, respectively.

The SBA 7(a) Securities Purchase Program was created to provide additional liquidity to the SBA 7(a) market so that banks are able to make more small business loans. Under this program, Treasury purchases 7(a) Securities collateralized with 7(a) loans (these loans are guaranteed by the full faith and credit of the United States Government) packaged on or after July 1, 2008. As of September 30, 2010, Treasury has entered into trades to purchase about $0.4 billion, of which about $0.2 billion had settled. The remaining trades settled by December 30, 2010. In May 2011, Treasury began selling its securities to bond market investors. As of September 30, 2011, Treasury held $0.1 billion of SBA 7(a) securities.

The CDCI Initiative was created to provide additional low-cost capital to small banks to encourage more lending to small businesses. Under the terms of the initiatives, Treasury purchases senior preferred stock (or subordinated debt) from eligible CDFI financial institutions. The senior preferred stock has an initial dividend rate of 2 percent. CDFIs may apply to receive capital up to 5 percent of risk-weighted assets. To encourage repayment while recognizing the unique circumstances facing CDFIs, the dividend rate will increase to 9 percent after 8 years. CDFIs participating in the CPP, subject to certain criteria, were eligible to exchange, through September 30, 2010, their current CPP preferred shares (subordinated debt) for CDCI preferred shares (subordinated debt). As of September 30, 2010, and 2011, Treasury had $0.6 billion invested under the CDCI Initiative.

Targeted Investment Program (TIP)

The TIP was designed to prevent a loss of confidence in financial institutions that could result in significant market disruptions, threatening the financial strength of similarly situated financial institutions, impairing broader financial markets, and undermining the overall economy.

In fiscal year 2009, Treasury invested $20.0 billion in each of Bank of America and Citigroup under TIP. In December 2009, both institutions repaid the invested amounts along with dividends through the date of repayment. In fiscal year 2010, Treasury received a total of $1.1 billion in dividends on the Bank of America and Citigroup investments and proceeds of $1.2 billion from the sale of Bank of America warrants. In fiscal year 2011, Treasury sold its warrants from Citigroup under TIP for $0.2 billion, and closed the program.

Asset Guarantee Program (AGP)

The AGP provided guarantees for assets held by systemically significant financial institutions that faced a risk of losing market confidence due in large part to a portfolio of distressed or illiquid assets. The AGP was applied with extreme discretion in order to improve market confidence in the systemically significant institution and in financial markets broadly.

In January 2009, Treasury finalized the terms of a guarantee agreement with Citigroup. Under the agreement, Treasury, FDIC, and the FRBNY provided protection against the possibility of large losses on an asset pool of approximately $301.0 billion of loans and securities which remained on Citigroup's balance sheet. Treasury's guarantee was limited to $5.0 billion. As a premium for the guarantee, Citigroup issued approximately $7.0 billion of cumulative preferred stock (subsequently converted to trust preferred securities with similar terms) with an 8.0 percent stated dividend rate and a warrant for the purchase of common stock; approximately $4.0 billion and the warrant was issued to Treasury and approximately $3.0 billion was issued to the FDIC. For fiscal year 2010, the AGP's subsidy income was $1.5 billion.

On December 23, 2009, the Treasury, Federal Reserve, Federal Deposit Insurance Corporation, and Citigroup terminated this program. The Government parties did not pay any losses under the program and kept $5.2 billion of $7 billion in trust preferred securities as well as warrants for common shares that were issued by Citigroup as consideration for such guarantee. On September 29, 2010, Treasury exchanged its remaining trust preferred securities for other Citigroup trust preferred securities containing market terms to facilitate a sale. On September 30, 2010, Treasury agreed to sell its trust preferred securities held for $2.2 billion. The sale was settled on October 5, 2010, and additional warrants were sold in January 2011 for $0.07 billion.

Housing Programs under TARP

The following housing programs under TARP provide stability for both housing market and homeowners. These programs assist homeowners who are experiencing financial hardships to remain in their homes while they get back on their feet or relocate to a more sustainable living situation. These programs fall into three initiatives:

- Making Home Affordable Program;
- Housing Finance Agency Hardest-Hit Fund, and
- Federal Housing Administration Refinance Program.

As of September 30, 2011, and 2010, Treasury has committed up to $45.6 billion for these programs. Payments made under the housing program under TARP from inception through September 30, 2011, and 2010, amounted to $2.4 billion and 0.5 billion, respectively.

For more details on the TARP, please see the Treasury's Annual Financial Report.

Note 6. Non-TARP Investments in American International Group, Inc.

Under the initial terms of a capital facility agreement between the FRBNY and AIG, a 77.9 percent equity interest in AIG (in the form of Series C Convertible Participating Serial Preferred Stock convertible into approximately 77.9 percent of the issued and outstanding shares of AIG common stock) was issued to a trust (Trust) established by the FRBNY. Subsequent to the initial agreement, a reverse stock split of AIG's common stock increased this equity interest to 79.8 percent. The General Fund of the U.S. Government was the sole beneficiary of the Trust. In connection with the establishment of the Trust, Treasury, as custodian of the General Fund, recorded a non-entity asset of $23.5 billion as of September 30, 2009, along with a corresponding entry to custodial revenue for the same amount, to reflect the value of the General Fund's beneficiary interest holding in the Trust. As of September 30, 2010, the value of the Trust had declined by $2.7 billion, reducing the carrying value of this non-entity asset to $20.8 billion.

On September 30, 2010, an AIG Recapitalization Agreement was established for the purpose of restructuring the holdings in AIG. This restructuring was executed on January 14, 2011, converting the Trust's AIG preferred stock into 562.9 million shares of AIG common stock, and the Trust was dissolved (see Note 5 for a discussion of the TARP-related transactions that occurred in connection with the January 14, 2011, restructuring).

On May 27, 2011, 200 million shares of AIG common shares held by the General Fund and Treasury under TARP (68 million and 132 million shares, respectively) was sold in the open market. The sale of the AIG common stock resulted in total gross cash proceeds of $5.8 billion, of which the General Fund and Treasury under TARP received $2.0 billion and $3.8 billion, respectively, for the fiscal year ended September 30, 2011.

After taking into consideration the May 2011 sale of AIG common stock, the carrying value of the non-TARP investment in AIG was $10.9 billion as of September 30, 2011, which represented the fair value as of that date of the remaining AIG common stock held by the General Fund. As of September 30, 2010, the carrying value of the non-TARP investment in AIG was $20.8 billion, which represented the fair value, as of that date, of the General Fund's sole beneficiary interest in the Trust. The fair value of the non-TARP AIG investments recorded as of September 30, 2011, and 2010 were based on the market value of AIG's common stock which is actively traded on the New York Stock Exchange. This basis of valuation was used for the Trust since the underlying AIG common stock, to which the preferred shares were converted, represented the best independent valuation available for the General Fund's beneficial interest. During fiscal years 2011 and 2010, AIG investments held on behalf of the General Fund experienced a net fair value decline of $9.9 billion and $2.7 billion, respectively. Accordingly, the carrying value of the AIG common stock investment was decreased by this amount.

Note 7. Inventories and Related Property, Net

Inventories and Related Property as of September 30, 2011, and 2010

(In billions of dollars)	Defense 2011	All Others 2011	Total 2011	Defense 2010	All Others 2010	Total 2010
Inventory purchased for resale	65.1	0.6	65.7	81.2	0.7	81.9
Inventory and operating material and supplies held for repair	48.3	0.6	48.9	46.5	0.6	47.1
Inventory—excess, obsolete, and unserviceable	7.8	-	7.8	8.4	0.1	8.5
Operating materials and supplies held for use	131.4	2.7	134.1	131.6	2.3	133.9
Operating materials and supplies held in reserve for future use	-	0.2	0.2	-	0.4	0.4
Operating materials and supplies—excess, obsolete, and unserviceable	2.2	0.1	2.3	2.6	0.1	2.7
Stockpile materials	-	48.6	48.6	-	49.0	49.0
Stockpile materials held for sale	0.5	0.2	0.7	0.6	0.2	0.8
Other related property	1.7	0.9	2.6	1.0	0.9	1.9
Allowance for loss	(14.5)	(0.3)	(14.8)	(39.7)	(0.3)	(40.0)
Total inventories and related property, net	242.5	53.6	296.1	232.2	54.0	286.2

Inventory purchased for resale is the cost or value of tangible personal property purchased by an agency for resale. As of September 30, 2011, DOD values approximately 87 percent of its resale inventory using the moving average cost (MAC) method. An additional 9 percent (fuel inventory) is reported using the first-in-first-out method. DOD reports the remaining 4 percent of resale inventories at an approximation of historical cost using LAC adjusted for holding gains and losses. The LAC method is used because DOD's legacy inventory systems do not maintain historical cost data.

Please refer to the individual financial statements of DOD for significant detailed information regarding its inventories.

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 economical to repair than to dispose of (operating materials and supplies).

Inventory—excess, obsolete, and unserviceable consists of:

- Excess inventory that 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 that is no longer needed due to changes in technology, laws, customs, or operations.
- Unserviceable inventory that is 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 they will eventually be needed. DOD, which accounts for most of the reported operating materials and supplies held for use, uses LAC, MAC, and Standard Price and expenses a significant amount when purchased instead of when consumed.

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

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

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

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

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

Other related property consists of the following:

- Commodities include items of commerce or trade that have an exchange value used to stabilize or support market prices. Please refer to the financial statements of the USDA for detailed information regarding commodities.
- Seized monetary instruments are comprised only of 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 considered a Government asset. It is accounted for in agency property-management records until the property is forfeited, returned, or otherwise liquidated. Please refer to the individual financial statements of the Department of Justice (DOJ), Treasury, and the Department of Homeland Security (DHS) for significant detailed information regarding seized property.
- Forfeited property is comprised of monetary instruments, intangible property, real property, and tangible personal property acquired through forfeiture proceedings; property acquired by the Government to satisfy a tax liability; and unclaimed and abandoned merchandise. Please refer to the individual financial statements of DOJ, Treasury, and DHS for significant detailed information regarding forfeited property.
- Foreclosed property is comprised of assets received in satisfaction of a loan receivable or as a result of payment of a claim under a guaranteed or insured loan (excluding commodities acquired under price support programs). All properties included in foreclosed property are assumed to be held for sale. Please refer to the individual financial statements of USDA and HUD for significant detailed information regarding foreclosed property.

Note 8. Property, Plant, and Equipment, Net

Property, Plant, and Equipment as of September 30, 2011

(In billions of dollars)	Cost		Accumulated Depreciation/ Amortization		Net	
	Defense	All Others	Defense	All Others	Defense	All Others
Buildings, structures, and facilities	230.2	220.6	118.6	115.5	111.6	105.1
Furniture, fixtures, and equipment	945.1	161.6	511.1	98.3	434.0	63.3
Construction in progress	46.5	47.5	N/A	N/A	46.5	47.5
Land	10.6	11.9	N/A	N/A	10.6	11.9
Internal use software	10.0	19.9	6.9	10.7	3.1	9.2
Assets under capital lease	1.2	2.9	0.7	1.5	0.5	1.4
Leasehold improvements	1.0	6.9	0.5	3.6	0.5	3.3
Other property, plant, and equipment	1.2	6.2	-	3.1	1.2	3.1
Subtotal	1,245.8	477.5	637.8	232.7	608.0	244.8
Total property, plant, and equipment, net		1,723.3		870.5		852.8

Property, Plant, and Equipment as of September 30, 2010

(In billions of dollars)	Cost		Accumulated Depreciation/ Amortization		Net	
	Defense	All Others	Defense	All Others	Defense	All Others
Buildings, structures, and facilities	207.4	211.6	112.0	110.8	95.4	100.8
Furniture, fixtures, and equipment	912.6	159.5	466.9	96.7	445.7	62.8
Construction in progress	38.6	41.3	N/A	N/A	38.6	41.3
Land	10.5	11.7	N/A	N/A	10.5	11.7
Internal use software	9.4	17.6	6.1	9.3	3.3	8.3
Assets under capital lease	1.0	3.2	0.6	1.4	0.4	1.8
Leasehold improvements	1.0	6.1	0.4	3.2	0.6	2.9
Other property, plant, and equipment	1.2	7.8	-	4.2	1.2	3.6
Subtotal	1,181.7	458.8	586.0	225.6	595.7	233.2
Total property, plant, and equipment, net		1,640.5		811.6		828.9

For further information related to multi-use heritage assets, see Note 27—Stewardship Land and Heritage Assets.

DOD comprises approximately 71.7 percent of the Government's reported property, plant, and equipment net as of September 30, 2011. Refer to the individual financial statements of DOD, DOE, the United States Postal Service (USPS), the Tennessee Valley Authority (TVA), GSA, DHS, and the Department of Interior (DOI), Department of State, VA, and DOT for significant detailed information on the useful lives and related capitalization thresholds for property, plant, and equipment. These agencies comprise 94.5 percent of the Government's total cost of property, plant, and equipment net of $852.8 billion as of September 30, 2011.

Note 9. Debt and Equity Securities

Debt and Equity Securities as of September 30, 2011

	By Category									
	Held-to-Maturity			Available-for-Sale			Trading			
(In billions of dollars)	Cost Basis	Unamortized Premium/ Discount	Net Investment	Cost Basis	Unrealized Gain	Fair Value	Cost Basis	Unrealized Gain	Fair Value	Total
Debt securities:										
Non-U.S. Government	0.2	-	0.2	15.5	0.3	15.8	5.1	0.1	5.2	21.2
Commercial	-	-	-	-	-	-	-	-	-	-
Mortgage/asset backed	-	-	-	-	-	-	5.2	0.1	5.3	5.3
Corporate and other bonds	-	-	-	-	-	-	11.2	0.8	12.0	12.0
All other debt securities	-	-	-	-	-	-	0.5	-	0.5	0.5
Equity securities:										
Common stocks	-	-	-	-	-	-	1.7	-	1.7	1.7
Unit trust	-	-	-	-	-	-	12.3	3.6	15.9	15.9
All other equity securities	2.9	-	2.9	-	-	-	2.6	(0.1)	2.5	5.4
Other	3.3	-	3.3	-	-	-	12.8	0.1	12.9	16.2
Total debt and equity securities categorized as held-to-maturity, available-for-sale or trading	6.4	-	6.4	15.5	0.3	15.8	51.4	4.6	56.0	78.2
Total RRB debt and equity securities										21.5
Total debt and equity securities										99.7

Debt and Equity Securities as of September 30, 2010

(In billions of dollars)	Held-to-Maturity			Available-for-Sale			Trading			Total
	Cost Basis	Unamortized Premium/ Discount	Net Investment	Cost Basis	Unrealized Gain	Fair Value	Cost Basis	Unrealized Gain	Fair Value	
Debt securities:										
Non-U.S. Government	0.2	-	0.2	12.3	0.3	12.6	4.5	0.5	5.0	17.8
Commercial	-	-	-	-	-	-	0.2	-	0.2	0.2
Mortgage/asset backed	-	-	-	-	-	-	2.8	0.1	2.9	2.9
Corporate and other bonds	-	-	-	-	-	-	9.5	0.9	10.4	10.4
All other debt securities	-	-	-	-	-	-	0.7	-	0.7	0.7
Equity securities:										
Common stocks	-	-	-	-	-	-	2.0	0.1	2.1	2.1
Unit trust	0.2	-	0.2	-	-	-	13.1	6.4	19.5	19.7
All other equity securities	-	-	-	2.8	-	2.8	3.3	-	3.3	6.1
Other	2.6	-	2.6	0.1	-	0.1	13.6	-	13.6	16.3
Total debt and equity securities categorized as held-to-maturity, available-for-sale or trading	3.0	-	3.0	15.2	0.3	15.5	49.7	8.0	57.7	76.2
Total RRB debt and equity securities										22.7
Total debt and equity securities										98.9

By Category: Held-to-Maturity, Available-for-Sale, Trading.

Debt and Equity Securities as of September 30, 2011, and 2010

(In billions of dollars)	By Agency 2011	2010
Debt and Equity Securities:		
Pension Benefit Guaranty Corporation	47.4	49.5
Railroad Retirement Board	21.5	22.7
Exchange Stabilization Fund	15.8	12.6
Tennessee Valley Authority	8.6	8.2
All other	6.4	5.9
Total Debt and Equity Securities	99.7	98.9

These debt and equity securities do not include nonmarketable Treasury securities, which have been eliminated in consolidation. Held-to-maturity debt and equity securities are reported at amortized cost, net of unamortized discounts and premiums. Available-for-sale debt and equity securities are reported at fair value. Trading debt and equity securities are reported at fair value. The Pension Benefit Guaranty Corporation (PBGC) and the TVA invest primarily in fixed maturity and equity securities, classified as trading. TVA also has a small investment in available-for-sale securities. The National Railroad Retirement Investment Trust (NRRIT), on behalf of the RRB, 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. As an investment company, NRRIT is subject to different accounting standards that do not require the classifications presented above. NRRIT's total debt and equity securities are presented as a separate line item. Please refer to NRRIT's financial statements for more detailed information concerning this specific investment information. The TVA balance includes $7.0 billion as of September 30, 2011, and 2010, respectively, for the Tennessee Valley Authority Retirement System (TVARS). Please refer to the individual financial statements of PBGC, NRRIT, Treasury, TVA and TVARS for more detailed information related to debt and equity securities. These agencies comprise 93.6 percent of the total reported debt and equity securities of $99.7 billion as of September 30, 2011.

Note 10. Derivatives

Derivatives are financial instruments that entities use to hedge their particular exposure to some sort of financial risk. These financial risks include interest rate risk, market price risk, credit risk, foreign exchange risk, and commodity risk. As FASAB (which determines GAAP for Federal entities) is silent on this issue, the accounting for derivative instruments are governed by FASB ASC Topic 815, *Derivatives and Hedging,* which aims to highlight to financial statement users additional disclosures on an entity's objectives in its use of derivatives and the method of accounting for such financial instruments. Derivatives are accounted for at market value in accordance with this standard. Derivatives are marked to market with changes in value reported within financial income. The hedge strategy (i.e., fair value, cashflow, or foreign currency) employed determines the financial statement impact on their statement of operations and net position. Per ASC Topic 815, the fair value of derivative instruments shall be presented on a gross basis when they are subject to master netting agreements.

PBGC uses derivatives to mitigate investment risks, enhance investment returns (derivatives are not used to leverage investment portfolios) and as a liquid and cost efficient substitute for positions in physical securities. PBGC utilizes a no hedging designation which results in the gain or loss on a derivative instrument being recognized currently in earnings. PBGC elects to net its derivative receivables and derivative payables and the related cash collateral received for its non-exchange derivative contracts subject to International Swaps and Derivatives Association, Inc. master agreements. As of September 30, 2011, PBGC had $0.1 billion of derivatives in an asset position (recorded in other assets). PBGC had $(0.02) billion of derivatives in an asset position (recorded in other assets) as of September 30, 2010, and $(0.01) billion of derivatives in a liability position (recorded in other liabilities) as of September 30, 2011, and 2010.

Other than certain derivative instruments in investment funds, TVA uses derivatives purely for hedging purposes and not for speculative purposes. The accounting for changes in fair value of these instruments depends on whether TVA uses regulatory accounting to defer the derivative gains and losses, and whether the derivative instrument qualifies for hedge accounting treatment. As of September 30, 2011, and 2010, respectively, TVA had $0.4 billion and $0.2 billion worth of derivatives in an asset position (recorded in other assets), and $2.1 billion and $1.6 billion worth of derivatives in a liability position (recorded in other liabilities).

The gain/(loss) on derivatives was $0.1 billion and $0.2 billion for PBGC and $(0.1) billion and $(0.1) billion for TVA for fiscal years 2011 and 2010, respectively.

Please refer to the individual financial statements of PBGC and TVA for more detailed information related to derivatives.

Note 11. Investments in and Liabilities to Government-Sponsored Enterprises

Fannie Mae and Freddie Mac are stockholder-owned GSEs. Congress established the GSEs to support the supply of mortgage loans. A key function is to package purchased mortgages into securities, which are subsequently sold to investors.

In the lead up to the financial crisis, increasingly difficult conditions in the housing market challenged the soundness and profitability of the GSEs, thereby undermining the entire housing market. This led Congress to pass the HERA. This Act created the FHFA, with enhanced regulatory authority over the GSEs, and provided the Secretary of the Treasury with certain authorities intended to ensure the financial stability of the GSEs, if necessary.

On September 7, 2008, FHFA placed the GSEs under conservatorship and Treasury entered into a SPSPA with each GSE. These actions were taken to preserve the GSEs' assets, ensure a sound and solvent financial condition, and mitigate systemic risks that contributed to current market instability.

The actions taken by Treasury thus far are temporary, as defined by section 1117 of HERA, and are intended to provide financial stability. The purpose of Treasury's actions is to maintain the solvency of the GSEs so they can continue to fulfill their vital roles in the home mortgage market while the Administration and Congress determine what structural changes should be made. The FHFA director may terminate the conservatorship if safe and solvent conditions can be established. Draws under the SPSPAs are designed to ensure the GSEs maintain positive net worth as a result of any net losses from operations, and also meet taxpayer dividend requirements under the SPSPAs. While this arrangement is somewhat circular in the event dividends exceed net income and draws are made to fund dividends, the SPSPAs were structured to ensure any draws result in an increased nominal investment as further discussed below. Per SFFAC No. 2, *Entity and Display*, these entities meet the criteria of "bailed out" entities. Accordingly, the Federal Government has not consolidated them into the financial statements, but included disclosure of the relationship(s) with the bailed out entities and any actual or potential material costs or liabilities in the consolidated financial statements.

Senior Preferred Stock Purchase Agreements (SPSPAs)

Under the SPSPAs, Treasury initially received from each GSE: (1) 1,000,000 shares of non-voting variable liquidation preference senior preferred stock with a liquidation preference value of $1,000 per share and (2) a non-transferable warrant for the purchase, at a nominal cost, of 79.9 percent of common stock on a fully-diluted basis. The warrants expire on September 7, 2028.

The senior preferred stock accrues dividends at 10.0 percent per year, payable quarterly. This rate will increase to 12 percent if, in any quarter, the dividends are not paid in cash, until all accrued dividends have been paid. Dividends of $15.6 billion and $12.1 billion were received during fiscal years ended September 30, 2011, and September 30, 2010, respectively. In addition, beginning on March 31, 2011, the GSEs were scheduled to begin paying Treasury a Periodic Commitment Fee (PCF) on a quarterly basis, payable in cash or via an increase to the liquidation preference. The PCF was to initially be established by Treasury on December 31, 2010, based on mutual agreement between Treasury and each GSE in consultation with the Chairman of the Federal Reserve Board, and then subsequently re-established every 5 years thereafter. This fee may be waived by Treasury for up to 1 year at a time, if warranted by adverse mortgage market conditions. Treasury waived the PCF for the calendar year 2011 given that the imposition of the PCF at that time would not fulfill its intended purpose of generating increased compensation to the American taxpayer.

These initial SPSPAs, which have no expiration date, provide that Treasury will disburse funds to the GSEs if at the end of any quarter the FHFA determines that the liabilities of either GSE exceed its assets. The maximum amount available to each GSE under this agreement was originally $100 billion and, in May 2009, the maximum was raised to $200 billion. In December 2009, Treasury amended the SPSPAs to replace the $200 billion per GSE funding commitment cap with a formulaic cap that will allow continued draws for 3 years at amounts that will automatically adjust upwards quarterly by the cumulative amount of any losses realized by either GSE and downward by the cumulative amount of any gains, but not below $200 billion, and will become fixed at the end of the 3 years. At the conclusion of the 3 year period ending December 2012, the remaining commitment will then be fully available to be drawn per the terms of the agreements (referred to hereafter as the "Adjusted Caps"). Draws against the funding commitment of the SPSPAs do not result in the issuance of additional shares of senior preferred stock; instead the liquidation preference of the initial 1,000,000 shares is increased by the amount of the draw.

Actual payments to the GSEs for fiscal years ended September 30, 2011, and 2010, were $20.8 billion and $52.6 billion, respectively. Additionally, $316.2 billion and $359.9 billion were accrued as a contingent liability as of September 30, 2011, and 2010, respectively. This accrued contingent liability is based on the projected draws under the SPSPAs. It is undiscounted and does not take into account any of the offsetting dividends which may be received as a result of those draws.

The $316.2 billion contingent liability as of September 30, 2011, represents the total estimated future payments for the life of the agreement under the Adjusted Caps and is the most likely liability estimate. Under this scenario, the estimated ultimate payments made to the GSEs under the SPSPAs total $485.2 billion. This amount consists of the $169.0 billion of payments made through September 30, 2011, and the $316.2 billion liability as of that date. Under an “extreme case” scenario, the estimated ultimate payments made to the GSEs under the SPSPAs total $545.1 billion.

OMB issued guidance to Treasury on October 7, 2009, allowing the use of fair value accounting for non-Federal securities beginning with reporting for fiscal year 2009. As a result, the GSE investments are reported at fair value as of September 30, 2011, and 2010. Annual valuations are performed as of September 30 for the preferred stock and warrants. In accordance with SFFAS No. 7, the annual valuation is classified as usual and recurring and thus recorded as an expense or revenue to the financial statements.

Changing Regulatory Environment

On June 20, 2011, FHFA published, in the Federal Register, a final rule to clarify certain terms of conservatorship and receivership operations for the GSEs. This rule was effective July 20, 2011. The key issues addressed in the final rule are the status and priority of claims and the relationships among various classes of creditors and equity-holders under conservatorships or receiverships.

On July 21, 2010, the President signed the Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), into law, which significantly changed the regulation of the financial services industry, including the creation of new standards related to regulatory oversight of financial institutions deemed systemically important; an orderly liquidation mechanism for these institutions; and oversight of derivatives, capital requirements, asset-backed securitization, mortgage underwriting, and consumer financial protection. The Dodd-Frank Act may result in the GSEs being subjected to new and additional regulatory oversight and standards, which would lead to increased restrictions on their day-to-day business and operations. Also, it contains a provision requiring the Secretary of the Treasury to conduct a study and develop recommendations regarding the options for ending the conservatorship. On February 11, 2011, the President delivered to Congress a report from the Secretary that provided recommendations regarding the options for ending the conservatorship and plans to wind down the GSEs. To date, Congress has not approved a plan to address what will be done with the GSEs.

As of September 30, 2011, and 2010, GSE investments consisted of the following:

Investments in GSE as of September 30, 2011

(In billions of dollars)	Gross Investments as of 9/30/11	Cumulative Valuation (Loss)	9/30/11 Fair Value
Fannie Mae Senior Preferred Stock	104.5	(26.7)	77.8
Freddie Mac Senior Preferred Stock	66.0	(12.4)	53.6
Fannie Mae Warrants Common Stock	3.1	(2.1)	1.0
Freddie Mac Warrants Common Stock	2.3	(1.7)	0.6
Total GSE Investment	175.9	(42.9)	133.0

Investments in GSE as of September 30, 2010

(In billions of dollars)	Gross Investments as of 9/30/10	Cumulative Valuation (Loss)	9/30/10 Fair Value
Fannie Mae Senior Preferred Stock	85.9	(29.4)	56.5
Freddie Mac Senior Preferred Stock	63.9	(12.7)	51.2
Fannie Mae Warrants Common Stock	3.1	(2.1)	1.0
Freddie Mac Warrants Common Stock	2.3	(1.8)	0.5
Total GSE Investment	155.2	(46.0)	109.2

Note 12. Other Assets

Other Assets as of September 30, 2011, and 2010

(In billions of dollars)	2011	2010
Advances and prepayments	112.9	90.8
FDIC Receivable from Resolution Activity	29.3	49.7
NCUA Loans	-	10.1
Regulatory assets	19.7	15.2
Other	17.4	17.5
Total other assets	179.3	183.3

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

The FDIC has the responsibility for resolving failed institutions in an orderly and efficient manner. The resolution process involves valuing a failing institution, marketing it, soliciting and accepting bid for the sale of the institution, determining which bid is least costly to the insurance fund, and working with the acquiring institution through the closing process. FDIC records receivables for resolutions that include payments by the Deposit Insurance Fund to cover obligations to insured depositors, advances to receiverships and conservatorships for working capital, and administrative expenses paid on behalf of receiverships and conservatorships.

The National Credit Union Administration (NCUA) provides a variety of loans as a liquidity lender to credit unions experiencing unusual or unexpected liquidity shortfalls. These loans can be either short or long term. NCUA also provides loans to stimulate economic development in low-income communities.

With regard to regulatory assets, the DOE's Power Marketing Authorities (PMAs) and the TVA record certain amounts as assets in accordance with FASB ASC Topic 980, *Regulated Operations*. The provisions of FASB ASC Topic 980 require that regulated enterprises reflect rate actions of the regulator in their financial statements, when appropriate. These rate actions can provide reasonable assurance of the existence of an asset, reduce or eliminate the value of an asset, or impose a liability on a regulated enterprise. In order to defer incurred costs under FASB ASC Topic 980, a regulated entity must have the statutory authority to establish rates that recover all costs, and those rates must be charged to and collected from customers. If the PMAs' or TVA's rates should become market-based, FASB ASC Topic 980 would no longer be applicable, and all of the deferred costs under that standard would be expensed.

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

Note 13. Accounts Payable

Accounts Payable as of September 30, 2011, and 2010

(In billions of dollars)	2011	2010
Department of Defense	26.1	31.1
Department of the Treasury	4.8	5.4
Department of Education	4.2	4.8
Department of Homeland Security	2.9	2.6
General Services Administration	2.7	2.4
Department of Justice	2.5	2.5
Tennessee Valley Authority	2.4	2.4
Department of State	1.9	1.8
Department of Energy	1.8	2.0
Agency for International Development	1.7	2.1
U.S. Postal Service	1.7	1.9
National Aeronautics and Space Administration	1.4	1.3
Department of Housing and Urban Development	1.4	1.0
Department of Transportation	1.2	0.7
Department of Veterans Affairs	1.1	5.0
All other	5.6	5.9
Total accounts payable	63.4	72.9

Accounts payable includes amounts due for goods and property ordered and received, services rendered by other than Federal employees, accounts payable for cancelled appropriations, and non-debt related interest payable.

Note 14. Federal Debt Securities Held by the Public and Accrued Interest

Federal Debt Securities Held by the Public and Accrued Interest

(In billions of dollars)	Balance September 30, 2010	Net Change During Fiscal Year 2011	Balance September 30, 2011	Average Interest Rate 2011	Average Interest Rate 2010
Treasury securities (public):					
Marketable securities:					
Treasury bills	1,783.7	(308.1)	1,475.6	0.1%	0.2%
Treasury notes	5,252.6	1,154.4	6,407.0	2.3%	2.6%
Treasury bonds	846.0	170.4	1,016.4	5.8%	6.1%
Treasury inflation-protected securities (TIPS)	593.6	111.7	705.3	1.9%	2.2%
Total marketable Treasury securities	8,475.9	1,128.4	9,604.3		
Nonmarketable securities	546.9	(24.2)	522.7	2.8%	2.8%
Net unamortized premiums/ (discounts)	(33.9)	4.4	(29.5)		
Total Treasury securities, net (public)	8,988.9	1,108.6	10,097.5		
Agency securities:					
Tennessee Valley Authority	23.4	1.0	24.4		
All other agencies	0.3	-	0.3		
Total agency securities, net of unamortized premiums and discounts	23.7	1.0	24.7		
Accrued interest payable	47.4	4.5	51.9		
Total Federal debt securities held by the public and accrued interest	9,060.0	1,114.1	10,174.1		

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

Federal debt securities held by the public outside the Government are held by individuals, corporations, State or local governments, FRBs, foreign governments, and central banks. The above table details Government borrowing primarily to finance operations and shows marketable and nonmarketable securities at face value less net unamortized discounts including accrued interest.

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

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

Section 3111 of Title 31, United States Code (U.S.C.) authorizes the Secretary of the Treasury to use money received from the sale of an obligation and other money in the General Fund of the Treasury to buy, redeem, or refund, at or before maturity, outstanding bonds, notes, certificates of indebtedness, Treasury bills, or savings certificates of the Government. There were no buyback operations in fiscal years 2011 and 2010.

Gross Federal debt (with some adjustments) is subject to a statutory ceiling (i.e., the debt limit). Prior to 1917, the Congress approved each debt issuance. In 1917, to facilitate planning in World War I, Congress established a dollar ceiling for Federal borrowing. On December 28, 2009, Public Law 111-123 was enacted, which increased the statutory debt limit to $12,394.0 billion. On February 12, 2010, Public Law 111-139 was enacted, which increased the statutory debt limit to $14,294.0 billion. On August 2, 2011, Public Law 112-25 was enacted, which increased the statutory debt limit to $14,694.0 billion on August 2, 2011, and to $15,194.0 billion on September 22, 2011. Public Law 112-25 also established procedures to further increase the statutory debt limit. Prior to the enactment of Public Law 112-25, Treasury faced a period that required it to depart from its normal debt management procedures and to invoke legal authorities to avoid exceeding the statutory debt limit. As of September 30, 2011, and 2010, debt subject to the statutory debt limit was $14,746.6 billion and $13,510.8 billion, respectively. 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 following table).

Intragovernmental Debt Holdings: Federal Debt Securities Held as Investments by Government Accounts as of September 30, 2011, and 2010

(In billions of dollars)	Balance 2010	Net Change During Fiscal Year 2011	Balance 2011
Social Security Administration, Federal Old-Age and Survivors Insurance Trust Fund	2,399.1	93.4	2,492.5
Office of Personnel Management, Civil Service Retirement and Disability Fund	780.4	23.4	803.8
Department of Defense, Military Retirement Fund	282.0	44.0	326.0
Department of Health and Human Services, Federal Hospital Insurance Trust Fund	279.5	(33.6)	245.9
Social Security Administration, Federal Disability Insurance Trust Fund	187.2	(25.2)	162.0
Department of Defense, Medicare-Eligible Retiree Health Care Fund	142.3	19.4	161.7
Department of Health and Human Services, Federal Supplementary Medical Insurance Trust Fund	71.0	(0.6)	70.4
Department of Energy, Nuclear Waste Disposal	47.6	1.0	48.6
Federal Deposit Insurance Corporation Funds	47.0	(1.4)	45.6
Office of Personnel Management, Postal Service Retiree Health Benefits Fund	42.1	1.6	43.7
Office of Personnel Management, Employees Life Insurance	37.6	2.1	39.7
Department of the Treasury, Exchange Stabilization Fund	20.4	2.3	22.7
Pension Benefit Guaranty Corporation Fund	19.9	1.1	21.0
Office of Personnel Management, Employees Health Benefits Fund	16.2	3.0	19.2
Department of State, Foreign Service Retirement and Disability Fund	15.9	0.5	16.4
Department of Transportation, Highway Trust Fund	24.5	(8.2)	16.3
Department of Labor, Unemployment Trust Fund	18.7	(2.7)	16.0
National Credit Union Share Insurance Fund	9.3	1.4	10.7
All other programs and funds	97.6	3.5	101.1
Subtotal	4,538.3	125.0	4,663.3
Unamortized net (discounts)/premiums	38.4	9.2	47.6
Total intragovernmental debt holdings, net	4,576.7	134.2	4,710.9

Intragovernmental debt holdings represent the portion of the gross Federal debt held as investments by Government entities such as trust funds, revolving funds, and special funds. This includes trust funds that are earmarked funds. For more information on earmarked funds, see Note 24─Earmarked Funds. These intragovernmental debt holdings are eliminated in the consolidation of these financial statements.

Note 15. Federal Employee and Veteran Benefits Payable

Federal Employee and Veteran Benefits Payable as of September 30, 2011, and 2010

(In billions of dollars)	Civilian 2011	Civilian 2010	Military 2011	Military 2010	Total 2011	Total 2010
Pension and accrued benefits	1,619.7	1,632.9	1,361.3	1,262.7	2,981.0	2,895.6
Post-retirement health and accrued benefits	342.5	355.5	842.3	904.7	1,184.8	1,260.2
Veterans compensation and burial benefits	N/A	N/A	1,533.7	1,474.8	1,533.7	1,474.8
Life insurance and accrued benefits	44.6	44.0	11.1	11.7	55.7	55.7
FECA benefits	24.2	21.8	8.3	8.3	32.5	30.1
Liability for other benefits	1.6	0.4	2.9	3.5	4.5	3.9
Total Federal employee and veteran benefits payable	2,032.6	2,054.6	3,759.6	3,665.7	5,792.2	5,720.3

Change in Pension and Accrued Benefits

(In billions of dollars)	Civilian 2011	Civilian 2010	Military 2011	Military 2010	Total 2011	Total 2010
Actuarial accrued pension liability, beginning of fiscal year	1,632.9	1,529.4	1,262.7	1,177.1	2,895.6	2,706.5
Pension Expense:						
Expected normal costs	36.8	31.8	24.9	24.0	61.7	55.8
Interest on pension liability during the period	78.3	93.4	62.6	67.0	140.9	160.4
Prior (or past) service cost from the initiation of a new plan	-	0.1	-	-	-	0.1
Actuarial (gains)/losses (from experience)	(70.6)	(39.8)	0.1	(21.6)	(70.5)	(61.4)
Actuarial (gains)/losses (from assumption changes)	15.9	90.5	62.0	66.6	77.9	157.1
Total pension expense	60.4	176.0	149.6	136.0	210.0	312.0
Less benefits paid	73.6	72.5	51.0	50.4	124.6	122.9
Actuarial accrued pension liability, end of fiscal year	1,619.7	1,632.9	1,361.3	1,262.7	2,981.0	2,895.6

Change in Post-Retirement Health and Accrued Benefits

(In billions of dollars)	Civilian		Military		Total	
	2011	2010	2011	2010	2011	2010
Actuarial accrued post-retirement health benefits liability, beginning of fiscal year	355.5	352.2	904.7	825.8	1,260.2	1,178.0
Post-Retirement Health Benefits Expense:						
Prior (and past) service costs from plan amendments	-	(0.1)	(15.9)	-	(15.9)	(0.1)
Normal costs	14.5	13.4	24.0	21.4	38.5	34.8
Interest on liability	17.8	21.7	45.8	48.0	63.6	69.7
Actuarial (gains)/losses (from experience)	(17.9)	(18.2)	(1.1)	154.7	(19.0)	136.5
Actuarial (gains)/losses (from assumption changes)	(13.8)	(0.1)	(94.0)	(125.4)	(107.8)	(125.5)
Total post-retirement health benefits expense	0.6	16.7	(41.2)	98.7	(40.6)	115.4
Less claims paid	13.6	13.4	21.2	19.8	34.8	33.2
Actuarial accrued post-retirement health benefits liability, end of fiscal year	342.5	355.5	842.3	904.7	1,184.8	1,260.2

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

OPM administers the largest civilian plan. DOD administers the largest military plan. Other significant pension plans with more than $10 billion in accrued benefits payable include those of the Coast Guard (DHS) and Foreign Service (Department of State).

Change in Civilian Life Insurance and Accrued Benefits

(In billions of dollars)	2011	2010
Actuarial accrued life insurance benefits liability, beginning of fiscal year	44.0	39.7
Life Insurance Benefits Expense:		
New entrant expense	0.4	0.3
Interest on liability	2.1	2.4
Actuarial (gains)/losses (from experience)	(0.5)	(0.4)
Actuarial (gains)/losses (from assumption changes)	(0.9)	2.5
Total life insurance benefits expense	1.1	4.8
Less costs paid	0.5	0.5
Actuarial accrued life insurance benefits liability, end of fiscal year	44.6	44.0

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

	Civilian				Military	
	2011		2010		2011	2010
	FERS	CSRS	FERS	CSRS		
Rate of interest	4.90%	4.60%	5.10%	4.80%	4.80%	5.00%
Rate of inflation	2.40%	2.40%	2.50%	2.50%	2.50%	2.40%
Projected salary increases	3.10%	3.10%	3.50%	3.50%	3.30%	3.60%

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

	Civilian		Military	
	2011	2010	2011	2010
Rate of interest	4.90%	5.10%	4.90%	5.00%
Single equivalent medical trend rate	-	-	5.20%	5.80%
Ultimate medical trend rate	4.35%	4.40%	5.25%	5.65%

Significant Long-Term Economic Assumptions Used in Determining Life Insurance Benefits and the Related Expense

	Civilian	
	2011	2010
Rate of interest	4.80%	4.90%
Rate of increase in salary	3.10%	3.50%

In fiscal year 2010, agencies implemented SFFAS No. 33, *Pension, Other Retirement Benefits, and Other Postemployment Benefits*: *Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates*. The standard requires the separate presentation of gains and losses from changes in long-term assumptions used to estimate liabilities associated with pensions, ORB, and OPEB on the Statement of Net Cost. SFFAS No. 33 also provides a standard for selecting the discount rate assumption for present value estimates of Federal employee pension, ORB, and OPEB liabilities. In addition, SFFAS No. 33 provides a standard for selecting the valuation date for estimates of Federal employee pension, ORB, and OPEB liabilities that will establish a consistent method for such measurements.

DOD's long-term ultimate medical trend rate for post-retirement health benefits liability is 5.25 percent for fiscal year 2011 and 5.65 percent for fiscal year 2010. For disclosure and comparison purposes, DOD's estimate of a single equivalent medical trend rate for fiscal year 2011 is 5.2 percent and for fiscal year 2010 is 5.8 percent, which is an approximation of the single equivalent rate that would produce that same actuarial liability as the actual rates used. Please refer to the individual financial statements of DOD for further details regarding Military Retirement Health Benefits-Medical Trend.

Civilian Employees

Pensions

OPM administers the largest civilian pension plan, which covers substantially all full-time, permanent civilian Federal 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 24—Earmarked Funds.

The Federal Retirement Thrift Investment Board administers the Thrift Savings Plan (TSP) Fund. The TSP Fund investment options include two fixed income funds (the G and F Funds), three stock funds (the C, S, and I Funds) and five lifecycle funds (L 2050, L 2040, L 2030, L 2020, and L Income). The L Funds diversify participant accounts among the G, F, C, S, and I Funds, using professionally determined investment mixes (allocations) that are tailored to different time horizons. Treasury securities held in the G Fund are included in Federal debt securities held by the public and accrued interest in the Balance Sheets. The G Fund held $139.3 billion and $123.6 billion in non-marketable Treasury securities as of September 30, 2011, and 2010, respectively.

Post-Retirement 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 insurance premiums under the Federal Employees Health Benefits Program (FEHB), these premiums cover only a portion of the costs. The OPM actuary applies economic assumptions to historical cost information to estimate the liability.

Life Insurance Benefits

One of the largest other employee benefits is the Federal Employee Group Life Insurance (FEGLI) 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 on behalf of, existing FEGLI participants. The OPM actuary uses interest rate, inflation, and salary increase assumptions that are consistent with the pension liability.

Workers' Compensation Benefits

The DOL determines both civilian and military agencies' liabilities for future workers' compensation benefits for civilian Federal employees, as mandated by the Federal Employees' Compensation Act (FECA), for death, disability, medical, and miscellaneous costs for approved compensation cases, and a component for incurred, but not reported, claims. The FECA liability is determined annually using historical benefit payment patterns related to injury years to predict the ultimate payments. These estimated payments have been discounted to present value using OMB's interest rate assumptions for 10-year U.S. Treasury notes. For 2011, a 3.54 percent interest rate was assumed in year one and 4.03 percent was assumed for year two and thereafter.

The DOL calculates the FECA liability using wage inflation factors cost of living adjustments or (COLA) and medical inflation factors (Consumer Price Index–Medical or (CPIM)). The table below reflects the compensation COLAs and CPIMs used in the estimations for various charge-back years.

Fiscal Year	COLA	CPIM
2012	2.10%	3.07%
2013	2.53%	3.62%
2014	1.83%	3.66%
2015	1.93%	3.73%
2016+	2.00%	3.73%

Military Employees (Including Veterans)

Pensions

The DOD Military Retirement Fund (MRF) finances military retirement and survivor benefit programs. The increase in the Military Retirement Pension liability is due to additional benefit accruals (normal cost), interest on the pension liability, assumption and benefit changes, and actuarial experience. Liabilities in the future will depend on expected changes due to interest and benefit accruals, future benefit changes, assumption changes, and actuarial experience.

This Fund receives income from three sources: monthly normal cost payments from the Services to pay for the current years' service cost; annual payments from Treasury to amortize the unfunded liability and pay for the increase in the normal cost attributable to Concurrent Receipt per Public Law 108-136; and investment income.

The military retirement system consists of a funded, noncontributory, defined benefit plan. It applies to military personnel (Departments of Army, Navy, Air Force, and the Marine Corps). This system includes nondisability retirement pay, disability retirement pay, and survivor annuity programs. Military personnel who remain on active duty for 20 years or longer are eligible for retirement. There are three different retirement benefit formulas that are currently being used by the military: Final Pay, High-3 Year Average, and Career Status Bonus/Military Retirement Reform Act of 1986 (REDUX). The date an individual enters the military determines which retirement system they would fall under and if they have the option to pick their retirement system. For more information on these benefits, see DOD's Websites http://www.dfas.mil/retiredmilitary/plan/estimate/csbredux.html.

Post-Retirement Health Benefits

Military retirees and their dependents are entitled to health care in military medical facilities if a facility can provide the needed care. Prior to becoming Medicare eligible, military retirees and their dependents also are entitled to participate in TRICARE, which reimburses (net of beneficiary copay and deductible requirements) for the cost of health care from civilian providers. TRICARE options are available in indemnity, preferred provider organization (PPO), and health maintenance organization (HMO) designs.

Since fiscal year 2002, TRICARE, as second payer to Medicare, covers military retirees and their dependents after they become Medicare eligible. This TRICARE coverage for Medicare eligible beneficiaries requires that the beneficiary enroll in Medicare Part B and is referred to as TRICARE for Life (TFL). Health care under TFL can be obtained from military medical facilities on an "as available" basis or from civilian providers. Military retiree health care actuarial liability figures include costs incurred in military medical facilities, as well as claims paid to civilian providers and certain administrative costs. Costs paid to civilian providers are net of Medicare's portion of the cost.

Chapter 56 of Title 10, U.S.C. created the DOD Medicare-Eligible Retiree Health Care Fund, which became operative on October 1, 2002. The purpose of this fund is to account for the health benefits of Medicare-eligible military retirees, their dependents, and survivors who are Medicare eligible. The Fund receives contributions from the Uniformed Services and Treasury, as well as interest earnings on its investments and pays costs incurred in military medical facilities, as well as claims for care provided by civilian providers under TFL, administration costs associated with processing the TFL claims, and capitated payments for coverage provided by U.S. Family Health Plans.

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. Accordingly, VA recognizes the medical care expenses in the period the medical care services are provided. For the fiscal years 2009 through 2011, the average medical care cost per year was $37.0 billion.

Veterans Compensation and Burial Benefits

The Government compensates disabled veterans and their survivors. Veterans compensation is payable as a disability benefit or a survivor's benefit. Entitlement to compensation depends on the veteran's disabilities having been incurred in, or aggravated during, active military service; death while on duty; or death resulting from service-connected disabilities, if not on 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 veterans' compensation and burial benefits payable increased by $58.9 billion in fiscal year 2011, and increased by $157.3 billion in fiscal year 2010.

The net cost of Veterans Compensation and Burial benefits is $58.9 billion and $223.8 billion for fiscal years 2011 and 2010, respectively. The fiscal year 2010 net cost of $223.8 billion does not include the $(66.5) billion cumulative effect of changes in accounting principle from adopting SFFAS No. 33 in fiscal year 2010.

Several significant actuarial assumptions were used in the valuation of compensation, pension, and burial benefits to calculate the present value of the liability. A liability was recognized for the projected benefit payments to: (1) those beneficiaries, including veterans and survivors, currently receiving benefit payments; (2) current Veterans who will in the future become beneficiaries of the compensation and pension programs; and (3) a proportional share of those in active military service as of the valuation date who will become veterans in the Future.

The Veterans Compensation and Burial benefits liability is a valuation of a long period of estimated cashflows. As a result, changes in economic assumptions can have a dramatic effect on the liability. If those changes to economic assumptions are in different directions from one period to the next, the changes to net cost from period to period are more pronounced as demonstrated over the past several years.

Change in Veterans Compensation and Burial Benefits

(In billions of dollars)	Compensation 2011	Compensation 2010	Burial 2011	Burial 2010	Total 2011	Total 2010
Actuarial accrued liability beginning of fiscal year	1,470.5	1,313.9	4.3	3.6	1,474.8	1,317.5
Prior period adjustments (not restated)	-	(66.4)	-	(0.1)	-	(66.5)
Actuarial accrued liability, beginning of fiscal year, as adjusted	1,470.5	1,247.5	4.3	3.5	1,474.8	1,251.0
Current Year Expense:						
Actuarial (gain)/losses (from experience)	-	122.4	-	-	-	122.4
Actuarial (gain)/losses (from assumption changes)	58.7	100.6	0.2	0.8	58.9	101.4
Total current year expense	58.7	223.0	0.2	0.8	58.9	223.8
Actuarial accrued liability end of fiscal year	1,529.2	1,470.5	4.5	1,533.7	1,533.7	1,474.8

Significant Economic Assumptions Used in Determining Veterans Compensation and Burial Benefits as of September 30, 2011, and 2010

	2011	2010
Rate of interest	4.53%	4.73%
Rate of inflation	2.78%	2.86%

Life Insurance Benefits

The largest veterans' life insurance programs consist of the following:

- National Service Life Insurance (NSLI) covers policyholders who served during World War II.
- Veterans' Special Life Insurance (VSLI) was established in 1951 to meet the insurance needs of veterans who served during the Korean Conflict and through the period ending January 1, 1957.
- Veterans' Reopened Insurance (VRI), which provided a 1-year reopening for insurance coverage in 1965 for those eligible to have obtained NSLI or VSLI and were disabled.

The components of veteran life insurance liability for future policy benefits are presented below.

Veterans Life Insurance Liability as of September 30, 2011, and 2010

(In billions of dollars)	2011	2010
Insurance death benefits:		
NSLI	6.2	6.8
VSLI	1.5	1.6
VRI	0.2	0.3
Other	0.6	0.5
Total death benefits	8.5	9.2
Death benefit annuities	0.1	0.1
Disability income and waiver	0.7	0.6
Insurance dividends payable	1.7	1.7
Unearned premiums	0.1	0.1
Total veterans life insurance liability	11.1	11.7

Insurance dividends payable consists of dividends left on a deposit with VA, related interest payable, and dividends payable to policyholders.

The VA supervises Servicemembers Group Life Insurance and Veterans Group Life Insurance programs that provide life insurance coverage to members of the uniformed armed services and veterans who served during the Vietnam era or thereafter. 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 non-exchange transaction and is not required to be recorded on the Balance Sheet. The projected amounts of future payments for pension benefits (presented for informational purposes only) as of September 30, 2011, and 2010, were $89.2 billion and $80.8 billion, respectively.

Note 16. Environmental and Disposal Liabilities

Environmental and Disposal Liabilities as of September 30, 2011, and 2010

(In billions of dollars)	2011	2010
Department of Energy:		
Environmental and Disposal Liabilities	250.6	250.2
Department of Defense:		
Environmental Restoration	29.4	27.9
Disposal of Weapon Systems Program	24.9	24.3
Environmental Corrective Other	5.7	5.4
Base Realignment and Closure	4.8	5.3
Total Department of Defense	64.8	62.9
All other agencies	8.7	8.2
Total environmental and disposal liabilities	324.1	321.3

During World War II and the Cold War, DOE (or predecessor agencies) developed a massive industrial complex to research, produce, and test nuclear weapons. This included nuclear reactors, chemical-processing buildings, metal machining plants, laboratories, and maintenance facilities that manufactured tens of thousands of nuclear warheads and conducted more than one thousand nuclear tests.

At all 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 buildings and large volumes of waste and special nuclear materials requiring treatment, stabilization, and disposal.

Estimated cleanup costs at sites for which there are no current feasible remediation approaches, such as the Nevada nuclear test site, are excluded from the estimates, although applicable stewardship and monitoring costs for these sites are included. The cost estimate would be higher if some remediation were assumed for these areas; however, because DOE has not identified effective remedial technologies for these sites, no basis for estimating costs is available.

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

DOE's environmental liability estimates are dependent on annual funding levels and achievement of work as scheduled. Congressional appropriations at lower than anticipated levels or unplanned delays in project completion would cause increases in life-cycle costs.

DOE is also required to recognize closure and post-closure costs for its active and surplus facilities and environmental corrective action costs for current operations. The cleanup cost associated with active and surplus facilities that is allocated to operating periods beyond the balance sheet date is identified as the unrecognized portion. For facilities newly contaminated since fiscal year 1997, cleanup costs allocated to future periods and not included in the liability amounted to $920.0 million and $608.0 million for fiscal years 2011 and 2010, respectively. The unrecognized portion of the cleanup cost is recognized over a predetermined period of time.

Please refer to the financial statements of the DOE for significant detailed information regarding DOE's environmental and disposal liabilities, including cleanup costs.

DOD follows the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA), Superfund Amendments and Reauthorization Act, Resource Conservation and Recovery Act (RCRA) and other applicable Federal or State laws to clean up contamination. The CERCLA and RCRA require the DOD to clean up contamination in coordination with regulatory agencies, current owners of property damaged by the Department, and third parties that have a partial responsibility for the environmental restoration. Failure to comply with agreements and legal mandates puts the DOD at risk of incurring fines and penalties.

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 non-range unexploded ordinance cleanup.

DOD uses engineering estimates and independently validated models to estimate environmental costs. The engineering estimates are used after obtaining extensive data during the remedial investigation/feasibility phase of the environmental project.

DOD expenses associated environmental costs systematically over the life of the asset using two methods: physical capacity for operating landfills and life expectancy in years for all other assets. The Department expenses the full cost to clean up contamination for stewardship property, plant, and equipment at the time the asset is placed into service. DOD has expensed the costs for cleanup associated with general property, plant, and equipment placed into service before October 1, 1997, except for costs intended to be recovered through user charges; for those costs, DOD has expensed cleanup costs associated with that portion of the asset life that has passed since it was placed into service. DOD systematically recognizes the remaining cost over the remaining life of the asset. The unrecognized portion of the cleanup cost associated with general property, plant, and equipment is $2.9 billion and $2.9 billion for fiscal years 2011 and 2010, respectively. Not all components of DOD are able to compile the necessary information for this disclosure, thus the amount reported may not accurately reflect DOD's total unrecognized costs associated with general property, plant, and equipment. DOD is implementing procedures to address these deficiencies.

DOD is unable to estimate and report a liability for environmental restoration and corrective action for buried chemical munitions and agents, because the extent of the buried chemical munitions and agents is unknown at this time. DOD is also unable to provide a complete estimate for the Formerly Utilized Sites Remedial Action Program. DOD has ongoing studies and will update its estimate as additional liabilities are identified. DOD has the potential to incur costs for restoration initiatives in conjunction with returning overseas Defense facilities to host nations. However, DOD is unable to provide a reasonable estimate at this time because the extent of required restoration is unknown.

Please refer to the financial statements of the DOD for further detailed information regarding DOD's environmental and disposal liabilities, including cleanup costs.

Note 17. Benefits Due and Payable

Benefits Due and Payable as of September 30, 2011, and 2010

(In billions of dollars)	2011	2010
Federal Old-Age and Survivors Insurance	53.1	51.7
Federal Hospital Insurance (Medicare Part A)	28.6	21.8
Grants to States for Medicaid	26.1	27.2
Federal Supplementary Medical Insurance (Medicare Parts B and D)	25.7	23.3
Federal Disability Insurance	23.9	23.7
Supplemental Security Income	5.2	5.4
Unemployment Insurance	3.2	6.3
All other Benefits Programs	5.2	4.9
Total Benefits Due and Payable	171.0	164.3

Benefits due and payable are amounts owed to program recipients or medical service providers as of September 30 that have not been paid. For a description of the programs, see the Unaudited Supplemental Information—Social Insurance section and Note 26—Social Insurance.

Note 18. Insurance and Guarantee Program Liabilities

Insurance and Guarantee Program Liabilities as of September 30, 2011, and 2010

(In billions of dollars)	2011	2010
Insurance and Guarantee Program Liabilities:		
Pension Benefit Guaranty Corporation—Benefit Pension Plans	93.0	90.0
Federal Deposit Insurance Corporation Funds	47.4	72.6
All other insurance and guarantee programs	21.3	13.0
Total insurance and guarantee program liabilities	161.7	175.6

PBGC insures pension benefits for 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 in general. As of September 30, 2011, and 2010, PBGC had total liabilities of $106.7 billion and $102.5 billion, and its total liabilities exceeded its total assets by $26.0 billion and $23.0 billion, respectively. In addition, as discussed in Note 22—Contingencies, PBGC reported reasonably possible contingent losses of about $250.2 billion and $190.0 billion as of September 30, 2011, and 2010, respectively.

Of the total FDIC amount as of September 30, 2011, and 2010, $7.2 billion and $21.3 billion, respectively, represents the recorded contingent liability and loss provision for institutions insured by the Deposit Insurance Fund that are likely to fail. In addition, $31.5 billion and $42.8 billion pertain to liabilities due to resolutions of failed or failing institutions and to pending depositor claims as of September 30, 2011, and 2010 respectively. Another $8.2 billion and $7.9 billion as of September 30, 2011, and 2010 respectively, pertains to the Temporary Liquidity Guarantee Program, which guarantees certain newly issued debt and certain noninterest-bearing transaction accounts in an effort to counter the system-wide crisis in the nation's financial sector. The remaining amounts represent contingent liabilities for litigation. As of September 30, 2011, and 2010, the Deposit Insurance Fund had total liabilities of $69.2 billion and $107.4 billion, respectively. As of September 30, 2011, total assets exceeded its total liabilities by $7.8 billion due to the overall improvement in the financial condition of the bank and thrift agency.

Of the $21.3 billion and $13.0 billion under all other insurance and guarantee programs as of September 30, 2011, and 2010, respectively, $10.3 billion and $4.6 billion, respectively, pertain to the USDA's Federal Crop Insurance Program. The increase in the loss ratio is due to the extreme drought in the Southwest and significant flooding along the Missouri and Mississippi rivers. The Federal Crop Insurance Program is administered by the Federal Crop Insurance Corporation, whose mission is to provide an actuarially sound risk management program to reduce agricultural producers' economic losses due to natural disasters. Also, $7.4 billion and 6.4 billion relates to the National Credit Union Administration's Temporary Corporate Credit Union Stabilization Fund as of September 30, 2011, and 2010, respectively. This Program guarantees the timely payment of principal and interest on certain unsecured debt of participating credit unions.

Note 19. Other Liabilities

Other Liabilities as of September 30, 2011, and 2010

(In billions of dollars)	2011	2010
Unearned revenue and assets held for others:		
Unearned fees for nuclear waste disposal (DOE) and other unearned revenue	64.4	74.2
Assets held on behalf of others	69.8	64.9
Subtotal	134.2	139.1
Employee-related liabilities:		
Accrued Federal employees wages and benefits	35.2	42.7
Selected DOE contractors' and D.C. employees' pension benefits	55.0	50.2
Subtotal	90.2	92.9
International monetary liabilities and gold certificates:		
Exchange Stabilization Fund	60.3	60.1
Gold Certificates (Note 2)	11.0	11.0
Subtotal	71.3	71.1
Subsidies and grants:		
Farm and other subsidies	12.5	13.2
Grant payments due to State and local governments and others	18.1	18.1
Subtotal	30.6	31.3
Miscellaneous liabilities:		
Legal and other contingencies	38.0	31.4
Bonneville Power Administration non-Federal power projects and capital lease liabilities, and disposal liabilities	13.5	9.4
Other miscellaneous	49.2	41.3
Subtotal	100.7	82.1
Total other liabilities	427.0	416.5

Other liabilities represent liabilities that are not separately identified on the Balance Sheets and are presented on a comparative basis by major category.

Unearned Revenue and Assets Held for Others

The Government recognizes a liability when it receives money in advance of providing goods and services or assumes custody of money belonging to others. The Government's unearned revenue from fees DOE has collected from utility companies for the future cost of managing the disposal of nuclear waste is about $30.0 billion and $28.0 billion as of September 30, 2011, and 2010, respectively. Other unearned revenue includes USPS income for such things as prepaid postage, outstanding money orders, and prepaid P.O. Box rentals. FDIC collected prepaid assessments from the financial institutions to address the Deposit Insurance Fund's (DIF) liquidity needs of $20.4 billion and $33.4 billion in fiscal years 2011 and 2010, respectively. Assets held on behalf of others include funds collected in advance and undelivered defense articles. The Foreign Military Sales program holds $58.6 billion and $53.9 billion as of September 30, 2011, and 2010, respectively for articles and services for future delivery to foreign governments.

Employee-Related Liabilities

This category includes amounts owed to employees at yearend and actuarial liabilities for certain non-Federal employees. Actuarial liabilities for Federal employees and veteran benefits are included in Note 15 and are reported on another line on the balance sheet. The largest liability in the employee-related liabilities category is the amount owed at the end of the fiscal year to Federal employees for wages and benefits (including accrued annual leave). In addition, DOE is liable to certain contractors such as the University of California, which operates the Lawrence Livermore National Laboratory, for contractor employee pension and postretirement benefits, which is about $30.2 billion and $28.3 billion as of September 30, 2011, and 2010, respectively. Also, the Government owed about $9.7 billion and $9.7 billion as of September 30, 2011, and 2010, respectively, for estimated future pension benefits of the District of Columbia's judges, police, firefighters, and teachers.

International Monetary Liabilities and Gold Certificates

Consistent with U.S. obligations in the IMF on orderly exchange arrangements and a stable system of exchange rates, the Secretary of the Treasury, with the approval of the President, may use the Exchange Stabilization Fund to deal in gold, foreign exchange, and other instruments of credit and securities.

Gold Certificates are issued in nondefinitive or book-entry form to the Federal Reserve banks. The Government's liability incurred by issuing the Gold Certificates, as reported on the Balance Sheet, is limited to the gold being held by the Department of the Treasury at the standard value established by law. Upon issuance of Gold Certificates to the Federal Reserve banks, the proceeds from the certificates are deposited into the operating cash of the U.S. Government. All of the Department of the Treasury's certificates issued are payable to the Federal Reserve banks.

Subsidies and Grants

The Government supports the public good through a wide variety of subsidy and grant programs in such areas as agriculture, medical and scientific research, education, and transportation. USDA programs such as the Conservation Reserve, Tobacco Transition Payment, and Direct and Counter-Cyclical Payment programs account for the majority of the subsidies due, about $8.9 billion, and $9.9 billion as of September 30, 2011, and 2010, respectively.

The Government awards hundreds of billions of dollars in grants annually. These include project grants that are competitively awarded for agency-specific projects, such as HHS grants to fund projects to "enhance the independence, productivity, integration and inclusion into the community of people with developmental disabilities." Other grants are formula grants, such as matching grants. Formula grants go to State governments for such things as education and transportation programs. These grants are paid in accordance with distribution formulas that have been provided by law or administrative regulations. Of the total liability reported for grants as of September 30, 2011, and 2010, DOT, Education, and HHS collectively owed their grantees about $15.0 billion and $14.9 billion, respectively. Refer to the financial statements and footnotes of the respective agencies for additional information.

Miscellaneous Liabilities

Some of the more significant liabilities included in this category are for (1) legal and other contingencies (see Note 22—Contingencies), (2) Bonneville Power Administration liability to pay annual budgets of several power projects for its electrical generating capacity, and (3) payables due to derivative contracts and the purchases of securities. In addition, many Federal agencies reported relatively small amounts of miscellaneous liabilities that are not otherwise classified.

Note 20. Collections and Refunds of Federal Revenue

Collections of Federal Tax Revenue for the Year Ended September 30, 2011

(In billions of dollars)	Federal Tax Revenue Collections	Tax Year to Which Collections Relate			
		2011	2010	2009	Prior Years
Individual income and tax withholdings	2,102.0	1,357.0	703.9	19.0	22.1
Corporation income taxes	242.8	165.7	62.6	1.9	12.6
Unemployment taxes	56.2	30.4	14.3	11.4	0.1
Excise taxes	75.7	56.3	19.0	0.1	0.3
Estate and gift taxes	9.1	-	6.4	0.7	2.0
Railroad retirement taxes	4.7	3.5	1.2	-	-
Fines, penalties, interest, and other revenue	5.4	5.2	0.1	0.1	-
Customs duties	29.9	29.9	-	-	-
Subtotal	2,525.8	1,648.0	807.5	33.2	37.1
Less: amounts collected for non-Federal entities	(0.9)				
Total	2,524.9				

Treasury is the Government's principal revenue-collecting agency. Collections of individual income and tax withholdings include FICA/SECA and individual income taxes. These taxes are characterized as non-exchange revenue.

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

Federal Tax Refunds Disbursed for the Year Ended September 30, 2011

(In billions of dollars)	Refunds Disbursed	Tax Year to Which Refunds Relate: 2011	2010	2009	Prior Years
Individual income and tax withholdings	344.4	1.1	302.8	26.5	14.0
Corporation income taxes	67.8	6.3	16.6	6.5	38.4
Unemployment taxes	0.1	-	0.1	-	-
Excise taxes	2.2	0.8	1.0	0.2	0.2
Estate and gift taxes	1.8	-	-	0.4	1.4
Customs duties	1.3	0.6	0.3	0.1	0.3
Total	417.6	8.8	320.8	33.7	54.3

Reconciliation of Revenue to Tax Collections for the Year Ended September 30, 2011, and 2010

(In billions of dollars)	2011	2010
Consolidated revenue per the Statements of Operations and Changes in Net Position	2,363.8	2,216.5
Tax refunds	417.6	468.9
First-time Homebuyers Tax Credit	(2.2)	(8.7)
Making work pay credit	(13.9)	(13.7)
Earned income tax credit and child tax credit imputed revenue	(78.3)	(77.4)
Other tax credits	(13.9)	(10.5)
Federal Reserve earnings	(82.5)	(75.8)
Nontax-related fines and penalties reported by agencies	(49.5)	(44.0)
Nontax-related earned revenue	(16.2)	(15.9)
Collections of Federal tax revenue	2,524.9	2,439.5

Consolidated revenue in the Statements of Operations and Changes in Net Position is presented on a modified cash basis, is net of tax refunds, and includes other nontax related revenue. First-time Homebuyer Credit, Earned Income Tax Credit and Child Tax Credit, Making work pay credit, and Other tax credits amounts (unaudited) are included in gross cost in the Statements of Net Cost as a component of Treasury. Collections of Federal tax revenue are reported on a gross cash basis. The table above reconciles total revenue to Federal tax collections.

Collections of Federal Tax Revenue for the Year Ended September 30, 2010

(In billions of dollars)	Federal Tax Revenue Collections	Tax Year to Which Collections Relate: 2010	2009	2008	Prior Years
Individual income and tax withholdings	1,988.8	1,315.9	635.9	20.2	16.8
Corporation income taxes	277.9	188.5	75.5	1.6	12.3
Unemployment taxes	45.3	24.9	11.4	8.9	0.1
Excise taxes	73.8	54.9	18.6	0.1	0.2
Estate and gift taxes	19.8	-	7.9	0.9	11.0
Railroad retirement taxes	4.6	3.5	1.1	-	-
Fines, penalties, interest, and other revenue	3.8	3.6	0.1	0.1	-
Customs duties	26.4	26.4	-	-	-
Subtotal	2,440.4	1,617.7	750.5	31.8	40.4
Less: amounts collected for non-Federal entities	(0.9)				
Total	2,439.5				

Federal Tax Refunds Disbursed for the Year Ended September 30, 2010

(In billions of dollars)	Refunds Disbursed	Tax Year to Which Refunds Relate: 2010	2009	2008	Prior Years
Individual income and tax withholdings	366.1	1.3	312.2	35.6	17.0
Corporation income taxes	98.3	2.7	16.2	16.8	62.6
Unemployment taxes	0.1	-	0.1	-	-
Excise taxes	2.2	0.6	0.9	0.3	0.4
Estate and gift taxes	0.9	-	0.2	0.4	0.3
Customs duties	1.3	0.7	0.2	0.1	0.3
Total	468.9	5.3	329.8	53.2	80.6

Note 21. Prior-Period Adjustments

Prior-Period Adjustments for the Year Ended September 30, 2011, and 2010

(In billions of dollars)	Changes to Net Position 2011	2010
Prior-Period Adjustments		
Department of Veterans Affairs	-	66.5
National Aeronautics and Space Administration	-	(3.0)
Other prior-period adjustments	-	(0.1)
Total Prior-Period Adjustments	-	63.4

For fiscal year 2011, as discussed in Note 1.V—Reclassifications, one fund previously reported as an earmarked fund was reclassified to non-earmarked funds and was recorded as a prior period adjustment. As shown in the Statement of Changes in Net Position, this reclassification had no effect on the total net position.

During fiscal year 2010, VA adopted SFFAS 33, *Pensions, Other Retirement Benefits, and Other Postemployment Benefits*: Reporting Gains and Losses from Changes in Assumptions, and Selecting Discount Rates and Valuation Dates. This resulted in a $66.5 billion reduction in the Veterans Compensation and Burial Actuarial Liabilities and an increase to VA's net position by $66.5 billion. Additionally, NASA reviewed the consumption method in relation to its business processes and operations and determined that it did not reflect NASA's business processes and operations and that the purchase method explained in SFFAS No. 3, *Accounting for Inventory and Related Property*, is the preferred method. Accordingly, NASA reduced its assets and net position by $3.0 billion.

Note 22. 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. The following table provides criteria for how Federal agencies are to account for loss contingencies, based on the likelihood of the loss and measurability.[1]

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. Report on Balance Sheet and Statement of Net Cost.	Accrue liability of the 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

[1] In addition, a third condition must be met to be a loss contingency: a past event or an exchange transaction must occur.
[2] For loss contingencies related to litigation, probable is defined as the future confirming event or events are more likely than not to occur, with the exception of pending or threatened litigation and unasserted claims. For the pending or threatened litigation and unasserted claims, the future confirming event or events are likely to occur.

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

Insurance Contingencies

At the time an insurance policy is issued, a contingency arises. The contingency is the risk of loss assumed by the insurer, that is, the risk of loss from events that may occur during the term of the policy. The Government has insurance contingencies that are reasonably possible in the amount of $267.0 billion as of September 30, 2011, and $224.2 billion as of September 30, 2010. The major programs are identified below:

- PBGC reported $250.2 billion and $190.0 billion as of September 30, 2011, and 2010, respectively, for the estimated aggregate unfunded vested benefits exposure to the PBGC for private-sector single-employer and multiemployer defined pension plans that are classified as a reasonably possible exposure to loss.
- Of the remaining $16.8 billion for 2011, FDIC reported $16.5 billion as of September 30, 2011, and $34.2 billion as of September 30, 2010, for identified additional risk in the financial services industry that could result in additional loss to the Deposit Insurance Fund should potentially vulnerable insured institutions ultimately fail. Actual losses, if any, will largely depend on future economic and market conditions.

Insurance in Force

Insurance in Force is the accumulation of policy limits for all policies issued and outstanding at a point in time. The Government has Insurance in Force in the amount of $1,408.6 billion as of September 30, 2011, and $1,394.8 billion as of September 30, 2010. These amounts represent estimated maximum exposure to insurance claims and guarantee programs. The major programs are identified below:

- The DHS reported $1,247.2 billion and $1,230.0 billion as of September 30, 2011, and 2010, respectively, for the National Flood Insurance Program (NFIP).
- The DOT reported $90.8 billion and $98.3 billion as of September 30, 2011, and 2010, respectively for the Federal Aviation Administration (FAA) Aviation Insurance Program.

Deposit Insurance

Deposit insurance covers all types of deposit accounts such as checking, NOW and savings accounts, money market deposit accounts, and certificates of deposit (CDs) received at an insured bank, savings association, or credit union. The insurance covers the balance of each depositor's account and shares, dollar-for-dollar, up to the insurance limit, including principal and any accrued interest through the date of the insured financial institution's closing. As a result, the Government has the following exposure from Federally-insured financial institutions:

- FDIC has estimated insured deposits of $6,777.0 billion as of September 30, 2011, and $5,423.0 billion as of September 30, 2010, for the Deposit Insurance Fund.
- NCUA has estimated insured shares of $782.4 billion as of September 30, 2011, and $750.9 billion as of September 30, 2010, for the National Credit Union Share Insurance Fund.

Legal Contingencies

Legal contingencies as of September 30, 2011, and 2010, are summarized in the table below:

(In billions of dollars)	2011			2010		
		Estimated Range of Loss for Certain Cases [2]			Estimated Range of Loss for Certain Cases [2]	
	Accrued Liabilities [1]	Lower End	Upper End	Accrued Liabilities [1]	Lower End	Upper End
Legal contingencies						
Probable.............	9.2	9.0	9.7	4.3	4.3	5.2
Reasonably possible		12.4	14.6		118.4	122.6

[1] Accrued liabilities are recorded and presented in the related line items of the balance sheet.
[2] Does not reflect the total range of loss; many cases assessed as reasonably possible of an unfavorable outcome did not include estimated losses that could be determined.

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

Management and legal counsel have determined that it is "probable" that some of these actions will result in a loss to the Government and the loss amounts are reasonably measurable. The estimated liabilities for these cases are $9.2 billion and $4.3 billion as of September 30, 2011, and 2010, respectively, and are included in "Other Liabilities" on the Balance Sheet. For example, DOI is subject to various claims and contingencies related to lawsuits. For cases in which payment has been deemed probable and for which the amount of potential liability has been estimated, about $4.7 billion and 0.3 billion has been accrued in the financial statements as of September 30, 2011 and 2010, respectively. The Cobell vs. Salazar lawsuit brought against the Interior Department and Treasury Department on behalf of 490,000 individual Indian trust beneficiaries for an historical accounting of their trust accounts and reform of trust management systems. On December 7, 2009, the parties announced that a $3.4 billion settlement had been reached. On December 8, 2010, the President signed into law H.R. 4783, the Claims Resolution Act of 2010, which authorized and funded the settlement. DOI has accrued the $3.4 billion in their financial statements. The settlement agreement provides for the distribution of $1.5 billion directly to individual Indians, the creation of a $1.9 billion fund to purchase highly fractioned interests in trust lands that stymie and slow the Government's management, and sets aside up to $60 million for educational scholarships for Indian children.

There are also administrative claims and legal actions pending where adverse decisions are considered by management and legal counsel as "reasonably possible" with an estimate of potential loss or a range of potential loss. The estimated potential losses for such claims and actions range from $12.4 billion to $14.6 billion as of September 30, 2011, and from $118.4 billion to $122.6 billion as of September 30, 2010.

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

- Tribal Trust Fund Cases - Numerous cases have been filed in U.S. District Court in which Native American Tribes seek a declaration that the United States has not provided the tribes with a full and complete accounting of their trust funds, and seek an order requiring the Government to provide such an accounting. It is not possible at this time to determine the likelihood of an unfavorable outcome or an estimate of the amount or range of any potential loss.
- Various parties filed administrative claims and lawsuits against the U.S. Army Corps of Engineers (USACE) as a result of Hurricane Katrina in 2005. Most of the Hurricane Katrina tort actions that have been filed are consolidated before a single judge sitting in the Eastern District of Louisiana. The court has classified the individual cases that have been consolidated into seven categories: Levee, MRGO, Insurance, Responder, Dredging Limitations, St. Rita Nursing Home, and Barge. Approximately 490,000 administrative claims related to the allegations in this consolidated action have been filed.

Environmental and Disposal Contingencies

Environmental and disposal contingencies as of September 30, 2011, and 2010, are summarized in the table below:

	2011	2011 Estimated Range of Loss for Certain Cases [2]		2010	2010 Estimated Range of Loss for Certain Cases [2]	
(In billions of dollars)	Accrued Liabilities [1]	Lower End	Upper End	Accrued Liabilities [1]	Lower End	Upper End
Environmental and disposal contingencies						
Probable	20.0	20.0	20.2	15.8	15.8	16.0
Reasonably possible		0.2	0.2		0.2	0.3

[1] Accrued liabilities are recorded and presented in the related line items of the Balance Sheet.
[2] Does not reflect the total range of loss; many cases assessed as reasonably possible of an unfavorable outcome did not include estimated losses that could be determined.

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

Management and legal counsel have determined that it is "probable" that some of these actions will result in a loss to the Government and the loss amounts are reasonably measurable. The estimated liabilities for these cases are \$20.0 billion and \$15.8 billion as of September 30, 2011, and 2010, respectively, and are included in "Other Liabilities" on the Balance Sheet. DOE is subject to Spent Nuclear Fuel litigation for damages suffered by all utilities as a result of the delay in beginning disposal of spent nuclear fuel and also damages for alleged exposures to radioactive and/or toxic substances. Significant claims for partial breach of contract and a large number of class action and/or multiple plaintiff tort suits have been filed with estimated liability amounts of \$19.1 billion and \$15.5 billion as of September 30, 2011, and 2010, respectively. However, DOE reported that several developments have made it difficult to predict the amount of the Government's likely liability, which at this time is undetermined.

Other Contingencies

DOT and HHS reported the following other contingencies:

- The Federal Highway Administration (FHWA) reimburses states for construction costs on projects related to the Federal Highway System of roads. FHWA has pre-authorized $41.4 billion and $40.2 billion to the states to establish budgets for its construction projects for fiscal years ending September 30, 2011, and 2010, respectively. Congress has not provided appropriations for these projects and no liability is accrued in the consolidated financial statements.
- Contingent liabilities have been accrued as a result of Medicaid audit and program disallowances that are currently being appealed by the States. The Medicaid amounts are $3.0 billion and $5.4 billion for fiscal years ending September 30, 2011, and 2010, respectively.

Treaties

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.

Note 23. Commitments

Long-Term Operating Leases as of September 30, 2011, and 2010

(In billions of dollars)	2011	2010
General Services Administration	26.7	26.1
U.S. Postal Service	7.3	7.8
Department of Health and Human Services	1.5	1.7
Department of State	1.4	1.3
Department of Defense	1.2	0.7
Securities and Exchange Commission	0.8	1.1
Department of Agriculture	0.8	1.0
Other Operating Leases	4.2	3.9
Total long-term operating leases	43.9	43.6

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. Undelivered orders represent the value of goods and services ordered that have not yet been received.

The Government has other commitments that may require future use of financial resources. For example, the Government has callable subscriptions in certain Multilateral Development Banks (MDBs), which are international financial institutions that finance economic and social development projects in developing countries. Callable capital stock shares in the MDBs serve as a supplemental pool of resources that may be called, and converted into ordinary paid in shares, if the MDB cannot otherwise meet certain 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. To date, there has never been a call on this capital for any of the major MDBs and none is anticipated.

Undelivered Orders and Other Commitments as of September 30, 2011, and 2010

(In billions of dollars)	2011	2010
Undelivered Orders:		
Department of Defense	315.9	348.6
Department of Education	229.2	237.5
Department of the Treasury	207.1	144.8
EOP Foreign Military Sales Program	121.4	112.4
Department of Transportation	104.7	102.1
Department of Health and Human Services	90.3	92.9
Department of Housing and Urban Development	56.9	64.8
Department of Agriculture	51.7	54.8
Department of Energy	45.7	49.2
Department of Homeland Security	36.3	37.7
Department of State	20.9	19.2
Agency for International Development	15.6	15.7
National Science Foundation	11.6	11.8
Environmental Protection Agency	10.8	11.4
Department of Justice	10.0	11.5
Export-Import Bank of the United States	9.7	5.6
All other agencies	62.1	63.8
Total undelivered orders	1,399.9	1,383.8
Other Commitments:		
Callable capital subscriptions for multilateral development banks	72.0	63.9
Fuel Purchase Obligations	8.5	7.9
Agriculture Direct Loans and Guarantees	5.9	4.8
Power Purchase Obligations	5.1	5.5
Long-term Satellite and Systems	3.2	3.9
Conservation Reserve Program	1.8	1.8
Contract Options and Negotiations	0.0	10.2
All other commitments	6.8	6.0
Total other commitments	103.3	104.0

Other Commitments and Risks

The U. S. Government has entered into agreements that could potentially require claims on Government resources in the future. For example, The Terrorism Risk Insurance Act of 2002 (TRIA or the Act) was signed into law on November 26, 2002. This law was enacted to address market disruptions resulting from terrorist attacks on September 11, 2001. On December 26, 2007, the Terrorism Risk Insurance Program Reauthorization Act of 2007 (Reauthorization Act) was enacted extending the Program through December 31, 2014. The Act helps to ensure available and affordable commercial property and casualty insurance for terrorism risk, and simultaneously allows private markets to stabilize. The Terrorism Risk Insurance Program is activated upon the certification of an "act of terrorism" by the Secretary of the Treasury in concurrence with the Secretary of State and the Attorney General. If a certified act of terrorism occurs, insurers may be eligible to receive reimbursement from the Government for insured losses above a designated deductible amount. Insured losses above this amount will be shared between insurance companies and the Government. The Act also gives Treasury authority to recoup Federal payments made under the Program through policyholder surcharges under certain circumstances and contains provisions designed to manage litigation arising from or relating to a certified act of terrorism. There were no claims under TRIA as of September 30, 2011, or September 30, 2010.

Note 24. Earmarked Funds

Earmarked Funds as of September 30, 2011 [1]

(In billions of dollars)	Federal Old-Age and Survivors Insurance Trust Fund	Military Retirement Fund	Civil Service Retirement and Disability Fund	Medicare-Eligible Retiree Health Care Fund (MERHCF)	Federal Hospital Insurance Trust Fund (Medicare Part A)	Civil Service Health Benefits Program Trust Funds
Assets:						
Cash and other monetary assets	-	-	-	-	-	-
Fund balance with Treasury	(0.6)	0.4	-	0.2	0.4	1.3
Investments in U.S. Treasury securities, net of unamortized premiums/discounts	2,492.5	368.2	803.8	185.9	245.9	62.9
Other Federal assets	26.2	3.6	10.7	1.9	37.0	1.1
Non-Federal assets	1.9	-	0.3	0.5	6.3	1.0
Total assets	2,520.0	372.2	814.8	188.5	289.6	66.3
Liabilities:						
Liabilities due and payable to beneficiaries	53.2	0.3	5.5	0.7	28.6	4.3
Other Federal liabilities	4.7	-	0.1	0.1	33.9	0.3
Other non-Federal liabilities	-	1,361.0	1,533.4	534.0	0.3	329.5
Total liabilities	57.9	1,361.3	1,539.0	534.8	62.8	334.1
Total net position	2,462.1	(989.1)	(724.2)	(346.3)	226.8	(267.8)
Total liabilities and net position	2,520.0	372.2	814.8	188.5	289.6	66.3
Change in net position:						
Beginning net position	2,370.7	(941.0)	(765.6)	(406.9)	261.8	(284.3)
Prior-period adjustment	-	-	-	-	-	-
Beginning net position, adjusted	2,370.7	(941.0)	(765.6)	(406.9)	261.8	(284.3)
Investment revenue	106.9	18.0	35.4	9.2	12.4	1.9
Individual income taxes	496.5	-	-	-	192.1	-
Unemployment and excise taxes	-	-	-	-	-	-
Other taxes and receipts	-	-	-	-	0.6	-
Miscellaneous earned revenues	-	-	-	-	-	-
Other changes in fund balance (e.g., appropriations, transfers)	81.7	87.3	31.3	21.1	16.2	10.3
Non-program expenses	-	-	-	-	-	-
Program net cost	593.7	153.4	25.3	(30.3)	256.3	(4.3)
Ending net position	2,462.1	(989.1)	(724.2)	(346.3)	226.8	(267.8)

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

Earmarked Funds as of September 30, 2011 [1]

(In billions of dollars)	Federal Disability Insurance Trust Fund	Federal Supplementary Medical Insurance Trust Fund (Medicare Parts B and D)	Exchange Stabilization Fund	All Other Earmarked Funds	Intra-Earmarked Fund Eliminations	Total Earmarked Funds
Assets:						
Cash and other monetary assets	-	-	66.7	0.4	-	67.1
Fund balance with Treasury	(0.4)	5.7	-	103.6	-	110.6
Investments in U.S. Treasury securities, net of unamortized premiums/discounts	162.0	70.4	22.7	193.4	-	4,607.7
Other Federal assets	1.8	29.3	0.1	23.0	(67.9)	66.8
Non-Federal assets	3.8	17.5	15.7	88.2	-	135.2
Total assets	167.2	122.9	105.2	408.6	(67.9)	4,987.4
Liabilities:						
Liabilities due and payable to beneficiaries	24.2	25.7	-	5.2	-	147.7
Other Federal liabilities	1.1	30.4	-	96.7	(67.9)	99.4
Other non-Federal liabilities	-	0.4	60.4	173.1	-	3,992.1
Total liabilities	25.3	56.5	60.4	275.0	(67.9)	4,239.2
Total net position	141.9	66.4	44.8	133.6	-	748.2
Total liabilities and net position	167.2	122.9	105.2	408.6	(67.9)	4,987.4
Change in net position:						
Beginning net position	166.7	53.5	43.8	148.2	-	646.9
Prior-period adjustment	-	-	-	2.0	-	2.0
Beginning net position, adjustment	166.7	53.5	43.8	150.2	-	648.9
Investment revenue	8.2	3.2	-	6.8	-	202.0
Individual income taxes	84.3	-	-	0.0	-	772.9
Unemployment and excise taxes	-	-	-	108.3	-	108.3
Other taxes and receipts	-	1.9	-	19.1	(0.7)	20.9
Miscellaneous earned revenues	-	-	-	4.9	-	4.9
Other changes in fund balance (e.g., appropriations, transfers)	10.3	225.6	-	56.7	-	540.5
Non-program expenses	-	-	-	4.8	-	4.8
Program net cost	127.6	217.8	(1.0)	207.6	(0.7)	1,545.4
Ending net position	141.9	66.4	44.8	133.6	-	748.2

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

Earmarked Funds as of September 30, 2010 [1]

(In billions of dollars)	Federal Old-Age and Survivors Insurance Trust Fund	Military Retirement Fund	Civil Service Retirement and Disability Fund	Medicare-Eligible Retiree Health Care Fund (MERHCF)	Federal Hospital Insurance Trust Fund (Medicare Part A)	Civil Service Health Benefits Program Trust Funds
Assets:						
Cash and other monetary assets	-	-	-	-	-.	-
Fund balance with Treasury	(0.4)	-	-	0.2	-.	1.1
Investments in U.S. Treasury Securities, net of unamortized premiums/discounts	2,399.1	318.6	780.4	164.4	279.5	58.4
Other Federal assets	26.7	3.1	10.1	1.8	28.5	1.3
Non-Federal assets	1.9	-	0.4	0.6	1.0	1.0
Total assets	2,427.3	321.7	790.9	167.0	309.0	61.8
Liabilities and net position:						
Liabilities due and payable to beneficiaries	51.7	4.2	5.5	0.7	21.8	4.0
Other Federal liabilities	4.9	0.1	0.1	0.1	25.2	0.4
Other non-Federal liabilities	-	1,258.4	1,550.9	573.1	0.2	341.7
Total liabilities	56.6	1,262.7	1,556.5	573.9	47.2	346.1
Total net position	2,370.7	(941.0)	(765.6)	(406.9)	261.8	(284.3)
Total liabilities and net position	2,427.3	321.7	790.9	167.0	309.0	61.8
Change in net position:						
Beginning net position	2,270.2	(898.8)	(696.0)	(361.4)	292.4	(290.8)
Prior-period adjustment	-	-	-	-	-	-
Beginning net position, adjusted	2,270.2	(898.8)	(696.0)	(361.4)	292.4	(290.8)
Investment revenue	108.4	10.4	36.4	5.3	14.2	1.8
Individual income taxes	552.8	-	-	-	183.6	-
Unemployment and excise taxes	-	-	-	-	-	-
Other taxes and receipts	-	-	-	-	0.6	-
Miscellaneous earned revenue	-	-	-	-	-	-
Other changes in fund balance (e.g., appropriations, transfers)	14.2	83.5	33.2	21.1	14.8	9.6
Non-program expenses	-	-	-	-	-	-
Program net cost	574.9	136.1	139.2	71.9	243.8	4.9
Ending net position	2,370.7	(941.0)	(765.6)	(406.9)	261.8	(284.3)

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

Earmarked Funds as of September 30, 2010 [1]

(In billions of dollars)	Federal Disability Insurance Trust Fund	Federal Supplementary Medical Insurance Trust Fund (Medicare Parts B and D)	Exchange Stabilization Fund	All Other Earmarked Funds	Intra-Earmarked Fund Eliminations	Total Earmarked Funds
Assets:						
Cash and other monetary assets	-	-	70.9	0.2	-	71.1
Fund balance with Treasury	(0.4)	2.0	-	104.2	-	106.7
Investments in U.S. Treasury Securities, net of unamortized premiums/discounts	187.2	71.0	20.4	198.5	-	4,477.5
Other Federal assets	2.2	25.6	0.1	23.7	(54.9)	68.2
Non-Federal assets	3.4	4.9	12.5	82.7	-	108.4
Total assets	192.4	103.5	103.9	409.3	(54.9)	4,831.9
Liabilities and net position:						
Liabilities due and payable to beneficiaries	24.3	23.3	-	7.9	-	143.4
Other Federal liabilities	1.4	26.4	-	86.6	(54.9)	90.3
Other non-Federal liabilities	-	0.3	60.1	166.6	-	3,951.3
Total liabilities	25.7	50.0	60.1	261.1	(54.9)	4,185.0
Total net position	166.7	53.5	43.8	148.2	-	646.9
Total liabilities and net position	192.4	103.5	103.9	409.3	(54.9)	4,831.9
Change in net position:						
Beginning net position	186.6	44.0	43.8	162.7	-	752.7
Beginning net position, adjusted	-	-	-	-	-	-
Beginning net position	186.6	44.0	43.8	162.7	-	752.7
Investment revenue	9.6	3.1	-	5.8	-	195.0
Individual income taxes	93.9	-	-	-	-	830.3
Unemployment and excise taxes	-	-	-	94.2	-	94.2
Other taxes and receipts	-	-	-	30.5	(0.5)	30.6
Miscellaneous earned revenue	-	-	-	4.5	-	4.5
Other changes in fund balance (e.g., appropriations, transfers)	(1.6)	209.7	0.1	97.5	-	482.1
Non-program expenses	-	-	-	1.5	-	1.5
Program net cost	121.8	203.3	0.1	245.5	(0.5)	1,741.0
Ending net position	166.7	53.5	43.8	148.2	-	646.9

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

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

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

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

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

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

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

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

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

Most of the earmarked fund assets are invested in intragovernmental debt holdings. The Government does not set aside assets to pay future benefits or other expenditures associated with earmarked funds. The cash receipts collected from the public for an earmarked fund are deposited in the U.S. Treasury, which uses the cash for general Government purposes. Treasury securities are issued to Federal agencies as evidence of its receipts. Treasury securities are an asset to the Federal agencies and a liability to the U.S. Treasury and, therefore, they do not represent an asset or a liability in the *Financial Report of the U.S. Government*. These securities require redemption if a fund's disbursements exceeds its receipts. Redeeming these securities will increase the Government's financing needs and require more borrowing from the public (or less repayment of debt), or will result in higher taxes than otherwise would have been needed, or less spending on other programs than otherwise would have occurred, or some combination thereof. See Note 14—Federal Debt Securities Held by the Public and Accrued Interest for further information related to the investments in Federal debt securities.

Depicted below is a description of the major earmarked funds shown in the above tables, which also includes the names of the Government agencies that administer each particular fund. For detailed information regarding these earmarked funds, please refer to the financial statements of the corresponding administering agencies. For information on the benefits due and payable liability associated with certain earmarked funds, see Note 17—Benefits Due and Payable.

Federal Old-Age and Survivors Insurance Trust Fund

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

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

Military Retirement Fund

The Military Retirement Fund, administered by DOD, 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 earnings on Treasury securities. The laws establishing the Military Retirement Fund and authorizing the depositing of amounts to the credit of the trust fund are set forth in 10 U.S.C. § 1461-1467.

Civil Service Retirement and Disability Fund

The CSRDF covers two Federal civilian retirement systems: the CSRS—for employees hired before 1984, and the FERS—for employees hired after 1983. OPM administers the CSRS and the FERS systems. The laws establishing the CSRDF and authorizing the depositing of amounts to the credit of the trust fund are set forth in 5 U.S.C. §§ 8331-8348. Funding sources include:

- Federal civilian employees' contributions.
- Agencies' contributions on behalf of employees.
- Appropriations.
- Interest earnings on Treasury securities.

Medicare-Eligible Retiree Health Care Fund

The Department of Defense Medicare-Eligible Retiree Health Care Fund, administered by the Secretary of the Treasury and established by 10 U.S.C. § 1111, finances and pays the liabilities under the DOD retiree health care programs for military retirees, their dependents and survivors who are Medicare-Eligible. 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 trust fund, payments to the fund authorized by 10 U.S.C. § 1116, and interest earned on investments authorized by 10 U.S.C. § 1117.

Federal Hospital Insurance Trust Fund (Medicare Part A)

The Federal Hospital Insurance Trust Fund, administered by HHS, 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.

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.

Civil Service Health Benefits Program Trust Funds

The Civil Service Health Benefits Program (HBP) provides health benefits to Federal employees and dependents as well as to Federal retirees, including USPS retirees, and survivor annuitants. The program is operated through two revolving trust funds. The HBP administers a wide variety of health and wellness plans including Fee-For-Service and HMO plans. Retired employees can choose to continue coverage upon separation from the Government. OPM administers the HBP.

The law establishing the first HBP trust fund, the FEHB Fund, and authorizing the depositing of amounts to the credit of the trust fund is set forth in 5 U.S.C. § 8909. The FEHB fund is funded on a "pay-as-you-go" basis and funding sources include:

- Federal civilian employees' contributions.
- Agencies' contributions on behalf of employees.
- Appropriations (for "employer" share related to retirement program annuitants).
- Interest earnings on Treasury securities.

The *Postal Accountability and Enhancement* (Postal Act of 2006) (Public Law No 109-435, Title VIII), made significant changes in the funding of retiree health benefits for employees of the USPS, including the requirement for the USPS to make scheduled payments to the second HBP trust fund, the newly-created Postal Service Retiree Health Benefits (PSRHB) Fund.

The laws establishing the PSRHB Fund and authorizing the depositing of amounts to the credit of the trust fund are set forth in 5 U.S.C. § 8909a. Public Law 109-435 requires the USPS to make scheduled payment contributions to the PSRHB Fund ranging from $5.4 billion to $5.8 billion per year from fiscal year 2007 through fiscal year 2016. Thereafter, the USPS will make annual payments in the amount of the normal cost payment. The PSRHB Fund is also funded by interest earnings on Treasury securities. However, Public Law 111-68 changed the USPS contribution for fiscal year 2009 to $1.4 billion rather than $5.4 billion. For fiscal years 2011 and 2010, the USPS contributions were $0.0 billion and $5.5 billion, respectively. Per Public Law 109-435 for fiscal years 2011 and 2010, the required USPS contributions were $5.5 billion. However, Congress extended the $5.5 billion payment due September 30, 2011, to November 18, 2011, and has subsequently extended the due date to December 16, 2011, per Public Law 112-55.

Federal Disability Insurance Trust Fund

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

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

The Federal Supplementary Medical Insurance Trust Fund, administered by HHS, finances the Supplementary Medical Insurance Program (Medicare Part B) and the Medicare Prescription Drug Benefit Program (Medicare Part D). These programs provide supplementary medical insurance for enrolled eligible participants to cover physician and outpatient services not covered by Medicare Part A and to obtain qualified prescription drug coverage, respectively. Medicare Part B financing is not based on payroll taxes; it is based on monthly premiums, income from the General Fund of the Treasury, and interest earnings on Treasury securities. The law establishing the Federal Supplementary Medical Insurance Trust Fund and authorizing the depositing of amounts to the credit of the trust fund is set forth in 42 U.S.C. § 1395t.

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

Exchange Stabilization Fund (ESF)

The Exchange Stabilization Fund may be used by the Secretary of Treasury to purchase or sell currencies, to hold U.S. foreign exchange and SDR assets, and to provide financing to foreign governments. Appropriations, U.S. SDR assets in the International Monetary Fund, investments in Treasury securities, and investments in Foreign Currency Denominated assets are the sources of revenues or financing sources to the ESF. The law establishing the ESF account and authorizing the use of its funds is section 10 of the Gold Reserve Act of 1934, as amended (31 U.S.C. § 5302).

All Other Earmarked Funds

The Government is responsible for the management of numerous earmarked funds that serve a wide variety of purposes. The earmarked funds presented on an individual basis in the preceding `table represent the majority of the Government's net position attributable to earmarked funds. All other earmarked activity is aggregated in accordance with SFFAS No. 27. For the years ending September 30, 2011, and 2010, there were approximately 630 and 621 earmarked funds, respectively. The earmarked funds within the "all other" aggregate, along with the agencies that administer them, include the following:

- Railroad Retirement Trust Fund—administered by RRB.
- National Flood Insurance Program—administered by DHS.
- Land and Water Conservation Fund, Reclamation Fund, Water and Related Resources Fund, Lower Colorado River Basin Fund, and Historic Preservation Fund—administered by DOI.
- Government National Mortgage Association (Ginnie Mae) and Recovery Act Funds—administered by HUD.
- National Telecommunications and Information Administration (NTIA) Digital Television Transition and Public Safety Fund and Broadband Technology Opportunities Program-Recovery Act Fund—administered by the Department of Commerce (DOC).
- Decommissioning and Decontamination Fund—administered by DOE.
- Black Lung Disability Trust Fund (BLDTF)—administered by DOL.
- Investor Protection Fund—administered by the Securities and Exchange Commission (SEC).
- Universal Service Fund—administered by the Federal Communication Commission (FCC).
- Crime Victims Fund—administered by DOJ.
- District of Columbia Pensions—administered by Treasury.
- Federal Employees' Life Insurance Fund—administered by OPM.
- Superfund (Hazardous Substance) and Leaking Underground Storage Tanks—administered by Environmental Protection Agency (EPA).

Unemployment Trust Fund (UTF) and Excise Taxes

In addition to the previous listed earmarked funds within the "all other" aggregate, there are 11 other earmarked funds, also within the "all other" aggregate that represent all the earmarked unemployment and excise tax revenues shown on the consolidated Statement of Operations and Changes in Net Position. The Unemployment Trust Fund represents all the earmarked unemployment tax revenues and the remaining 10 other earmarked funds represent all the earmarked excise tax revenues.

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

Employer taxes provide the primary funding source for the UTF and constitute all the earmarked unemployment tax revenues as shown on the consolidated Statement of Operations and Changes in Net Position. For the years ending September 30, 2011, and 2010, UTF unemployment tax revenues were $56.1 billion and $45.2 billion, respectively. However, interest earnings on Treasury securities also provide income to the fund. Appropriations have supplemented the fund's income during periods of high and extended unemployment. The law establishing the UTF and authorizing the depositing of amounts to the credit of the trust fund is set forth in 42 U.S.C. § 1104.

In addition, there are 10 other earmarked funds within the "all other" aggregate that represent all of the earmarked excise tax revenue shown on the consolidated Statement of Operations and Changes in Net Position. Two of these earmarked funds, the Highway Trust Fund and the Airport and Airway Trust Fund, represent more than 90 percent of the total earmarked excise tax revenues. Both of these earmarked funds are administered by the DOT and, for more detailed information regarding them, please refer to DOT's financial statements.

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. 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 excise taxes on gasoline and other fuels, certain tires, the initial sale of heavy trucks, and highway use by commercial motor vehicles. For the years ending September 30, 2011, and 2010, Highway Trust Fund excise tax revenues were $36.9 billion and $35.0 billion, respectively. As funds are needed for payments, the Highway Trust Fund corpus investments are liquidated and funds are transferred to the Federal Highway Administration, the Federal Transit Administration, or other DOT entities, for payment of obligations.

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. The law establishing the Airport and Airway Trust Fund and authorizing the depositing of amounts to the credit of the trust fund is set forth in 26 U.S.C. § 9502. Funding sources include:

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

For the years ending September 30, 2011, and 2010, Airport and Airway Trust Fund excise tax revenues were $11.5 billion and $10.6 billion, respectively. These revenue amounts do not reflect any transfers from the Highway Trust Fund to the Airport and Airway Trust Fund for fuel which was used in aviation, but which was taxed at highway rates under P.L. 109-59 Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users (SAFETEA-LU).

Miscellaneous Earned Revenues

Miscellaneous earned revenues due to earmarked funds activity primarily relate to royalties retained by various earmarked funds within DOI.

Intra-Earmarked Fund Eliminations

The intra-earmarked fund eliminations represent the activity between earmarked funds that are administered by different Federal agencies and which are eliminated to produce consolidated earmarked revenues and net costs as shown on the Statement of Operations and Changes in Net Position. Significant examples of such intra-earmarked fund activity include the financial interchanges and transactions between the Railroad Retirement Trust Fund, the Social Security Trust Funds, and the Medicare Trust Funds, which are administered by the RRB, SSA and HHS, respectively. The financial interchanges and transactions between RRB's Railroad Retirement Trust Fund, SSA's Federal Old-Age and Survivors Insurance Trust Fund and the Disability Insurance Trust Fund, and HHS' Federal Hospital Insurance Trust Fund are intended to put the latter three trust funds in the same position they would have been, had railroad employment been covered under the Social Security Act. For further information, see the Railroad Retirement program description within Note 26—Social Insurance.

Note 25. Fiduciary Activities

Fiduciary activities are the collection or receipt, and the management, protection, accounting, investment and disposition by the Government of cash or other assets in which non-Federal individuals or entities have an ownership interest that the Government must uphold. Fiduciary cash and other assets are not assets of the Government and accordingly are not recognized on the consolidated Governmentwide Balance Sheet. Examples of the Government's fiduciary activities include the Thrift Savings Plan, which is administered by the Federal Retirement Thrift Investment Board, and the Indian Tribal and individual Indian Trust Funds, which are administered by the DOI.

Schedule of Fiduciary Net Assets as of September 30, 2011, and 2010

(In billions of dollars)	2011	2010
FRTIB-Thrift Savings Plan	281.6	264.0
Department of the Interior	3.8	3.7
All other	5.8	4.9
Total fiduciary net assets	291.2	272.6

In accordance with the requirements of SFFAS No. 31, *Accounting for Fiduciary Activities,* fiduciary investments in Treasury securities and fund balance with Treasury held by fiduciary funds are to be recognized on the Governmentwide Balance Sheet as debt held by the public and as liability for fiduciary fund balance with Treasury, respectively. Refer to Note 14—Federal Debt Securities Held by the Public and Accrued Interest for more information on Treasury securities.

As of September 30, 2011, total fiduciary investments in Treasury securities and in non-Treasury securities are $143.9 billion and $145.1 billion, respectively. As of September 30, 2010, total fiduciary investments in Treasury securities and in non-Treasury securities are $127.5 billion and $143.4 billion, respectively. As of September 30, 2011, and 2010, the total fiduciary fund balance with Treasury is $1.2 billion and $0.8 billion, respectively. A liability for this fiduciary fund balance with Treasury is reflected as other miscellaneous liabilities in Note 19—Other Liabilities.

As of September 30, 2011, and 2010, collectively, the fiduciary investments in Treasury securities and fiduciary fund balance with Treasury held by all Government entities represent $4.0 billion and $2.9 billion, respectively, of unrestricted cash included within cash held by Treasury for Governmentwide Operations shown in Note 2—Cash and Other Monetary Assets.

FRTIB-Thrift Savings Plan

The TSP is administered by an independent Government agency, the Federal Retirement Thrift Investment Board (FRTIB), which is charged with operating the TSP prudently and solely in the interest of the participants and their beneficiaries. Assets of the TSP are maintained in the Thrift Savings Fund (the Plan).

The TSP is a retirement savings and investment plan for Federal employees and members of the uniformed services. It was authorized by the United States Congress in the Federal Employees' Retirement System Act of 1986 (FERSA). The Plan provides Federal employees and members of the uniformed services with a savings and tax benefit similar to what many private sector employers offer their employees. The Plan was primarily designed to be a key part of the retirement package (along with a basic annuity benefit and Social Security) for employees who are covered by the FERS.

As of September 30, 2011, and 2010, the TSP held $281.6 billion and $264.0 billion, respectively, in net assets, which included $139.3 billion and $123.6 billion, respectively, of U.S. Government Securities (amounts are unaudited). The most recent audited financial statements for the TSP are as of December 31, 2010, and 2009. As of December 31, 2010, and 2009, the TSP held $281.0 billion and $244.4 billion, respectively, in net assets, which included $124.7 billion and $114.9 billion, respectively, of U.S. Government Securities. These unaudited amounts above are included to enhance comparability of the TSP net assets with the remainder of the Government's fiduciary net assets as of September 30, 2011, and 2010.

Federal employees, who are participants of FERS, the CSRS, or equivalent retirement systems, as provided by statute, and members of the uniformed services, are eligible to join the Plan immediately upon being hired. Generally, FERS employees are those employees hired on or after January 1, 1984, while CSRS employees are employees hired before January 1, 1984, who have not elected to convert to FERS. Each group has different rules that govern contribution rates. As of December 31, 2010, and 2009, there were approximately 4.4 million and 4.3 million participants in the TSP, respectively, with approximately 2.9 million and 2.8 million, respectively, contributing their own money. For further information about FRTIB and the TSP, please refer to the FRTIB website at http://www.frtib.gov.

DOI–Indian Trust Funds

As stated above, DOI has responsibility for the assets held in trust on behalf of American Indian Tribes and individuals, and these account for all of DOI's fiduciary net assets. DOI maintains accounts for Tribal and Other Trust Funds (including the Alaska Native Escrow Fund and Individual Indian Money Trust Funds) in accordance with the American Indian Trust Fund Management Reform Act of 1994. The fiduciary balances that have accumulated in these funds have resulted from land use agreements, royalties on natural resource depletion, other proceeds derived directly from trust resources, judgment awards, settlements of claims, and investment income. These funds are maintained for the benefit of individual Native Americans as well as for designated Indian tribes. DOI maintains separate Financial Statements for these trust funds which were prepared using the cash or modified cash basis of accounting, a comprehensive basis of accounting other than GAAP. The independent auditors' reports were qualified as it was not practical to extend audit procedures sufficiently to satisfy themselves as to the fairness of the trust fund balances. For further information related to these assets, see the financial statements of the DOI.

All Other Entities with Fiduciary Activities

The Government is responsible for the management of other fiduciary net assets on behalf of various non-Federal entities. The component agencies presented individually in the table on the previous page represent the vast majority of the Government's fiduciary net assets. All other component entities with fiduciary net assets are aggregated in accordance with SFFAS No. 31. As of September 30, 2011, and 2010, including FRTIB and DOI, there are a total of 15 and 15 Federal entities, respectively, with fiduciary activities with a grand total of 58 and 58 fiduciary funds, respectively. For further information relating to the fiduciary activities of the remaining component entities within the "all other" aggregate, please refer to the financial statements for:

- Small Business Administration
- Library of Congress
- Department of the Treasury
- Department of State
- Department of Defense
- Department of Transportation
- Department of Labor
- Department of Agriculture
- Smithsonian Institution
- Department of Commerce
- National Labor Relations Board
- National Endowment for the Arts (2011 only)
- Government Accountability Office, and
- Peace Corps (2010 only).

Note 26. Social Insurance

The Statement of Social Insurance presents the projected actuarial present value of the estimated future revenue and estimated future expenditures of the Social Security, Medicare, Railroad Retirement, and Black Lung social insurance programs which are administered by the SSA, HHS, RRB, and DOL, respectively. These estimates are based on the economic and demographic assumptions presented later in this note as set forth in the relevant Social Security and Medicare trustees' reports and in the agency financial report of HHS and in the relevant agency performance and accountability reports for SSA and RRB and the annual financial report for DOL. The projections are based on the continuation of program provisions contained in current law. The estimates in the consolidated Statements of Social Insurance (SOSI) of the open group measures are for persons who are participants or eventually will participate in the programs as contributors (workers) or beneficiaries (retired workers, survivors, and disabled) during the 75-year projection period (Black Lung is projected only through September 30, 2040, because the projection period will terminate on September 30, 2040).

Contributions and earmarked taxes consist of: payroll taxes from employers, employees, and self-employed persons; revenue from Federal income taxation of Old-Age Survivors and Disability Insurance (OASDI) and railroad retirement benefits; excise tax on coal (Black Lung); and premiums from, and State transfers on behalf of, participants in Medicare. Income for all programs is presented from a consolidated perspective. Future interest payments and other future intragovernmental transfers have been excluded upon consolidation. Expenditures include scheduled benefit payments and administrative expenses. Scheduled benefits are projected based on the benefit formulas under current law. However, current Social Security and Medicare law provides for full benefit payments only to the extent that there are sufficient balances in the trust funds.

Actuarial present values of estimated future revenue (excluding interest) and estimated future expenditures for the Social Security, Medicare, and Railroad Retirement social insurance programs are presented for three different groups of participants: (1) current participants who have attained eligibility age, (2) current participants who have not attained eligibility age, and (3) future participants who are new entrants expected to become participants in the future. Current participants in the Social Security and Medicare programs form the "closed group" of taxpayers and/or beneficiaries who are at least 15 years of age at the start of the projection period. For the 2007 Medicare projections, current participants are at least 18 years of age at the beginning of the projection period. Since the projection period for the Social Security, Medicare, and Railroad Retirement social insurance programs consists of 75 years, the period covers virtually all of the current participants' working and retirement years, a period that could be greater than 75 years in a relatively small number of instances. Future participants for Social Security and Medicare include births during the projection period and individuals below age 15 (below age 18 for the Medicare programs for 2007) as of January 1 of the valuation year. Railroad Retirement's future participants are the projected new entrants as of January 1 of the valuation year.

The present values of future expenditures in excess of future revenue are 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.

The trust fund balances as of the valuation date for the respective programs, including interest earned, are in the table shown below. Substantially all of the Social Security (OASDI) and Medicare Hospital Insurance (HI), and Supplementary Medical Insurance (SMI) trust fund balances consist of investments in special non-marketable U.S. Treasury securities that are backed by the full faith and credit of the U.S. Government.

Social Insurance Programs Trust Fund Balances [1]

(In billions of dollars)	2011	2010	2009	2008	2007
Social Security	2,609	2,540	2,419	2,238	2,048
Medicare:					
HI	272	304	321	312	300
SMI Part B	71	76	59	53	38
SMI Part D	1	1	1	3	1
Railroad Retirement	26	25	22	33	32
Black Lung	(6)	(6)	(6)	(10)	(10)

[1] As of the valuation date of the respective programs.

Social Security

The Old Age and Survivors Insurance (OASI) program, created in 1935, and the Disability Insurance (DI) program, created in 1956, collectively referred to as OASDI or “Social Security,” provides cash benefits for eligible U.S. citizens and residents. Eligibility and benefit amounts are determined under the laws applicable for the period. Current law provides that the amount of the monthly benefit payments for workers, or their eligible dependents or survivors, is based on the workers’ lifetime earnings histories.

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

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

Medicare

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

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

The Medicare Prescription Drug, Improvement, and Modernization Act (MMA), enacted on December 8, 2003, created the Part D account in the SMI Trust Fund to account for the prescription drug benefit that began in 2006. The MMA established within SMI two Part D accounts related to prescription drug benefits: the Medicare Prescription Drug Account and the Transitional Assistance Account. The Medicare Prescription Drug Account was used in conjunction with the broad, voluntary prescription drug benefits that commenced in 2006. The Transitional Assistance Account was used to provide transitional assistance benefits, beginning in 2004 and extending through 2005, for certain low-income beneficiaries prior to the start of the new prescription drug benefit.

Affordable Care Act (ACA)

The Affordable Care Act improves the financial outlook for Medicare substantially; however, the effects of some of the new law's provisions on Medicare are not known at this time, with the result that the projections are very uncertain, especially in the longer-range future. For example, the ACA initiative for aggressive research and development has the potential to reduce Medicare costs in the future; however, as specific reforms have not yet been designed, tested, or evaluated, their ability to reduce costs cannot be estimated at this time, and thus no specific savings have been reflected in the projections for the initiative.

Another important example involves lower payment rate updates to most categories of Medicare providers in 2011 and later. These updates will be adjusted downward by the increase in productivity experienced in the economy overall. Since the provision of health services tends to be labor-intensive and is often customized to match an individuals' specific needs, most categories of health providers have not been able to improve their productivity to the same extent as the economy at large. Over time, the productivity adjustments mean that the prices paid for health services by Medicare will grow about 1.1 percent per year more slowly than the increase in prices that providers must pay to purchase the goods and services they use to provide health care services. Unless providers could reduce their cost per service correspondingly, through productivity improvements, or other steps, they could eventually become unwilling or unable to treat Medicare beneficiaries.

It is possible that providers can improve their productivity, reduce wasteful expenditures, and take other steps to keep their cost growth within the bounds imposed by the Medicare price limitations. Similarly, the implementation of payment and delivery system reforms, facilitated by the ACA research and development program, could help constrain cost growth to a level consistent with the lower Medicare payments. These outcomes are far from certain, however. The feasibility of such sustained improvements is debatable. Without fundamental changes in current health care delivery systems and payment mechanisms the Medicare price constraints would probably become unworkable in which case Congress would likely override them, much as they have done to prevent the reductions in physician payment rates otherwise required by the sustainable growth rate formula in current law.

The reductions in provider payments reflected in these updates, if implemented for all future years as required under current law, could have secondary impacts, for beneficiary access to care; utilization, intensity and quality of services; and other factors. These possible impacts are speculative, and at present there is not consensus among experts as to their potential scope. Further research and analysis will help to better inform this issue and may enable the development of specific projections of secondary effects under current law in the future.

Because knowledge of the potential long-range effects of the productivity adjustments, delivery and payment innovations, and certain aspects of the Affordable Care Act is so limited, in August 2010, the HHS Secretary working on behalf of the Medicare Board of Trustees, established an independent panel of technical of expert actuaries and economists to review the assumptions and methods used by the Medicare Trustees to make projections of the financial status of the trust funds. The members of the Panel were selected in October 2010 and began their deliberations in November 2010. They were asked to focus their immediate attention on the long-range Medicare expenditure growth rate assumption. In its interim report, the Panel found that the long-range Medicare growth rate assumptions used in the 2010 Medicare Trustees Report and in the 2010 Statement of Social Insurance for the current-law projections were not unreasonable in light of the provisions of the Affordable Care Act. The Panel recommended the continued use of a supplemental analysis, similar to the illustrative projection in the 2010

Medicare Trustees Report, for the purpose of illustrating the higher Medicare costs that would result if the reduction in physician payment rates and the productivity adjustments to most other provider payment updates are not fully implemented as required under current law. [1]

The Panel members noted the extreme difficulty involved in developing long-range Medicare cost growth assumptions, due to the many uncertainties that surround not only the long-term evolution of the U.S. health care system but also the system's interaction with the provisions of the Affordable Care Act. The Medicare Trustees will continue their efforts, with the assistance of the panel, to develop possible improvements to the cost growth assumptions underlying the 2010 Medicare Trustee Report.

The SOSI projections are based on current law. Therefore, the productivity adjustments are assumed to occur in all future years, as required by the Affordable Care Act. In addition, an almost 30 percent reduction in Medicare payment rates for physician services in January 2012 is assumed to be implemented as required under current law, despite the virtual certainty that Congress will continue to override this reduction. Therefore, it is important to note that the actual future costs for Medicare are likely to exceed those shown by these current-law projections.

The extent to which actual future Part A and Part B costs exceed the projected current-law amounts due to changes to the productivity adjustments and physician payments depends on both the specific changes that might be legislated and on whether Congress would pass further provisions to help offset such costs. As noted, these examples only reflect hypothetical changes to provider payment rates.

It is likely that in the coming years Congress will consider, and pass, numerous other legislative proposals affecting Medicare. Many of these will likely be designed to reduce costs in an effort to make the program more affordable. In practice, it is not possible to anticipate what actions Congress might take, either in the near term or over longer periods.

The Medicare Board of Trustees, in their annual report to Congress, references an alternative scenario to illustrate the potential understatement of costs under current law. This alternative scenario assumes that the productivity adjustments are gradually phased out over the 16 years starting in 2020 and that the physician fee reductions are overridden. These examples were developed by management for illustrative purposes only; the calculations have not been audited; and the examples do not attempt to portray likely or recommended future outcomes. Thus, the illustrations are useful only as general indicators of the substantial impacts that could result from future legislation affecting the productivity adjustments and physician payments under Medicare and of the broad range of uncertainty associated with such impacts. The table below contains a comparison of the Medicare 75-year present values of income and expenditures under current law with those under the alternative scenario illustration.

[1] The Interim Report of the Technical Panel of the Medicare Trustees Report is available at http://aspe.hhs.gov/health/medpanel/2010/interim1103.shtml

Medicare Present Values (in billions) (Unaudited)

	2011 Consolidated SOSI	Illustrative Alternative Scenario [1, 2]
Income		
Part A	$15,104	$15,104
Part B [3]	5,086	7,740
Part D [4]	2,484	2,484
Total Income	$22,674	$25,328
Expenditures		
Part A	$18,356	$23,640
Part B	18,940	28,744
Part D	9,950	9,950
Total Expenditures	$47,246	$62,334
Part A	$3,252	$8,536
Part B	13,854	21,004
Part D	7,466	7,466
Excess of Expenditures over Income	$24,572	$37,006

[1] These amounts are not presented in the 2011 Trustees' Report.
[2] At the request of the Trustees, the Office of the Actuary at CMS has prepared an illustrative set of Medicare Trust Fund projections that differ from current law. No endorsement of the illustrative alternative to current law by the Trustees, CMS, or the Office of the Actuary should be inferred.
[3] Excludes $13,854 billion and $21,004 of General Revenue Contributions from the 2011 Consolidated SOSI projection and the Illustrative Alternative Scenario's projection, respectively; i.e., to reflect Part B income on a consolidated Governmentwide basis.
[4] Excludes $7,466 billion of General Revenue Contributions from both the 2011 Consolidated SOSI projection and the Illustrative Alternative Scenario's projection, respectively; i.e., to reflect Part D income on a consolidated Governmentwide basis.

As expected, the differences between the current-law projections and the illustrative alternative are substantial for Part A and Part B. All Part A fee-for-service providers are affected by the productivity adjustments, so the current law projections reflect an estimated 1.1 percent reduction in annual Part A cost growth each year. If the productivity adjustments were gradually phased out, as illustrated under the alternative scenario, the present value of Part A expenditures is estimated to be roughly 29 percent higher than the current-law projection. As indicated above, the present value of Part A income is unchanged under the alternative scenario.

The Part B expenditure projections are significantly higher under the alternative scenario than under current law, both because of the assumed gradual phase-out of the productivity adjustments and the assumption that the scheduled physician fee reductions would be overridden and based on annual increases in the Medicare Economic Index. The productivity adjustments are assumed to affect more than half of Part B expenditures at the time their phase-out is assumed to begin. Similarly, physician fee schedule services are assumed to be roughly 30 percent higher under the alternative scenario than under current law at that time. The combined effect of these two factors results in a present value of Part B expenditures under the alternative scenario that is approximately 52 percent higher than the current-law projection.

The Part D projections are unaffected under the alternative projection because the services are not impacted by the productivity adjustments or the physician fee schedule reductions.

Social Security and Medicare–Demographic and Economic Assumptions

The Boards of Trustees [2] of the OASDI and Medicare Trust Funds provide in their annual reports to Congress short-range (10-year) and long-range (75-year) actuarial estimates of each trust fund. Because of the inherent uncertainty in estimates for 75 years into the future, the Boards use three alternative sets of economic and demographic assumptions to show a range of possibilities. Assumptions are made about many economic and demographic factors, including GDP, earnings, the CPI, the unemployment rate, the fertility rate, immigration, mortality, disability incidence and terminations and, for the Medicare projections, health care cost growth. The assumptions used for the most recent set of projections shown in Tables 1A (Social Security) and Table 1B (Medicare) are generally referred to as the "intermediate assumptions," and reflect the trustees' reasonable estimate [3] of expected future experience. For further information on Social Security and Medicare demographic and economic assumptions, refer to SSA's Performance and Accountability Report and HHS' Agency Financial Report.

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

[3] Statement of Federal Financial Accounting Standard (SFFAS) No. 33: *Pensions, Other Retirement Benefits, and Other Postemployment Benefits*: Reporting the Gains and Losses From Changes in Assumptions and Selecting Discount Rates and Valuation Dates, effective for fiscal years beginning after September 30, 2009, revised SFFAS No. 17: *Accounting for Social Insurance*, paragraphs 25, 27 (2), and 27 (4), by replacing the term "best estimate" with "reasonable estimate."

Table 1A
Social Security – Demographic and Economic Assumptions

Demographic Assumptions

Year	Total Fertility Rate [1]	Age-Sex Adjusted Death Rate [2] (per 100,000)	Net Immigration [3] (persons)	Period Life Expectancy at Birth [4]	
				Male	Female
2011	2.07	766.5	895,000	75.9	80.6
2020	2.05	707.8	1,195,000	77.1	81.4
2030	2.02	648.7	1,115,000	78.2	82.4
2040	2.00	596.6	1,070,000	79.3	83.3
2050	2.00	550.8	1,050,000	80.3	84.1
2060	2.00	510.5	1,040,000	81.3	84.9
2070	2.00	474.9	1,030,000	82.1	85.7
2080	2.00	443.2	1,030,000	82.9	86.4

Economic Assumptions

Year	Real Wage Differential [5] (percent)	Average Annual Wage in Covered Employment [6] (percent change)	CPI [7] (percent change)	Real GDP [8] (percent change)	Total Employment [9] (percent change)	Average Annual Interest Rate [10] (percent)
2011	2.9	4.1	1.2	2.7	0.7	3.1
2020	1.1	3.9	2.8	2.1	0.5	5.7
2030	1.2	4.0	2.8	2.2	0.5	5.7
2040	1.2	4.0	2.8	2.2	0.5	5.7
2050	1.2	4.0	2.8	2.2	0.5	5.7
2060	1.1	3.9	2.8	2.1	0.5	5.7
2070	1.1	3.9	2.8	2.1	0.4	5.7
2080	1.2	4.0	2.8	2.1	0.4	5.7

[1] The total fertility rate for any year is the average number of children who would be born to a woman in her lifetime if she were to experience the birth rates by age observed in, or assumed for, the selected year, and if she were to survive the entire childbearing period. The ultimate total fertility rate of 2.0 is assumed to be reached in 2035.

[2] The age-sex-adjusted death rate is the crude rate that would occur in the enumerated total population as of April 1, 2000, if that population were to experience the death rates by age and sex assumed for the selected year. The death rate is a summary measure and not a basic assumption; it summarizes the effects of the basic assumptions from which it is derived.

[3] Net immigration is the number of persons who enter during the year (both legally and otherwise) minus the number of persons who leave during the year. It is a summary measure and not a basic assumption; it summarizes the basic assumptions from which it is derived.

[4] The period life expectancy for a group of persons born in the selected 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 assumed for the given year. It is a summary measure and not a basic assumption; it summarizes the effects of the basic assumptions from which it is derived.

[5] The real-wage differential is the difference between the percentage increases, before rounding, in the average annual wage in covered employment, and the average annual CPI.

[6] The average annual wage in covered employment is the total amount of wages and salaries for all employment covered by the OASDI program in a year divided by the number of employees with any such earnings during the year. It is a summary measure and not a basic assumption; it summarizes the basic assumptions from which it is derived.

[7] The CPI is the annual average value for the calendar year of the CPI for urban wage earners and clerical workers.

[8] The real GDP is the value of total output of goods and services produced in the U.S., expressed in 2005 dollars. It is a summary measure and not a basic assumption; it summarizes the effects of the basic assumptions from which it is derived.

[9] Total employment represents the total of civilian and military employment in the U.S. economy. It is a summary measure and not a basic assumption; it summarizes the basic assumptions from which it is derived.

[10] The average annual interest rate is the average of the nominal interest rates, which, in practice, are compounded semiannually for special-issue Treasury obligations sold only to the trust funds in each of the 12 months of the year. It is a summary measure and not a basic assumption; it summarizes the basic assumptions from which it is derived.

Table 1B
Medicare – Demographic and Economic Assumptions

	Demographic Assumptions		
Year	Total Fertility Rate[1]	Age-Sex Adjusted Death Rate[2] (per 100,000)	Net Immigration[3] (persons)
2011	2.07	766.5	895,000
2020	2.05	707.8	1,195,000
2030	2.02	648.7	1,115,000
2040	2.00	596.6	1,070,000
2050	2.00	550.8	1,050,000
2060	2.00	510.5	1,040,000
2070	2.00	474.9	1,030,000
2080	2.00	443.2	1,030,000

	Economic Assumptions							
					Per Beneficiary Cost (percent change)[7]			
						SMI		
Year	Real Wage Differential[4] (percent)	Average Annual Wage in Covered Employment (percent change)	CPI[5] (percent change)	Real GDP[6] (percent change)	HI	Part B	Part D	Real Interest Rate[8] (percent)
2011	2.9	4.1	1.2	2.7	2.3	3.7	3.1	1.5
2020	1.1	3.9	2.8	2.1	3.3	5.5	6.5	2.9
2030	1.2	4.0	2.8	2.2	4.6	4.9	5.7	2.9
2040	1.2	4.0	2.8	2.2	4.9	4.5	5.4	2.9
2050	1.2	4.0	2.8	2.2	3.9	4.1	5.1	2.9
2060	1.1	3.9	2.8	2.1	3.7	4.1	4.8	2.9
2070	1.1	3.9	2.8	2.1	3.6	3.9	4.6	2.9
2080	1.2	4.0	2.8	2.1	3.3	3.7	4.4	2.9

[1] The total fertility rate for any year is the average number of children who would be born to a woman in her lifetime if she were to experience the birth rates by age observed in, or assumed for, the selected year, and if she were to survive the entire childbearing period. The ultimate total fertility rate is assumed to be reached in 2035.
[2] The age-sex-adjusted death rate is the crude rate that would occur in the enumerated total population as of April 1, 2000, if that population were to experience the death rates by age and sex assumed for the selected year. The death rate is a summary measure and not a basic assumption; it summarizes the effects of the basic assumptions from which it is derived.
[3] Net immigration is the number of persons who enter during the year (both legally and otherwise) minus the number of persons who leave during the year. It is a summary measure and not a basic assumption; it summarizes the basic assumptions from which it is derived.
[4] The real-wage differential is the difference between the percentage increases, before rounding, in the average annual wage in covered employment, and the average annual CPI.
[5] The CPI is the annual average value for the calendar year of the CPI for urban wage earners and clerical workers.
[6] The real GDP is the value of total output of goods and services produced in the U.S., expressed in 2005 dollars. It is a summary measure and not a basic assumption; it summarizes the effects of the basic assumptions from which it is derived.
[7] These increases reflect the overall impact of more detailed assumptions that are made for each of the different types of service provided by the Medicare program (for example, hospital care, physician services, and pharmaceutical costs). These assumptions include changes in the payment rates, utilization, and intensity of each type of service.
[8] The average annual interest rate earned on new trust fund securities, above and beyond the rate of inflation.

Railroad Retirement

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

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

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

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

Railroad Retirement–Employment, Demographic and Economic Assumptions

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

Three employment assumptions were used in preparing the projections and reflect optimistic, moderate and pessimistic future passenger rail and freight employment. The average railroad employment is assumed to be 218,000 in 2011 under the moderate employment assumption. This employment assumption, based on a model developed by the Association of American Railroads, assumes that (1) passenger service employment will remain at the level of 44,000 and (2) the employment base, excluding passenger service employment, will decline at a constant 2.0 percent annual rate for 23 years, at a falling rate over the next 25 years, and remain level thereafter. All the projections are based on an open-group (i.e., future entrants) population.

The moderate (middle) economic assumptions include a long-term cost of living increase of 3.0 percent, an interest rate of 7.5 percent, and a wage increase of 4.0 percent. The cost of living assumption reflects the expected level of price inflation. The interest rate assumption reflects the expected return on NRRIT investments. The wage increase reflects the expected increase in railroad employee earnings.

Sources of the demographic assumptions including mortality rates and total termination rates, remarriage rates for widows, retirement rates and withdrawal rates, are listed in Table 2. For further details on the employment, demographic, economic and all other assumptions, refer to the *U.S. Railroad Retirement Board Annual Report*, and the 24th *Actuarial Valuation of the Assets and Liabilities under the Railroad Retirement Acts* (Valuation Report) as of December 31, 2007, with Technical Supplement.

Table 2
Railroad Retirement Demographic Actuarial Assumptions (Sources)

<table>
<tr><td rowspan="5">Mortality Rates [1]</td><td>Mortality after age retirement</td><td>2007 RRB Annuitants Mortality Table</td></tr>
<tr><td rowspan="2">Mortality after disability retirement</td><td>2007 RRB Disabled Mortality Table for Annuitants with Disability Freeze</td></tr>
<tr><td>2007 RRB Disabled Mortality Table for Annuitants without Disability Freeze</td></tr>
<tr><td>Mortality during active service</td><td>2003 RRB Active Service Mortality Table</td></tr>
<tr><td>Mortality of widow annuitants</td><td>1995 RRB Mortality Table for Widows</td></tr>
<tr><td rowspan="2">Total Termination Rates [2]</td><td>Termination for spouses</td><td>2007 RRB Spouse Total Termination Table</td></tr>
<tr><td>Termination for disabled children</td><td>2004 RRB Total Termination Table for Disabled Children</td></tr>
<tr><td>Widow Remarriage Rate [3]</td><td colspan="2">1997 RRB Remarriage Table</td></tr>
<tr><td rowspan="2">Retirement Rates [4]</td><td>Age retirement</td><td>See the Valuation Report.</td></tr>
<tr><td>Disability retirement</td><td>See the Valuation Report.</td></tr>
<tr><td>Withdrawal Rates [5]</td><td colspan="2">See the Valuation Report.</td></tr>
</table>

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

Black Lung–Disability Benefit Program

The Black Lung Disability Benefit Program provides for compensation and medical benefits for eligible coal miners who are totally disabled due to pneumoconiosis (black lung disease) as a result of their coal mine employment. The same program also provides for survivor benefits for eligible survivors of coal miners who died due to pneumoconiosis. DOL operates the Black Lung Disability Benefit Program. BLDTF provides benefit payments to eligible coal miners totally disabled by pneumoconiosis and to eligible survivors when no responsible mine operator can be assigned the liability.

Black lung disability benefit payments are funded by excise taxes from coal mine operators based on the sale of coal, as are the fund's administrative costs. These taxes are collected by the Internal Revenue Service (IRS) and transferred to the BLDTF, which was established under the authority of the Black Lung Benefits Revenue Act, and administered by the Treasury. Prior to October 3, 2008, the Black Lung Benefits Revenue Act provided for repayable advances to the BLDTF from the general fund of Treasury, in the event that BLDTF resources were not adequate to meet program obligations.

Black Lung–Demographic and Economic Assumptions

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

The economic assumptions used for the most recent set of projections are coal excise tax revenue estimates, Federal civilian pay raises, medical cost inflation, and the interest rate on new debt issued by the BLDTF. Projections are sensitive to changes in the tax rate and changes in interest rates on debt issued by the BLDTF.

Estimates of future receipts of the black lung excise tax are based on projections of future coal production and sale prices prepared by the Energy Information Agency of DOE. Treasury's Office of Tax Analysis provides the first 11 years of tax receipt estimates. The remaining years are estimated using a growth rate based on both historical tax receipts and Treasury's estimated tax receipts. The coal excise tax rate structure is $1.10 per ton of underground-mined coal and $0.55 per ton of surface-mined coal sold, with a cap of 4.4 percent of sales price. Based on Treasury's interpretation of the Act, the higher excise tax rates will continue until the earlier of December 31, 2018, or the first December 31 after 2008, in which there exist no (1) balance of repayable debt described in section 9501 of the Internal Revenue Code and (2) unpaid interest on the debt. Starting in 2019, the tax rates revert to $0.50 per ton of underground-mined coal and $0.25 per ton of surface-mine coal sold, and a limit of 2.0 percent of sales price.

OMB supplies assumptions for future monthly benefit rate increases based on increases in the Federal pay scale and future medical cost inflation based on increases in the CPIM, which are used to calculate future benefit costs. During the current projection period, future benefit rate increases 0.0 percent in 2012 and medical cost increases 3.2 percent in 2012, and ranges from 3.6 percent to 3.8 percent thereafter. Estimates for administrative costs for the first 11 years of the projection are supplied by DOL's Budget Office, based on current year enacted amounts, while later years are based on the number of projected beneficiaries.

Public Law 110-343, Division B—Energy Improvement and Extension Act of 2008, enacted on October 3, 2008, in section 113, (1) allowed for the temporary increase in coal excise tax rates to continue an additional 5 years beyond the current statutory limit, and (2) restructured the BLDTF debt by refinancing the outstanding repayable advances (which had higher interest rates) with the proceeds from issuing discounted debt instruments similar in form to zero-coupon bonds (which had lower interest rates), plus a one-time appropriation. Public Law 110-343 also allowed that any debt issued by the BLDTF subsequent to the refinancing may be used to make benefit payments, other authorized expenditures, or to repay debt and interest from the initial refinancing. All debt issued by the BLDTF was effected as borrowing from the Treasury's Bureau of the Public Debt.

Statement of Changes in Social Insurance Amounts

The Statement of Changes in Social Insurance Amounts reconciles the change (between the current valuation and the prior valuation) in the present value of future revenue less future expenditures for current and future participants (the open group measure) over the next 75 years (except Black Lung is projected only through September 30, 2040, because the projection period will terminate on September 30, 2040). The reconciliation identifies several components of the changes that are significant and provides reasons for the changes. The following disclosures relate to the Statement of Changes in Social Insurance Amounts including the reasons for the components of the changes in the open group measure during the reporting period from the end of the previous reporting period for the Federal Government's social insurance programs.

Social Security

All estimates relating to the Social Security program in the Statement of Changes in Social Insurance Amounts are presented as incremental to the prior change. As an example, the present values shown for economic data and assumptions, represent the additional effect that these new data and assumptions have, once the effects from the demography and the change in the valuation period have been considered.

Assumptions Used for the Components of the Changes for the Social Security Program

The present values included in the Statement of Changes in Social Insurance Amounts are for the current and prior years and are based on various economic and demographic assumptions used for the intermediate assumptions in the Social Security Trustees Reports for those years. Table 1A summarizes these assumptions for the current year.

Present values as of January 1, 2010, are calculated using interest rates from the intermediate assumptions of the 2010 Social Security Trustees Report. All other present values in the Statement of Changes in Social Insurance Amounts are calculated as a present value as of January 1, 2011. Estimates of the present value of changes in social insurance amounts due to changing the valuation period and changing demographic data and assumptions are presented using the interest rates under the intermediate assumptions of the 2010 Social Security Trustees Report. Since interest rates are an economic estimate and all estimates in the Statement of Changes in Social Insurance Amounts are incremental to the prior change, all other present values in the Statement of Changes in Social Insurance Amounts are calculated using the interest rates under the intermediate assumptions of the 2011 Social Security Trustees Report.

Changes in Valuation Period

The effect on the 75-year present values of changing the valuation period from the prior valuation period (2010-84) to the current valuation period (2011-85) is measured by using the assumptions for the prior period and applying them, in absence of any changes, to the current valuation period. Changing the valuation period removes a small negative net cashflow for 2010 and replaces it with a much larger negative net cashflow for 2085. The present value of future net cashflows (including or excluding the combined OASI and DI Trust Fund assets at the start of the period) was therefore decreased (made more negative) when the 75-year valuation period changed from 2010-84 to 2011-85.

Changes in Demographic Data and Assumptions

The ultimate demographic assumptions for the current valuation period are the same as those for the prior valuation period. However, the starting demographic values were changed. The economic recovery has been slower than was assumed for the prior valuation period.

- The inclusion of final mortality data for 2007 results in lower starting death rates and faster near-term declines in death rates at older ages for the current valuation period.
- Revised historical estimates of net other immigration and final data on legal immigration for 2009 are also used in the current valuation. Based on estimates from the Department of Homeland Security for 2007 and 2008 and due to the weak U.S. economy since 2008, net other immigration levels for 2007-10 are assumed negative for the current valuation period. These levels are significantly lower than the positive estimates used in the prior valuation period.
- Birth rates projected through 2026 are slightly lower in the current valuation; preliminary birth data for 2008 and 2009 was lower than was expected for the prior valuation.
- Updated starting values of population levels were incorporated in the current valuation.

Except for updating starting values of population levels, inclusion of each of these demographic data sets decreases the present value of future net cashflows.

The following demographic methods were changed in the current valuation.

- The method for determining the initial projected rates of mortality decline was changed to place greater emphasis on recent experience. These initial rates of decline are now determined using the most recent 10 years of historical data, rather than the most recent 20 years. This change increased the rate of decline in death rates at older ages for years following the year of final data (2007) up to the year the ultimate rates of decline are fully in effect (2035).
- The historical estimates of the other immigrant population by age and sex were improved, resulting in greater consistency between the other immigrant population and the total population.

Both of these changes to demographic methods decrease the present value of future net cashflows.

Changes in Economic Data and Assumptions

The ultimate economic assumptions for the current valuation period are the same as those for the prior valuation period. However, the starting economic values and near-term economic growth rate assumptions were changed. The economic recovery has been slower than was assumed for the prior valuation period.

- For the current valuation period, OASDI taxable earnings are considerably lower for the starting year, 2010, than were projected for the prior valuation period. Even though earnings grow faster after 2010 through 2019, the projected level of earnings is lower through 2018 for the current valuation period.
- Unemployment rates are slightly higher over first few years of the projection for the current valuation period.
- The real interest rate is lower over first few years of the projection for the current valuation period.

Inclusion of each of these economic revisions decreases the present value of future net cashflows.

A change to the methodology for projecting labor force participation was implemented in the current valuation period. The assumed effect of gains in life expectancy on labor force participation for persons over 40 was doubled, significantly increasing projected participation rates at higher ages. Disability prevalence was added as an input variable to the labor force model for persons over normal retirement age, partially offsetting increases in the labor force due to changes in life expectancy. Inclusion of these changes to labor force participation projections increase the present value of future net cashflows.

Changes in Methodology and Programmatic Data

Several methodological improvements and updates of program-specific data are included in the current valuation and the most significant are identified below.

- Disabled worker mortality and termination rates were updated to reflect a more recent historical period. Inclusion of these updates decrease the present value of future net cashflows.
- The historical sample of new beneficiaries, which serves as the basis of average benefit levels, was updated from a 2006 sample to a 2007 sample. Inclusion of this update increases the present value of future net cashflows.

Changes in Law or Policy

There were no legislative changes, included in the current valuation and not in the prior valuation, that are projected to have a significant effect on the present value of the 75-year net cashflows.

Medicare

All estimates relating to the Medicare program in the Statement of Changes in Social Insurance Amounts are presented as incremental to the prior change. As an example, the present values shown for demographic assumptions, represent the additional effect that these assumptions have, once the effects from the change in the valuation period and projection base have been considered.

Assumptions Used for the Components of the Changes for the Medicare Program

The present values included in the Statement of Changes in Social Insurance Amounts are for the current and prior years and are based on various economic and demographic assumptions used for the intermediate assumptions in the Medicare Trustees Reports for those years. Table 1.B summarizes these assumptions for the current year.

Present values as of January 1, 2010, are calculated using interest rates from the intermediate assumptions of the 2010 Medicare Trustees Report. All other present values in the Statement of Changes in Social Insurance Amounts are calculated as a present value as of January 1, 2011. Estimates of the present value of changes in social insurance amounts due to changing the valuation period, projection base, and demographic assumptions are determined using the interest rates under the intermediate assumptions of the 2010 Medicare Trustees Report. Since interest rates are economic assumptions, the estimates of the present values of changes in economic assumptions are presented using the interest rates under the intermediate assumptions of the 2011 Medicare Trustees Report.

Changes in Valuation Period

The effect on the 75-year present values of changing the valuation period from the prior valuation period (2010-84) to the current valuation period (2011-85) is measured by using the assumptions for the prior valuation period and applying them, in the absence of any other changes, to the current valuation period. Changing the valuation period removes a small negative net cashflow for 2010 and replaces it with a much larger negative net cashflow for 2085. The present value of future net cashflow was therefore decreased (made more negative) when the 75-year valuation period changed from 2010-84 to 2011-85.

Change in Projection Base

Actual revenue and expenditures in 2010 were different than what was anticipated when the 2010 Medicare Trustees Report projections were prepared. Part A revenue was lower than estimated and Part A expenditures were higher than anticipated, due to the impacts of the economic recession. Part B total revenue and expenditures were lower than estimated based on actual experience. For Part D, actual revenue and expenditures were both slightly lower than prior estimates. The net impact of the Part A, B, and D projection-base changes is a slight decrease in the future net cashflow.

Changes in Demographic Data and Assumptions

The demographic assumptions used in the Medicare projections are the same as those used for the Old-Age, Survivors and Disability Insurance (OASDI) and are prepared by the Office of the Chief Actuary at the Social Security Administration (SSA).

The ultimate demographic assumptions for the current valuation period are the same as those for the prior valuation period. However, the starting demographic values were changed.

- The inclusion of final mortality data for 2007 results in lower starting death rates and faster near-term declines in death rates at older ages for the current valuation period.
- Revised historical estimates of net other immigration and final data on legal immigration for 2009 also are used in the current valuation. Based on estimates from the Department of Homeland Security for 2007 and 2008, and due to the weak U.S. economy since 2008, net other immigration levels for 2007 – 2010 are assumed negative for the current valuation period. These levels are significantly lower than the positive estimates used in the prior valuation period.
- Birth rates projected through 2026 are slightly lower in the current valuation; preliminary birth data 2008 and 2009 was lower than expected for the prior valuation.

These changes have little impact on the present values of future expenditures and revenue.

Changes in Economic and Other Health Care Assumptions

The economic assumptions used in the Medicare projections are the same as those used for the Old-Age, Survivors and Disability Insurance (OASDI) and are prepared by the Office of the Chief Actuary at the Social Security Administration (SSA).

The ultimate economic assumptions for the current valuation period are the same as those for the prior valuation period. However, the starting economic values and near-term economic growth rate assumptions were changed. The economic recovery has been slower than was assumed for the prior valuation period.

- For the current valuation period, HI taxable earnings are considerably lower for the starting year, 2010, than were projected for the prior valuation period. The projected level of taxable earnings grows more slowly through 2017 for the current valuation period.
- Unemployment rates are slightly higher over the first few years of the projection for the current valuation period.

The interest rates assumed in the short-range period are lower for the current valuation period.

Inclusion of each of these economic revisions decrease the present value of future net cashflow.

The health care assumptions are specific to the Medicare projections. The following health care assumptions were changed in the current valuation:

- Utilization rates for certain hospitals were lowered,
- Components of price updates for home health agency services were lowered.
- Slightly lower residual assumptions were used for certain Part B services in the short-range period.
- Slight refinement in the Part B application of the *Affordable Care Act* multifactor productivity adjustments were used in the long-range period, which lowers expenditures.
- The utilization assumed for beneficiaries assumed to switch from Medicare Advantage to fee-for-service was lowered.
- The utilization assumed for beneficiaries assumed to switch from fee-for-service to Medicare Advantage was increased.
- Assumed utilization of skilled nursing facility and home health agency services was increased.
- The projected growth in prescription drug spending in the United States was reduced.

These changes had a net negative impact on the future net cashflow for total Medicare. For Part A, these changes resulted in a net increase to the present value of both revenue and expenditures, with an overall increase on the future net cashflow. For Part B, these changes resulted in a net increase to the present value of both revenue and expenditures with an overall decrease on the future net cashflow.

Changes in Law or Policy

Although Medicare legislation was enacted since the prior valuation date, most of the provisions have a negligible impact on the present value of the 75-year revenue, expenditures, and net cashflow. However, the enacted changes to the physician payment update very slightly increased the present value of expenditures, and decreased the 75-year present value of future net cashflow.

Railroad Retirement

The largest change in the open group measure of the Railroad Retirement social insurance program is due to changes in economic data and assumptions. Although ultimate economic assumptions remained the same, select economic assumptions were updated in 2011 along with the following other components of changes in the open group measure.

Changes in Valuation Period

The change in the valuation period (from 2010-2084 to 2011-2085) had a minimal effect on the social insurance open group measure.

Changes in Demographic Data and Assumptions

Demographic assumptions were not changed between 2010 and 2011. Changes in demographic data had a minimal effect on the open group measure.

Changes in Economic Data and Assumptions

Ultimate economic assumptions were not changed from last year’s report, but the select economic assumptions were. The actual COLA of 0.0 percent was used for 2011 in place of the 0.5 percent COLA assumed for 2011 in last year’s Statement of Social Insurance. A wage increase rate of 2.4 percent was used for 2010 rather than the assumed 4 percent wage increase rate used for 2010 in last year’s Statement of Social Insurance. Also, the actual 2010 investment return of 14.4 percent was higher than the assumed 7.5 percent investment rate used for 2010 in last year’s Statement of Social Insurance. Economic data and assumptions for Cost of Living Adjustments, wage increase rate, and investment return were updated in 2011 and had the greatest effect on the open group measure.

Changes in Methodology and Programmatic Data

There were no changes in methodology and programmatic data.

Changes in Law or Policy

There were no changes in law or policy.

Black Lung

The significant assumptions used in the projections of the Black Lung social insurance program presented in the Statement of Social Insurance are the number of beneficiaries, life expectancy, coal excise tax revenue estimates, the tax rate structure, Federal civilian pay raises and medical cost inflation. These assumptions also affect the amounts reported on the Statement of Changes in Social Insurance Amounts. From fiscal year 2010 to fiscal year 2011, the decrease in the assumptions about coal excise tax revenues represents the largest decrease in the open group measure. From fiscal year 2010 to fiscal year 2011, the coal excise tax revenue projections were revised downward to reflect current year experience and a decrease in future collections. From fiscal year 2010 to fiscal year 2011, the increase in the assumptions about beneficiaries, including costs (not associated with medical inflation or Federal civilian pay raises), number, type, age, and life expectancy represents the largest increase in the open group measure. From fiscal year 2010 to fiscal year 2011, the assumptions about the beneficiaries were revised downward to reflect current year experience and a decrease in future expenditures. From fiscal year 2010 to fiscal year 2011, the increases and decreases with respect to changes in assumptions for Federal civilian pay raises for income benefits, medical cost inflation for medical benefits, and administrative costs were based on revisions to reflect current year experience and future costs. From fiscal year 2010 and fiscal year 2011, the change in economic assumption about the interest rate represents the change in the discount rate from 3.75 percent to 3.375 percent. There were no changes in law or policy from fiscal year 2010 to fiscal year 2011.

Note 27. Stewardship Land and Heritage Assets

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

The majority of public lands that are under the management of DOI were acquired by the Government during the first century of the Nation's existence between 1781 and 1867. Stewardship land accounts for 28 percent of the current U.S. landmass.

Stewardship lands are used and managed in accordance with the statutes authorizing their acquisition or directing their use and management. Additional detailed information concerning stewardship land, such as agency stewardship policies, physical units by major categories, and the condition of stewardship land, can be obtained from the financial statements of DOI, DOC, DOD, and USDA.

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 non-financial. The public entrusts the Government with these assets and holds it accountable for their preservation. Examples of heritage assets include the Mount Rushmore National Memorial and Yosemite National Park. Other examples of heritage assets include the Declaration of Independence, the U.S. Constitution, and the Bill of Rights preserved by the National Archives. Also included are national monuments/structures such as the Vietnam Veterans Memorial, the Jefferson Memorial, and the Washington Monument, as well as the Library of Congress. Many other sites such as battlefields, historic structures, and national historic landmarks are placed in this category, as well.

Many laws and regulations govern the preservation and management of heritage assets. Established policies by individual Federal agencies for heritage assets ensure the proper care and handling of the assets under their control and preserve these assets for the benefit of the American public.

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

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

The discussion of the Government's heritage assets is not all-inclusive. Rather, it highlights significant heritage assets reported by Federal agencies. Please refer to the individual financial statements of the DOC, VA, State, DOD, National Archives and Records Administration, and Web sites for the Library of Congress (http://www.loc.gov/index.html) and the Smithsonian Institution (http://www.si.edu), for additional information on multi-use heritage assets, agency stewardship policies, and physical units by major categories and conditions.

United States Government
Supplemental Information (Unaudited)
For the Years Ended September 30, 2011 and 2010

Fiscal Projections for the U.S. Government – FY 2011

This section is prepared pursuant to Statement of Federal Financial Accounting Standard (SFFAS) 36, *Reporting Comprehensive Long-Term Fiscal Projections for the U.S. Government*. It is intended to help readers of the Financial Report of the U.S. Government (FR) assess whether future budgetary resources will be sufficient to sustain public services and to meet future obligations as they come due, assuming that the Federal Government's current policies for spending and taxation are continued. Such an assessment requires prospective information about receipts and spending, the resulting debt, and how these amounts relate to the economy. The assessment is also referred to as reporting on "fiscal sustainability."

The information in this section is important not only for its financial, but also its social and political, implications. Financial reports should provide information that can help readers assess the likelihood that the Government will be able to continue providing the equivalent level of public services and to assess whether financial burdens without related benefits will be shifted to future taxpayers. Fiscal sustainability reporting should assist the reader in understanding these financial, social, and political implications.

The projections and analysis presented here are mathematical extensions and extrapolations based on an array of assumptions as described below, including the assumption that current Federal policy does not change. These projections cannot be interpreted as forecasts or predictions of the future, in part because they encompass hypothetical future trends or events that are improbable. This is the second year in which this information is included with the other Supplemental Information, and the methods and assumptions used in producing this section are still under development.

Statement of Long Term Fiscal Projections

Table 1, on the following page, presents projections of the Federal Government's receipts and non-interest spending.[1] Receipt categories include individual income taxes, Social Security and Medicare payroll taxes, and all other receipts. On the spending side, the projections include both discretionary programs, such as defense spending, which are funded through annual appropriations, and mandatory (entitlement) programs, such as Social Security and Medicare, which generally provide benefits under permanent or multi-year appropriations. The Federal budget provides the framework used for the projections in Table 1, which differs in some respects from the presentation of the projections in the trustees' reports for Social Security and Medicare (as explained below). The key assumptions used in the long-term fiscal projections are summarized in the next section. This year's projections for Social Security and Medicare are based on the same economic and demographic assumptions as are used for the 2011 trustees' reports and the Statement of Social Insurance, while comparative information presented from last year's report is based on the 2010 trustees' reports. Projections for the other categories are consistent with the assumptions used for the trustees' reports. In order to produce a more realistic projection of the fiscal outlook under current policy, the projections assume several likely departures from current law, noted below.

[1] For the purposes of this analysis, spending is defined in terms of outlays. In the context of Federal budgeting, spending can either refer to budget authority – the authority to commit the government to spend an amount – or to outlays, which reflect actual payments made.

The projections in Table 1 are expressed in present value dollars as of October 1, 2011, and as a percentage of the present value of Gross Domestic Product (GDP).[2] The present value of a future amount, for example, $1 billion in March 2021, is the amount of money that if invested on October 1, 2011 in an account earning the government borrowing rate would have a value of $1 billion in March 2021.[3] The present value of a receipt or expenditure category over 75 years is the sum of the annual present value amounts. GDP measures the total value of all final goods and services produced in the U.S. in a year and is a standard measure of the overall size of the economy. When expressing a receipt or expenditure category over 75 years as a percent of GDP, the present value dollar amount is divided by the present value of GDP over 75 years. Measuring receipts and expenditures as a percentage of GDP is a useful indicator of the economy's capacity to sustain Government programs. The interest rates used to compute present values are the rates that underlie the projections in the 2011 Social Security and Medicare trustees' reports, with comparative present values presented from last year's report consistent with the 2010 trustees' report. The use of discount factors consistent with the Social Security actuaries rate allows for consistent present value budget calculations over 75 years between this report and the trustees' reports. Present value calculations under higher and lower interest rate scenarios are presented in the "Alternative Scenarios" section.

Table 1: Long-Term Fiscal Projections of Federal Receipts and Spending

	75-Year Present Values[1]					
	Dollars in Trillions			% GDP[2]		
Receipts:	2011	2010	Change	2011	2010	Change
Social Security Payroll Taxes	39.1	37.8	1.3	4.4	4.4	0.0
Medicare Payroll Taxes	13.0	12.4	0.6	1.5	1.4	0.0
Individual Income Taxes	93.5	90.6	2.9	10.5	10.5	0.0
Other Receipts	34.7	34.4	0.3	3.9	4.0	-0.1
Total Receipts	**180.2**	**175.2**	**5.0**	**20.3**	**20.2**	**0.0**
Non-interest Spending:						
Defense Discretionary	28.7	31.0	-2.3	3.2	3.6	-0.4
Nondefense Discretionary	15.4	30.7	-15.4	1.7	3.6	-1.8
Social Security	51.8	49.1	2.6	5.8	5.7	0.1
Medicare Part A[3]	17.6	17.3	0.4	2.0	2.0	0.0
Medicare Parts B&D[4]	21.1	20.4	0.7	2.4	2.4	0.0
Medicaid	24.0	24.2	-0.3	2.7	2.8	-0.1
Other Mandatory	28.1	18.8	9.3	3.2	2.2	1.0
Total Non-interest Spending	**186.7**	**191.6**	**-4.9**	**21.0**	**22.1**	**-1.2**
Non-interest Spending less Receipts	6.4	16.3	-9.9	0.7	1.9	-1.2

1/ 75-year present value projections for 2011 are as of 9/30/2011 for the period FY 2012-2086; projections for 2010 are as of 9/30/2010 for the period FY 2011-2085.

2/ The 75-year present value of nominal GDP, which drives the calculations above is $889.8 trillion starting in FY 2012, and was $865.6 trillion starting in FY 2011.

3/ Represents portions of Medicare supported by payroll taxes.

4/ Represents portions of Medicare supported by general revenues. Consistent with the President's Budget, Parts B & D are presented net of premiums.

The projections shown in Table 1 are made over a 75-year time frame, consistent with the time frame featured in the Social Security and Medicare trustees' reports. As discussed later, one notable difference between the analysis in the Long-Term Fiscal Projections and the trustees' reports is that these projections are based on fiscal years starting on October 1, 2011, whereas the trustees' reports feature projections made on a calendar-year basis. This difference allows the projections to start from the actual results from fiscal year 2011. This Report also considers the period of time beyond the 75-year window, noting most importantly that the assumptions become more uncertain the further in time the projections are extended. This report compares projections of fiscal sustainability between 2011 and 2010, with significant changes between the two years evident in Table 1 and characterized and explained in Table 2 in the "Current Policy Projections for Primary Deficits" section.

Just as the financial statements give information about the financial position of the Federal government, but not State or local governments, the analysis and discussion of long-term fiscal projections for the U.S. Government does not address the fiscal sustainability of State and local governments.

[2] GDP is the total market value of all final goods and services produced domestically during a given period of time. The components of GDP are: private sector consumption and investment, government consumption and investment, and net exports (exports less imports). Equivalently, GDP is a measure of the gross income generated from domestic production over the same time period.

[3] Present values recognize that a dollar paid or collected in the future is worth less than a dollar today because a dollar today could be invested and earn interest. To calculate a present value, future amounts are thus reduced using an assumed interest rate, and those reduced amounts are summed.

Assumptions Used and Relationship to Other Financial Statements

A fundamental assumption underlying the projections in Table 1 is that current Federal policy – as defined below – does not change. The projections are therefore neither forecasts nor predictions. If policy changes are enacted, perhaps in response to projections like those presented here, then actual fiscal outcomes will of course be different than those projected.

Even if policy does not change, actual expenditures and receipts could differ materially from those projected here. This is because the long-range projections are inherently uncertain and because simplifying assumptions are made. One key simplifying assumption, for example, is that interest rates paid on public debt remain unchanged, regardless of the amount of debt outstanding. It is likely that if the debt rises as shown in these projections, future interest rates will increase. To help illustrate this uncertainty, present value calculations under higher and lower interest rate scenarios are presented in the "Alternative Scenarios" section.

The projections in Table 1 focus on future cash flows, and do not reflect either the accrual basis or the modified-cash basis of accounting. These cash-based projections reflect receipts or spending at the time cash is received or when a payment is made by the Government. In contrast, accrual-based projections would reflect amounts in the time period in which income is earned or when an expense or obligation is incurred. The cash basis is consistent with methods used to prepare the Statement of Social Insurance (SOSI) and the generally cash-based Federal budget.

The following summarizes the assumptions used for the key categories of receipts and spending presented in Table 1 and in the related analysis:

- **Social Security:** Social Security (OASDI) spending in the fiscal projections is based on the projected expenditures in the Social Security trustees' report for benefits,[4] plus the Railroad Retirement interchange, but excluding administrative expenses. The projections of Social Security payroll taxes and future Social Security spending begin with actual budget data for FY 2011. The projected growth rates for future spending and payroll taxes are derived from the spending and tax growth rate projections underlying the latest trustees' report.

- **Medicare:** Current law Medicare spending is based on incurred expenditures from the 2011 Medicare trustees' report, which reflects the changes in Medicare that are projected to result from passage of the -Affordable Care Act (ACA) in 2010. However, some adjustments are required to convert these amounts to Medicare spending as measured in these projections and in the budget. Medicare Part B and D premiums,[5] as well as State contributions to Part D, are subtracted from gross spending in measuring Part B and Part D outlays in the projections and the budget just as they are subtracted from gross cost to yield net cost in the financial statements.[5] The budget treats the premiums as "negative spending" rather than receipts, since they represent payment for a service. This is similar to the financial statement treatment of premiums as "earned" revenue as distinct from all other sources of revenue, which are unearned. In the budget, Government receipts are defined as payments obtained through the Government's sovereign power to tax, similar to (unearned) revenue in the financial statements. With these adjustments, Medicare spending net of administrative costs corresponds to Medicare spending in the budget. The 2011 long-term fiscal projection uses historical budget data from FY 2011 for Medicare spending and Part A payroll tax revenues, with both growing at growth rates presented in the trustees' report. Also, as discussed in Note 26, there is uncertainty about whether the projected reductions in health care cost growth will be fully achieved. Note 26 includes an alternative projection to illustrate the uncertainty of projected Medicare costs.

- **Medicaid:** The model for the Medicaid program starts with the projections from the *2010 Actuarial Report on the Financial Outlook for Medicaid* prepared by the Office of the Actuary, Centers for Medicare and Medicaid Services (CMS).[6] As projections in that report only extend until 2019, the model assumes that Medicaid benefits in 2020 and later years grow at the same rate per beneficiary as Medicare benefits grow.

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[4] As indicated in the more detailed discussion of Social Insurance in Note 26 to the financial statements.

[5] Medicare Part B and D premiums and State contributions to Part D are subtracted from the Part B and D spending displayed in Table 1. The total 75-year present value of these subtractions is $8.1 trillion, or 0.9 percent of GDP.

[6] Christopher J. Truffer, John D. Klemm, Christian J. Wolfe, and Kathryn E. Rennie *2010 Actuarial Report on the Financial Condition for Medicaid*, Office of the Actuary, Centers for Medicare and Medicaid Services, United States Department of Health and Human Services.

Supporting this assumption is a historical trend where the average annual growth in Medicaid outlays per beneficiary from 1987 to 2011 has been within 0.2 percent growth per year of the average annual growth in Medicare outlays per beneficiary over the same period. The model accounts for the effects of the ACA to reflect higher future enrollment, as calculated by CMS, and reflects other adjustments to align the base projections with the latest budget data. The Medicaid projections reflect the temporary increase in Medicaid spending due to the American Recovery and Reinvestment Act of 2009 (ARRA) and the phase-out of that spending.

- **Other Mandatory Spending:** Other mandatory spending components are assumed to increase by the rate of growth in nominal GDP, implying that such spending will remain constant as a percentage of GDP in the long run. Adjustments are made for temporary spending that is not expected to persist in the long run: the mandatory spending authorized by ARRA and other stabilization measures including temporary expansions in unemployment insurance benefits, the implementation of the Troubled Asset Relief Program (TARP), the purchase of government sponsored enterprise (GSE) preferred stock, and higher net spending for the Federal Deposit Insurance Corporation (FDIC). The 75-year present value of these temporary measures totals $0.1 trillion.

- **Discretionary Spending:** In these projections, aside from the expected reductions in Overseas Contingency Operations (OCO) spending, discretionary spending is capped at the levels enacted in the Budget Control Act of 2011 (BCA) through FY 2021, after which it resumes growth at the same rate as nominal GDP, and thus plateaus at a long-term level of 3.1 percent of GDP by 2023 once the OCO adjustment has been fully phased out. Adjustments are made for the discretionary components of temporary spending authorized by ARRA. The 75-year present value of OCO and the discretionary measures in ARRA total $0.6 trillion, or 0.1 percent of present value GDP.

- **Receipts (Other than Social Security and Medicare):** Instead of attempting a projection of the entire income distribution, the fiscal projections link individual income taxes to wages and salaries, and all other receipts to GDP. Individual income taxes are projected to return to their historical ratio to wages and salaries of about 17 percent over the next several years, and from that point on to increase gradually to almost 28% in 2086 to reflect the progressive nature of the Federal income tax, which implies that as real wages rise over time, the average taxpayer will move into higher tax brackets. The levels of individual income taxes are also adjusted over the next several years for the phase-out of the temporary tax cuts enacted by ARRA. Computing individual income taxes as a ratio of wages and salaries allows the projections to reflect changes in the ratio of taxable income to total GDP. All other receipts also rise over the next several years back to their historical ratio to GDP of around 4 percent from 1979 through 2010.

- **Further Budget Control Act (BCA) Deficit Reduction:** The BCA created the Joint Select Committee on Deficit Reduction with a goal to reduce the deficit by at least $1.5 trillion. Because the Joint Committee failed to reach agreement on a deficit reduction proposal, under current law automatic procedures specified in the BCA will result in $1.2 trillion in reductions in discretionary and mandatory spending through 2021. The projections assume that such automatic reductions occur or that the reductions are replaced with an equivalent set of cuts, with the effects estimated through 2021 using the procedures set forth in the BCA and the resulting lower levels of spending grown with nominal GDP thereafter.

- **Interest Spending:** Interest spending is determined by projected interest rates and the level of outstanding debt held by the public. The long-run interest rate assumptions convert those in the 2011 Social Security Trustees Report[7] to a fiscal year basis. The average interest rate over the projection period is 5.6 percent. These rates are then used to convert future cash flows to present values as of the start of fiscal year 2012.

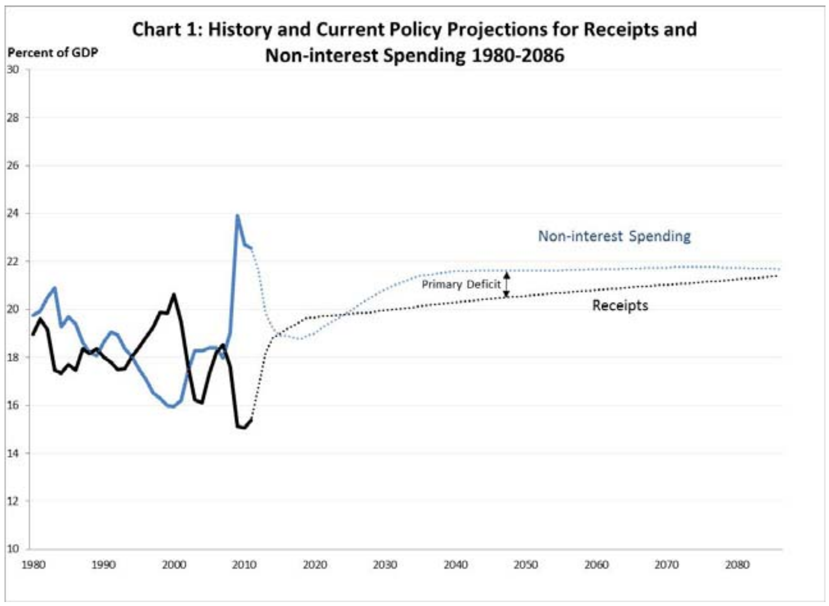
[7] As indicated in the more detailed discussion of Social Insurance in Note 26 to the financial statements.

Departures from Current Law and Policy

As noted earlier, the long-term fiscal projections are made on the basis of current Federal policy, even where current Federal policy would not be continued under provisions of current law. For example, the projections presented in Table 1 and throughout this analysis are made without regard to the statutory limit on outstanding Federal debt. The projection also assumes several other departures from current law: continued discretionary appropriations throughout the projection period, the continued payment of Social Security and Medicare benefits beyond the projected point of trust fund exhaustion, extension of some of the 2001/2003 tax cuts, indexing of the alternative minimum tax (AMT), and the reauthorization of many mandatory programs with expiration dates prior to the end of the 75-year projection period. The projections assume reductions in Medicare physician fees will occur as scheduled under current law, just as they are reflected in the Medicare trustees' report and in the Statement of Social Insurance.[8]

The Sustainability of Fiscal Policy

An important purpose of the Financial Report is to help citizens and policymakers assess whether current fiscal policy is sustainable and, if it is not, the urgency 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 GDP (debt to GDP) is stable over time. The discussion below focuses on balancing revenues and expenditures over time, and does not consider fairness or efficiency implications of the reforms necessary to achieve sustainability.



It is shown below that, under current policy, the ratio of debt to GDP is projected to rise only 1.2 percent from 2013 to 2022, before resuming faster growth over the remainder of the 75-year window, eventually exceeding 280 percent by 2086. The continuing rise in this ratio by the end of the 75-year horizon means that current policy is unsustainable. If these projections were extended beyond 2086, deficits excluding interest would persist as the population continues to age and if the other assumptions made for the 75-year horizon continue to hold. Persistence of the primary deficit beyond the 75-year horizon implies that the ratio of debt to GDP would continue to grow beyond the 75-year horizon.

Current Policy Projections for Primary Deficits

A key determinant of growth in the debt-to-GDP ratio and hence fiscal sustainability is the primary deficit-to-GDP ratio. The primary deficit is the difference between non-interest spending and receipts, and the primary deficit-to-GDP ratio is the primary deficit expressed as a percent of GDP. As shown in Chart 1, the primary deficit-to-GDP

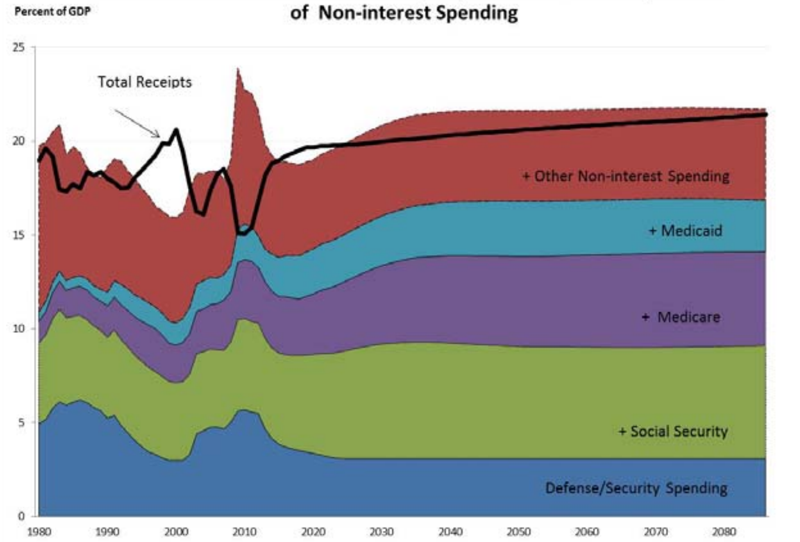
[8] Congress has acted repeatedly to prevent the reductions in Medicare physician fees from taking place, but recent actions have also included spending reductions to offset the cost of physician fee relief. The assumption here that future reductions will occur as scheduled under current law is comparable to an assumption that the reductions will be overridden but the resulting costs will be paid for with reductions in other areas.

ratio grew rapidly in 2009 and stayed large in 2010 and 2011 due to the financial crisis and the recession and the policies pursued to combat both. The primary deficit ratio is projected to fall rapidly between 2012 and 2019 (turning to surplus in 2015) as spending reductions called for in the BCA take effect and the economy recovers. Between 2019 and 2035, however, increased spending for Social Security and health programs due to continued aging of the population is expected to cause the primary balance to steadily deteriorate. A primary deficit is expected to reappear in 2025 that reaches 1.3 percent of GDP in 2035. After 2035, the projected primary deficit-to-GDP ratio slowly declines as the impact of the baby boom generation retiring dissipates. Between 2035 and 2086, the projected primary deficit averages 0.9 percent of GDP.

The revenue share of GDP fell substantially in 2009 and 2010 and increased only modestly in 2011 because of the recession and tax reductions enacted as part of the 2009 ARRA and the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010. The share is projected to return to near its long-run average as the economy recovers and the temporary tax cuts expire. After the economy is fully recovered, receipts are projected to grow slightly more rapidly than GDP as increases in real incomes cause more taxpayers and a larger share of income to fall into the higher individual income tax brackets.[9] This projection assumes that Congress and the President will continue to enact legislation that prevents the share of income subject to the Alternative Minimum Tax from rising.

On the spending side, the non-interest spending share of GDP is projected to fall from its current level of 22.6 percent to about 20 percent in 2013, and stay at or below that level until 2026, and to then rise gradually and plateau at about 22 percent beginning in about 2040. The reduction in the non-interest spending share of GDP over the next two years is mostly due to the caps on discretionary spending and the automatic spending cuts mandated by the BCA, and the subsequent increase is principally due to growth in Medicare, Medicaid, and Social Security spending (see Chart 2). The retirement of the baby boom generation over the next 25 years is projected to increase the Social Security, Medicare, and Medicaid spending shares of GDP by about 1.4 percentage points, 1.3 percentage points, and 1.0 percentage points, respectively. After 2035, the Social Security spending share of GDP is relatively steady, while the Medicare and Medicaid spending share of GDP continues to increase, albeit at a slower rate, due to projected increases in health care costs.

Chart 2: Historical and Current Policy Projections for the Composition of Non-interest Spending



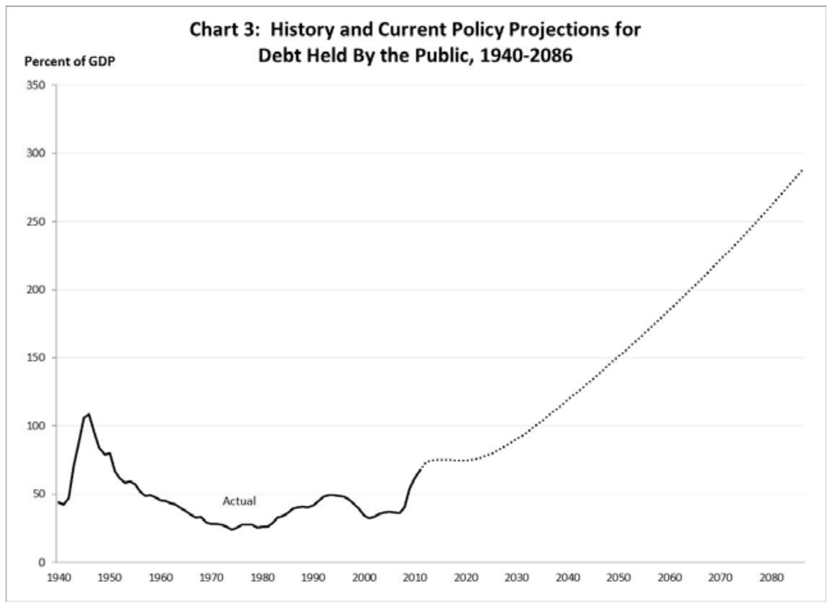
Both Medicare and Medicaid projections continue to be significantly affected by the enactment of the ACA in 2010. The reform expands health insurance coverage, but the long-term budgetary effect will depend on the effectiveness of provisions designed to reduce health care cost growth. The 2011 Medicare trustees' report reflects the ACA and thus projects reductions in future Medicare cost growth as called for by the new law. If the trustees' report projections hold true, there will be a substantial slowdown in future Medicare spending and following the projections methodology outlined above there will also be a slowdown in future Medicaid spending growth. However, even with this reduced growth in Medicare and Medicaid spending, there is still a persistent gap between projected receipts and projected total Federal non-interest spending.

[9] Projected revenues also account for increases (as a share of GDP) in employer-sponsored health insurance costs, which are tax exempt.

The overall 75-year present value net excess of non-interest spending over receipts expressed in Table 1 of $6.4 trillion (0.7 percent of the 75-year present value of GDP) for the 2011 projections can be expressed in terms of funding sources. In these projections there is an excess of receipts over spending of $6.0 trillion or 0.7 percent of GDP among programs funded by the government's general revenues but an imbalance of $12.4 trillion or 1.4 percent of GDP among Social Security (OASDI) and Medicare Part A, which are funded by payroll taxes and which are not funded in any material respects by the government's general revenues. By comparison, the 2010 projections showed that programs funded by the government's general revenues had an imbalance of $5.3 trillion or 0.6 percent of GDP while the payroll tax funded programs had an imbalance of $11.0 trillion or 1.3 percent of GDP.[10] While the imbalance for payroll tax funded programs has actually risen modestly since 2010, programs funded by general revenues are no longer in imbalance in 2011 and show a large present value surplus more than offsetting the increase in the dedicated imbalance. This speaks further to the gains brought about through the BCA in 2011.

Table 2: Components of Change (PV Dollars in Trillions)	
Non-Interest Spending Less Receipts: FY 2010	16.3
Components of Change:	
Change due to Enacted Legislation.....................	-11.0
Change in Economic Assumptions.......................	2.4
Change in Reporting Period...............................	1.0
Change in Technical Assumptions.......................	-2.3
Total	-9.9
Non-Interest Spending Less Receipts: FY 2011	6.4

As shown in Table 1 and discussed above, the 2011 projection of the 75-year present value imbalance of spending over receipts of $6.4 trillion is a sizable drop from the 2010 projection, which measured the 75-year imbalance as $16.3 trillion. Table 2 breaks down the sources of the change in this key projection from 2010 to 2011 and clearly illustrates the projected effects of newly enacted legislation as the main driver of the change since last year. The changes due to enacted legislation shown on Table 2 reflect the effect on the long-term fiscal imbalance of the incorporation of the passage of key pieces of legislation since 2010 including the 2011 full year continuing resolution, as well as the BCA. The enactment of discretionary caps in the BCA improved the long run fiscal imbalance in the 2011 projections by $7.0 trillion and the additional deficit reduction from the automatic spending reductions improved the fiscal imbalance by $4.1 trillion. Technical adjustments and changes to modeling assumptions improved the fiscal picture by $2.3 trillion since 2010. The main source of these changes are actual budget numbers being lower than projected in 2010, as well as refinements to the fiscal projections model. Also reflected are revised economic assumptions, as well as the effect of changing the projection period from 2011-2085 to 2012-2086, which collectively somewhat reduce the overall decreases brought about since 2010 from legislation.



[10] If payroll and self-employment taxes and related assets in the OASDI Trust Funds or Medicare Part A become insufficient to cover related benefits, as indicated by projections, additional funding for each of these two programs would be necessary or scheduled benefits would need to be reduced. If the government's general revenues are insufficient to cover both mandated transfers to Medicare Parts B and D and spending for other general government programs funded by the government's general revenues, either Medicare Parts B and D revenues (premiums and state transfers), or the government's general revenues would need to be increased, spending for Medicare Parts B and D and/or other general government spending would need to be reduced, and/or additional amounts would need to be borrowed from the public.

Another way of viewing the improvement in the financial outlook in this year's Report relative to last year's Report is in terms of the projected level of publicly-held debt in 2085. The ratio of publicly-held debt to GDP in 2085 is projected to reach 283 percent in this year's Report, which compares with 352 percent projected in last year's Report.

Current Policy Projections for Debt and Interest Payments

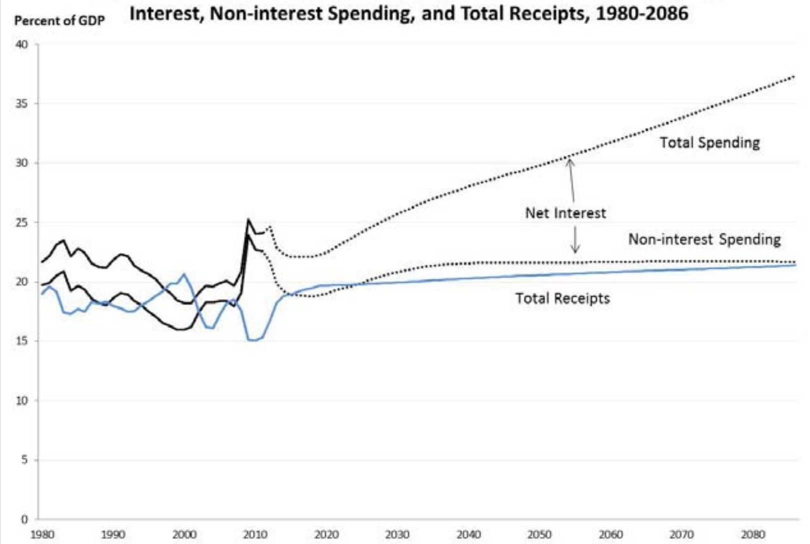
The primary deficit projections in Chart 1, along with projections for interest rates and GDP, determine the projections for the ratio of debt held by the public to GDP that are shown in Chart 3. That ratio was 68 percent at the end of fiscal year 2011, and under current policy, it is projected to exceed 76 percent in 2022, 125 percent in 2042, and 287 percent in 2086. The continuous rise of the debt-to-GDP ratio illustrates that current policy is unsustainable.

The change in debt held by the public from one year to the next is approximately equal to the unified budget deficit, the difference between total spending and total receipts.[11] Total spending consists of non-interest spending plus interest spending. Chart 4 shows that the rapid rise in total spending and the unified deficit is almost entirely due to projected interest payments on the debt. As a percent of GDP, interest spending was 1.5 percent in 2011, and under current policies it is projected to reach 5 percent by 2031 and nearly 16 percent by 2086.

The Fiscal Gap

The fiscal gap measures how much the primary surplus (receipts less non-interest spending) must increase in order for fiscal policy to achieve a target debt-to-GDP ratio in a particular future year. In these projections, the fiscal gap is estimated over a 75-year period, from 2012 to 2086, and the target debt-to-GDP ratio is equal to the ratio at beginning of the projection period, in this case the end of fiscal year 2011 debt-to-GDP ratio of 68 percent of GDP.

Chart 4: History and Current Policy Projections for Total Spending, Net Interest, Non-interest Spending, and Total Receipts, 1980-2086



The 75-year fiscal gap under current policy is estimated at 1.8 percent of GDP, as reflected in Table 3, which represents about 9% of the 75-year present value of projected receipts and of non-interest spending. As noted in Table 1, the difference between projected programmatic (non-interest) spending and receipts is 0.7 percent of GDP (reflecting the deficit condition of excess spending over receipts). However, eliminating this primary deficit of 0.7 percent of GDP is not sufficient to stabilize the debt-to-GDP ratio. Because interest rates are assumed to exceed the growth rate of GDP, reaching primary balance will still leave debt rising relative to GDP. The average primary surplus needed to return the debt-to-GDP ratio of 68 percent to its initial level and fully close the fiscal gap is 1.1 percent of GDP per year.

[11] Debt held by the public is also affected by certain transactions not included in the unified budget deficit, such as changes in Treasury's cash balances and the nonbudgetary activity of Federal credit financing accounts. These transactions are assumed to hold constant at about 0.6 percent of present value GDP.

The Cost of Closing the 75-Year Fiscal Gap

The longer policy action to close the fiscal gap is delayed, the larger the post-reform primary surplus must be to stabilize the debt-to-GDP ratio by the end of the 75 year period. Varying the years in which reforms are introduced while holding constant the ultimate target ratio of debt to GDP helps to illustrate the cost of delaying policy changes that close the fiscal gap. The reforms considered here increase the primary surplus relative to current policy by a fixed percent of GDP starting in the reform year. Three such policies are considered, each beginning in a different year. The analysis shows that the longer policy action is delayed, the larger the post-reform primary surplus must be to stabilize the debt-to-GDP ratio in 2086. Future generations are harmed by policy delay because higher primary surpluses imply lower spending and/or higher taxes than would be needed with earlier deficit reduction.

As previously shown in Chart 1, under current policy, primary deficits occur in virtually every year of the projection period. Table 3 shows primary surplus changes necessary to make the debt-to-GDP ratio in 2086 equal to its level in 2011 under each of the three policies. If reform begins in 2012, then it is sufficient to raise the primary surplus share of GDP by 1.8 percentage points in every year between 2012 and 2086 in order to have a debt-to-GDP ratio in 2086 equal to the level in 2011. This raises the average 2011-2086 primary surplus-to-GDP ratio from -0.7 percent to 1.1 percent.

Table 3

Costs of Delaying Fiscal Consolidation

Period of Delay	Change in Average Primary Surplus
No Delay: Reform in 2012	1.8 percent of GDP between 2012 and 2086
Ten Years: Reform in 2022	2.2 percent of GDP between 2022 and 2086
Thirty Years: Reform in 2032	2.8 percent of GDP between 2032 and 2086

Note: Reforms taking place in 2011, 2021, and 2031 from the 2010 Report were 2.4, 2.9, and 3.7 percent of GDP.

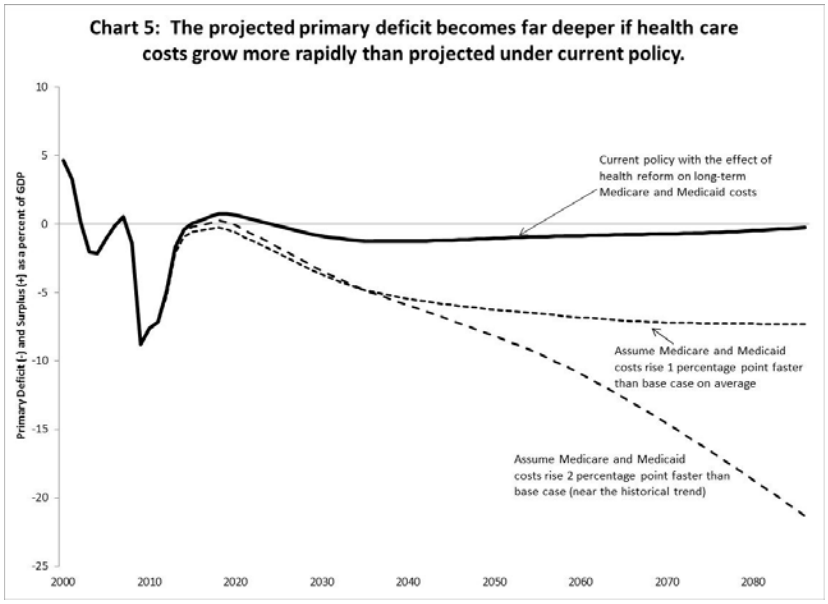
In contrast to a reform that begins immediately, if reform is begun in 2022 or 2032, the primary surplus must be raised by 2.2 percent and 2.8 percent of GDP, respectively, in order to reach a debt-to-GDP ratio in 2086 equal to the level in 2011. The difference between the primary surplus increasing in 2022 and 2032 (2.2 and 2.8 percent of GDP, respectively) rather than in 2012 (1.8 percent of GDP) is a measure of the additional burden policy delay would impose on future generations. The costs of delay are due to the debt-to-GDP ratio rising during the interim period, which increases the future amount of interest that must be covered with the primary surplus. Delaying reform increases the cost of reaching the target debt-to-GDP ratio even if the target year is extended beyond 2086, since the starting debt-to-GDP ratio will be higher.

These estimates likely understate the cost of delay because they do not assume interest rates will rise as the debt-to-GDP ratio grows. If a higher debt-to-GDP ratio increases the interest rate, making it more costly for the government to service its debt and simultaneously slowing private investment, the primary surplus required to return the debt-to-GDP ratio to its 2011 level will also increase. This dynamic may accelerate with higher ratios of debt to GDP, potentially leading to the point where there may be no feasible level of taxes and spending that would reduce the debt-to-GDP ratio to its 2011 level. The potential impact of changes in interest rates is among the variables explored in the following section.

Alternative Scenarios

The long-run outlook for the budget is extremely uncertain and therefore it makes sense to consider possible alternative projections to indicate the range of uncertainty. There are many dimensions to the projections for which reasonable variations could be considered. Some of the key issues concern long-run economic and demographic assumptions. The long-run fiscal gap is partly the result of demographic patterns that have emerged over the last 50 years with lower birth rates and reduced mortality. The population is aging rapidly and will continue to do so over the next several decades, which puts pressure on programs such as Social Security, Medicare, and Medicaid nursing care. A shift in expected fertility, mortality, or immigration rates could have important long-run effects on the projections. Increases in immigration or fertility rates, or reduction in the mortality rate would improve the long-term fiscal projections. Conversely, decreases in immigration or fertility rates, or improvements in the mortality rate would result in deterioration in the long-term fiscal projections. The remainder of this section will focus on two important variables that can also impact fiscal projections: the growth rate of heath care costs and interest rates.

Effect of Changes in Health Care Cost Growth



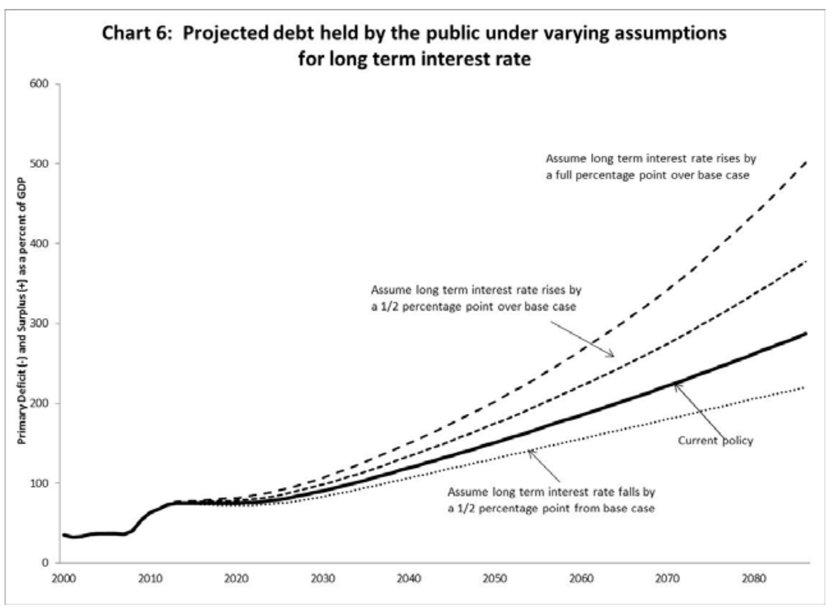
One of the most important assumptions underlying the projections is the projected growth of health care costs. Enactment of the ACA in 2010 reduced the projected long-run growth rates of health care costs, but these growth rates are still highly uncertain. As an illustration of the dramatic effect of variations in health care growth rates, Chart 5 and Table 4 show the effect on future primary deficits as well as the present value imbalance of growth rates that are one percent higher or two percent higher than the growth rates in the base projection. Relative to the base assumption of 0 percent average excess health cost growth, the one percent higher health care cost growth scenario raises the 75-year present value of non-interest spending less receipts to 4.8 percent of GDP, compared to 0.7 percent of GDP assumed in the base projection. The two percent higher health cost growth scenario raises the 75-year present value of non-interest spending less receipts even further, to 7.5 percent of GDP. The dramatic deterioration on the long-run fiscal outlook caused by higher health care cost growth shows the critical importance of managing health care cost growth, including through effective implementation of the ACA.

Table 4

Impact of Alternative Health Cost Scenarios on 75-year PV imbalance

	75-Year Present Value Fiscal Imbalance:	
Scenario	**Dollars in Trillions**	**% GDP**
Base Case: 0% Average Excess Health Cost Growth	6.4	0.7
1% Average Excess Health Cost Growth	42.7	4.8
2% Average Excess Health Cost Growth	66.5	7.5

Effects of Changes in Interest Rates



A higher debt-to-GDP ratio is likely to increase the interest rate on Government debt, making it more costly for the Government to service its debt. If a constant ratio of debt-to-GDP is not achieved and the ratio continues to rise continuously, long-term interest rates would be expected to rise further, worsening the debt ratio in the process. Chart 6 and Table 5 display several alternative scenarios where differing interest rate assumptions are used from the base case found in the Social Security trustees' report. In the scenario where the interest rate rises a constant one-half percentage point above the base projection starting in 2012, the debt-to-GDP ratio in 2086 rises from 287 percent to 378 percent. As shown in Table 5, the present value imbalance falls from $6.4 trillion to $5.5 trillion. Adding a full percentage point to the base projection starting in 2012 raises the 2086 debt-to-GDP ratio to 502 percent, but drops the 75-year fiscal imbalance to $4.7 trillion. To show the effects of achieving balance and lowering long-term debt-to-GDP and interest rates, lowering interest rates by one-half percentage point from the base projection starting in 2012 in turn lowers the 2086 debt ratio to 220 percent; however lowering the interest rate raises the 75-year present value imbalance to $7.6 trillion. It is clear that there is risk to continuing down a path of rising debt-to-GDP ratios, with a compounding impact that could lead to even worse consequences if no policy actions are taken.

Table 5

Impact of Alternative Interest Rate Scenarios on 75-year PV imbalance

	75-Year Present Value Fiscal Imbalance:	
Scenario	**Dollars in Trillions**	**% GDP**
Base Case: Average of 5.6 percent over 75 years	6.4	0.7
0.5 percent higher interest rate in each year	5.5	0.7
1.0 percent higher interest rate in each year	4.7	0.7
0.5 percent lower interest rate in each year	7.6	0.7

Other key economic assumptions in this report include the future growth rate of real GDP, which itself depends on assumptions such as future growth in the labor force and labor productivity. Historically, U.S. labor productivity has increased at a rate of about 2 percent or more per year, but there have been periods when productivity grew less rapidly and other periods in which it grew faster. Productivity growth has averaged 2.5 percent per year over the last 15 years, which is above its long-run trend. In these projections, the rate of productivity growth is assumed to be somewhat below its long-run trend, which is a conservative assumption. It is unlikely that higher productivity growth will be sufficient to resolve the long-run budget problem. Faster growth will lead to higher wages, which will lead to more tax revenue in the near term, but these gains will be partly offset by higher payments for Social Security and other benefit programs in the long term, because benefits are tied to wages. Inflation is not a major factor in these calculations. Changes in the trend rate of inflation have offsetting effects on future revenues and future spending, so the budget effect is more nearly neutral in the long run.

Fiscal Projections in Context

All of the major countries of the world have outstanding government debt. The United States Government's debt as a percentage of GDP is relatively large compared with other countries, but far from the largest among the countries in the Organization for Economic Co-operation and Development (OECD). Based on historical data as reported by the OECD, the 31 OECD countries ranged in debt ratios in 2009 from 6 percent of GDP to 126 percent of GDP, with the United States in the higher echelon.[12] However, each country is different in how it finances its sovereign debt, how robustly its economies grow, and how fair and stable taxation and benefits are across generations and income levels, so the comparison of current debt levels across nations and what they mean for fiscal projections across nations is not well defined. Past accrual of debt is certainly important, but future action encompassed in fiscal projections is a more prudent gauge for comparison.

Several countries have begun to produce long-range fiscal projections in the last two decades. However, comparisons are difficult because the coverage of the reports and the time horizon projected vary across countries. The horizon for most of these reports is less than 75 years, and the projections are not always updated annually. Some of the countries that have produced long-range projections have shown sustainable policies in the long run, although the recent financial crisis will have worsened the near-term budget outlook in almost every country. Early developers of such fiscal projections include Australia, New Zealand, Canada, the United Kingdom, Denmark, Sweden, Norway, and the Netherlands.[13]

[12] Central Government Debt, OECD National Accounts Statistics (database) available at http://www.oecd-ilibrary.org/finance-and-investment/total-central-government-debt-2010_20758294-2010-table1

[13] The Organization for Economic Cooperation and Development (OECD) released a policy brief in October 2009 (available at http://www.oecd.org/dataoecd/40/26/43836144.pdf) describing the efforts of different member countries to produce long-term fiscal projections.

Conclusion

The United States took a potentially significant step towards fiscal sustainability in 2010 by reforming its system of health insurance. The legislated changes for Medicare, Medicaid, and other health coverage hold the prospect of lowering the long-term growth trend for future health care costs and significantly reducing the long-term fiscal gap. Furthermore, enactment of the Budget Control Act in August 2011 placed limits on future discretionary spending and established a process to assure further deficit reduction of $1.2 trillion over 10 years. But even with the new laws, the projections in this Report indicate that if policy remains unchanged then the debt-to-GDP ratio will continually increase over the next 75 years and beyond, which means current policies are not sustainable and must ultimately change. Subject to the important caveat that policy changes are not so abrupt that they slow the economic recovery, the sooner policies are put in place to avert these trends, the smaller are the revenue increases and/or spending decreases necessary to reach a target debt-to-GDP ratio in 2086 and return the Nation to a sustainable fiscal path.

The projections presented in this Report assume current policies remain unchanged so as to inform the question of whether current fiscal policy is sustainable and, if it is not sustainable, the magnitude of needed reforms to make it sustainable. The projections are therefore neither forecasts nor predictions. If policy changes are enacted, perhaps in response to projections like those presented here, then actual financial outcomes will of course be different than those projected. While this these projections of expenditures and receipts under current policies are highly uncertain, there is little question that current policies cannot be sustained indefinitely.

Social Insurance

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

Social Security and Medicare

Social Security

The OASI Trust Fund was established on January 1, 1940, as a separate account in the Treasury. The 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 because of medical conditions and certain family members of such eligible individuals. 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. At the end of calendar year 2010, OASDI benefits were paid to approximately 54 million beneficiaries.

The primary financing of these two funds are taxes paid by workers, their employers, and individuals with self-employment income, based on work covered by the OASDI Program. Since 1990, employers and employees have each paid 6.2 percent of taxable earnings. The self-employed pay 12.4 percent of taxable earnings. Payroll taxes are computed on wages and net earnings from self-employment up to a specified maximum annual amount, referred to as maximum taxable earnings ($106,800 in 2011), that increases each year with economy-wide average wages.

Legislation passed in 1984 subjected up to half of OASDI benefits to tax and allocated the revenue to the OASDI Trust Funds, and in 1993 legislation upped the potentially taxed portion of benefits to 85 percent and allocated the additional revenue to the Hospital Insurance Trust Fund.

Medicare

The Medicare Program, created in 1965, also has two separate trust funds: the Hospital Insurance (HI, Medicare Part A) and Supplementary Medical Insurance (SMI, Medicare Parts B and D) Trust Funds.[1] HI pays for inpatient acute hospital services and major alternatives to hospitals (skilled nursing services, for example) and SMI pays for hospital outpatient services, physician services, and assorted other services and products through the Part B account and pays for prescription drugs through the Part D account. Though the events that trigger benefit payments are similar, HI and SMI have different earmarked financing structures. Similar to OASDI, HI is financed primarily by payroll contributions. Currently, employers and employees each pay 1.45 percent of earnings, while self-employed workers pay 2.9 percent of their net earnings. Beginning in 2013, employees and self-employed individuals with earnings above certain thresholds will pay an additional HI tax of 0.9 percent on earnings above those thresholds. Other income to the HI Trust 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. As is explained in the next section, these Treasury securities and related interest have no effect on the consolidated statement of Governmentwide finances.

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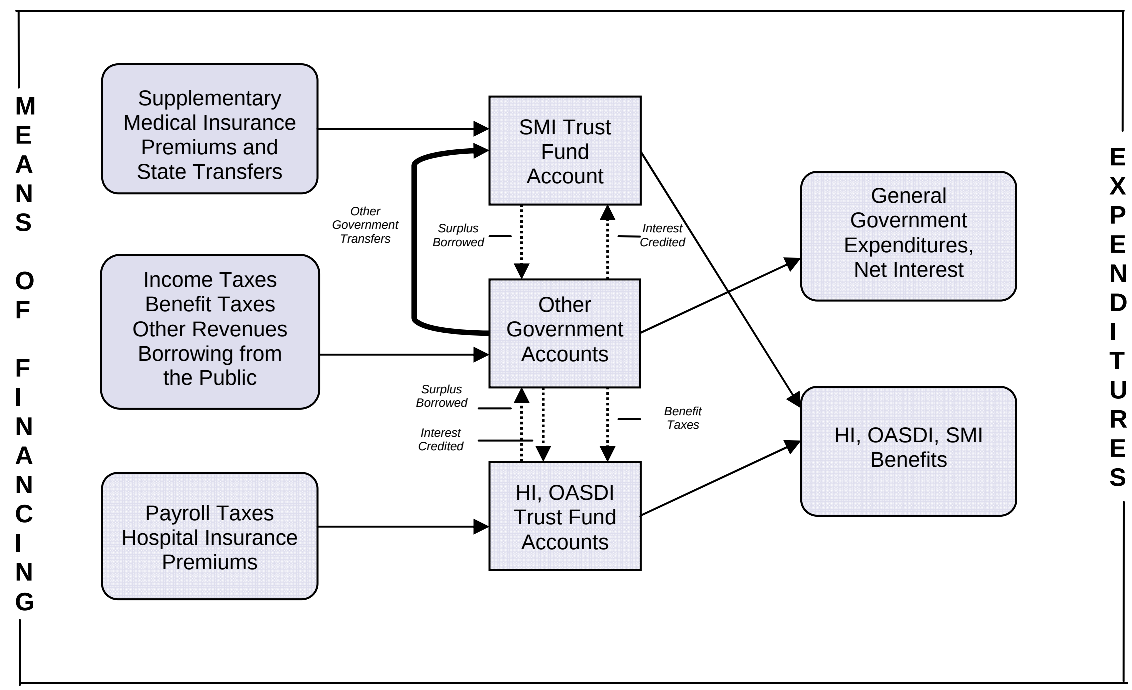
[1] Medicare legislation in 2003 created the new Part D account in the SMI Trust Fund to track the finances of a new prescription drug benefit that began in 2006. As in the case of Medicare Part B, approximately three-quarters of revenues to the Part D account will come from future transfers from the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

For SMI, transfers from the General Fund of the Treasury represent the largest source of income covering about 76 percent and 80 percent of program costs for Parts B and D, respectively. In 2011, beneficiary premiums and, for Part D, State transfers financed approximately 24 percent and 20 percent of costs for Parts B and D, respectively. With the introduction of Part D drug coverage, Medicaid is no longer the primary payer of drug benefits for beneficiaries dually eligible for Medicare and Medicaid. For those beneficiaries, States must pay the Part D account a portion of their estimated foregone drug costs for this population (referred to as State transfers). As with HI, interest received on Treasury securities held in the SMI Trust Fund is credited to the fund. These Treasury securities and related interest have no effect on the consolidated statement of Governmentwide finances. See Note 26—Social Insurance, for additional information on Medicare program financing.

Figure 1
Social Security, Medicare, and Governmentwide Finances



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 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, and has a broader focus than the trust fund perspective that may appropriately be referred to as the "budget perspective" or the "Governmentwide perspective." Social Security and Medicare are among the largest expenditure categories of the U.S. Federal budget. Together, they now account for more than a third of all Federal spending and the percentage is projected to rise dramatically for the reasons discussed below. This section describes in detail the important relationship between the trust fund perspective and the Governmentwide perspective.

Figure 1 is a simplified graphical depiction of the interaction of the Social Security and Medicare Trust Funds with the rest of the Federal budget.[2] The boxes on the left show sources of funding, those in the middle represent the trust funds and other Government accounts (of which the General Fund is a part) into which that funding flows, and the boxes on the right show simplified expenditure categories. The figure is intended to illustrate how the various sources of program revenue flow through the budget to beneficiaries. The general approach is to group revenues and expenditures that are linked specifically to Social Security and/or Medicare separately from those for other 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 represents revenue from the public that are earmarked specifically for the respective trust fund, and cannot be used for other purposes. In contrast, personal and corporate income taxes and other revenue go into the General Fund of the Treasury and are drawn down for any Government program for which Congress has approved spending.[3] The arrows from the boxes on the left represent the flow of the 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 to the SMI Trust Fund from 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 only one of the programs that is funded through transfers from the General Fund of the Treasury, which is part of the other Government accounts (the Part D account also receives transfers from the States). The transfers finance roughly three-fourths of SMI Program expenses. The transfers are automatic; their size depends on how much the program requires, not on how much 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 increase beyond growth in general revenues as shown below, they are projected to increase significantly in coming years—then Congress must either raise taxes, cut other Government spending, reduce SMI benefits, or borrow even more.

The dotted lines between the middle boxes of Figure 1 also represent intragovernmental transfers but those transfers arise in the form of “borrowing/lending” between the Government accounts. Interest credited to the trust funds arises when the excess of program income over expenses is loaned to the General Fund. The vertical lines labeled *Surplus Borrowed* represent these flows from the trust funds to the other Government accounts. These loans reduce the amount the General Fund has to borrow from the public to finance a deficit (or likewise increase the amount of debt paid off if there is a surplus). However, 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. 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 finance the benefits paid by the trust fund through general revenues or borrowing, just as for any Governmental program.

Actual dollar amounts roughly corresponding to the flows presented in Figure 1 are shown in Table 1 for fiscal year 2011. 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 ($306.3 billion) and interest credits ($132.1 billion) received by the trust funds appear as negative entries under “Other Government” and are thus offsetting when summed for the total budget column. These two intragovernmental transfers are the key to the differences between the trust fund and budget perspectives.

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

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

From the Governmentwide perspective, only revenues received from the public (and States in the case of Medicare, Part D) and expenditures made to the public are important for the final balance. Trust fund revenue from the public consists of payroll taxes, benefit taxes, and premiums. For HI, the difference between total expenditures made to the public ($259.6 billion) and revenues ($213.1 billion) was ($46.5 billion) in 2011, 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 2011. The difference ($227.5 billion) resulted in a net draw on the overall budget balance in that year. For OASDI, the difference between total expenditures made to the public ($730.7 billion) and revenues from the public ($602.1 billion) was ($128.6) billion in 2011, indicating that OASDI had a negative effect on the overall budget outcome *in that year*.

The trust fund perspective is captured in the bottom section of each of the three trust fund columns. For HI, total expenditures exceeded total revenues by $33.1 billion in 2011, as shown at the bottom of the first column. This cash deficit was made up by calling in past loans made to the General Fund (i.e., by redeeming Trust Fund assets). For SMI, total revenues of $301.3 billion ($72.9 + $228.4), including $225.2 billion transferred from other Government accounts (the General Fund), exceeded total expenditures by $0.9 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 $798.7 billion ($602.1 + $196.6), including interest and other Government transfers, exceeded total expenditures of $730.7 billion by $68.0 billion.

Table 1
Revenues and Expenditures for Medicare and Social Security Trust Funds and the Total Federal Budget for the Fiscal Year ended September 30, 2011

(In billions of dollars)	Trust Funds HI	SMI	OASDI	Total	All Other	Total [1]
Revenues from the public and States:						
Payroll and benefit taxes, State grants...	207.2		602.1	809.3		809.3
Premiums	5.9	64.5		70.4		70.4
Other taxes and fees		8.4		8.4	1,414.4	1,422.8
Total..	213.1	72.9	602.1	888.1	1,414.4	2,302.5
Total expenditures to the public [2].............	259.6	300.4	730.7	1,290.7	2,310.4	3,601.1
Net results—budget perspective [3].........	(46.5)	(227.5)	(128.6)	(402.6)	(896.0)	(1,298.6)
Revenues from other Government accounts:						
Transfers	0.5	225.2	80.6	306.3	(306.3)	
Interest credits	12.9	3.2	115.9	132.1	(132.1)	
Total..	13.4	228.4	196.6	438.4	(438.4)	
Net results—trust fund perspective (change in trust fund balance) [3]..........	(33.1)	0.9	68.0	35.8	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 $1,298.6 billion was the total Federal deficit in fiscal year 2011.
[2] The OASDI figure includes $4.6 billion transferred to the Railroad Retirement Board for benefit payments and is, therefore, an expenditure to the public.
[3] Net results are computed as revenues less expenditures.

Notes: Amounts may not add due to rounding.
"N/A" indicates not applicable.

Cashflow Projections

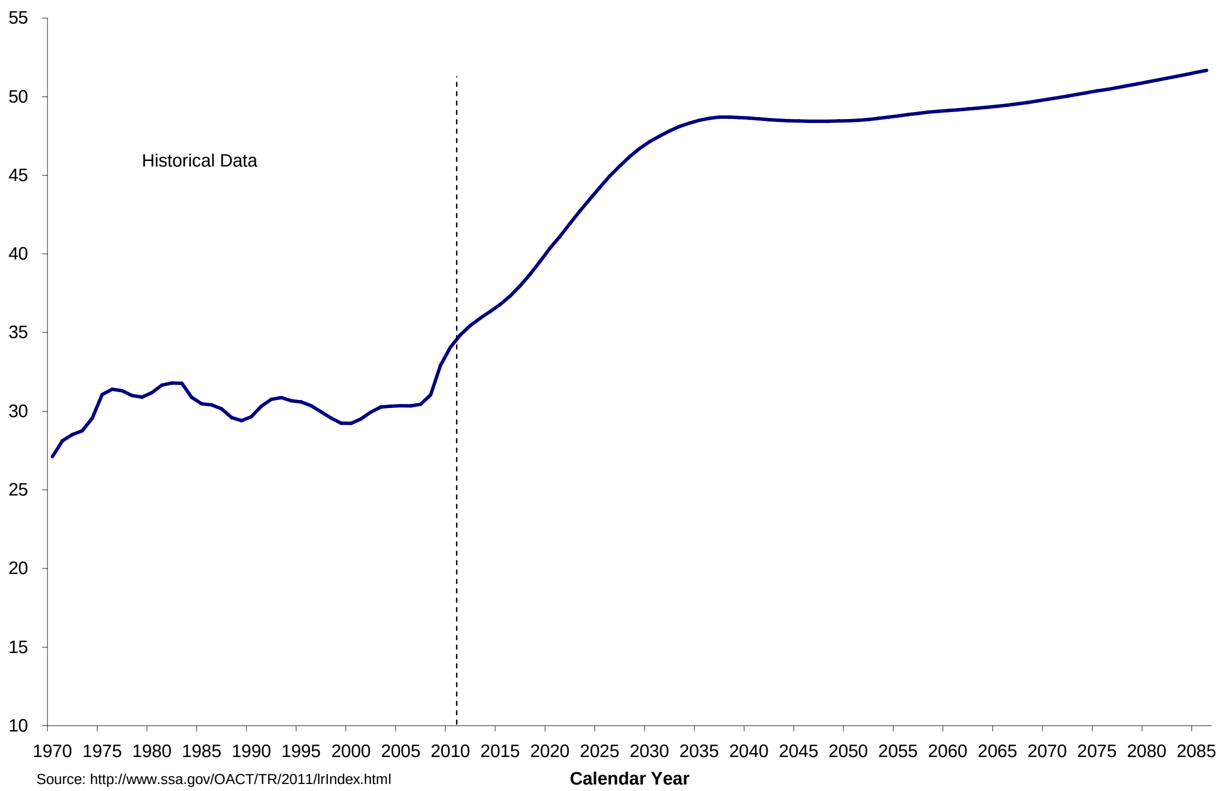
Background

Economic and Demographic Assumptions. The Boards of Trustees [4] of the OASDI and Medicare Trust Funds provide in their annual reports to Congress short-range (10-year) and long-range (75-year) actuarial estimates of each trust fund. Because of the inherent uncertainty in estimates for 75 years into the future, the Boards use three alternative sets of economic and demographic assumptions to show a range of possibilities. The economic and demographic assumptions used for the most recent set of intermediate projections for Social Security and Medicare are shown in the "Social Security" and "Medicare" sections of Note 26—Social Insurance.

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

Beneficiary-to-Worker Ratio. Underlying the pattern of expenditure projections for both the OASDI and Medicare Programs is the impending demographic change that will occur as the large baby-boom generation, born in the years 1946 to 1964, retires or reaches eligibility age. The consequence is that the number of beneficiaries will increase much faster than the number of workers who pay taxes that are used to pay benefits. The pattern is illustrated in Chart 1 which shows the ratio of OASDI beneficiaries to 100 covered workers for the historical period and estimated for the next 75 years. In 2011, there were about 35 beneficiaries for every 100 workers. By 2030, there will be about 47 beneficiaries for every 100 workers. A similar demographic pattern confronts the Medicare Program. For example, for the HI Program, there were about 30 beneficiaries for every 100 workers in 2011; by 2030, there are expected to be about 43 beneficiaries for every 100 workers. This ratio for both programs will continue to increase to about 49 beneficiaries for Medicare and 52 beneficiaries for OASDI for every 100 workers by the end of the projection period, after the baby-boom generation has moved through the Social Security system and as birth rates decline and longevity increase.

Chart 1—OASDI Beneficiaries per 100 Covered Workers 1970-2085



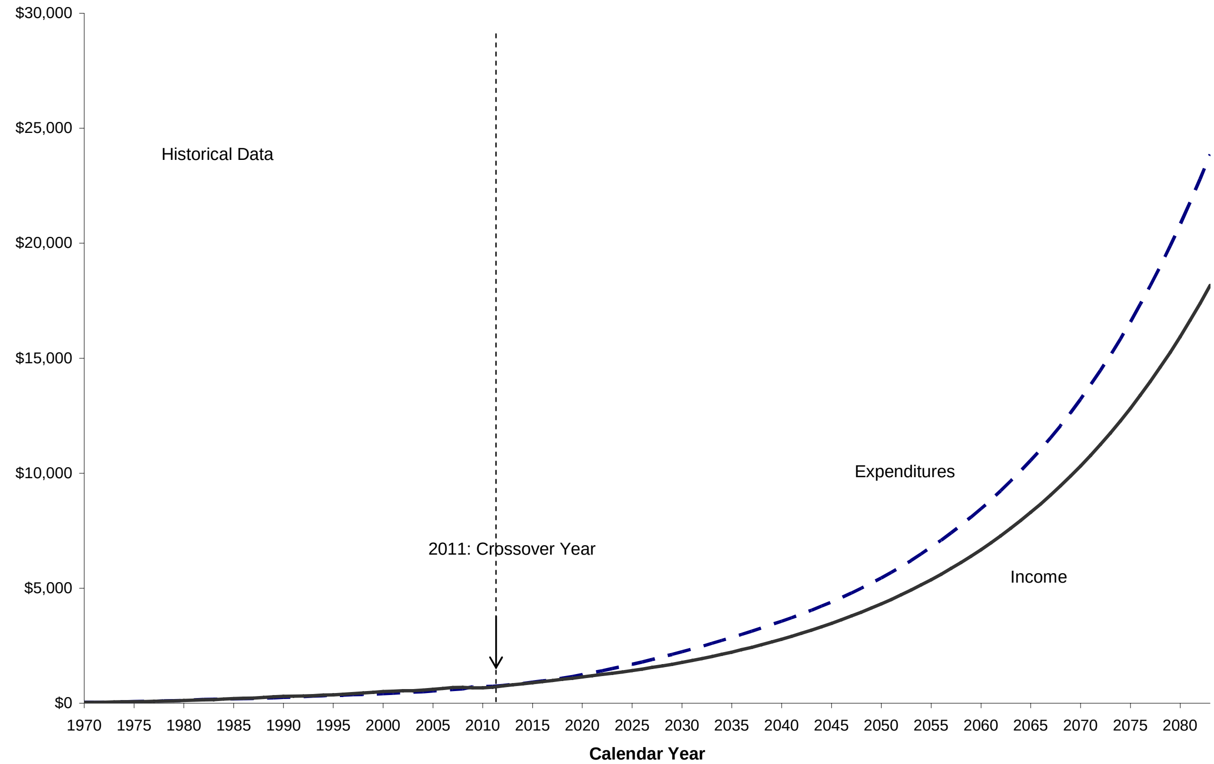
Source: http://www.ssa.gov/OACT/TR/2011/lrIndex.html

Social Security Projections

Income and Expenditures. Chart 2 shows historical values and actuarial estimates of combined OASDI annual income (excluding interest) and expenditures for 1970-2085. 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 1970-2085

(In billions of dollars)



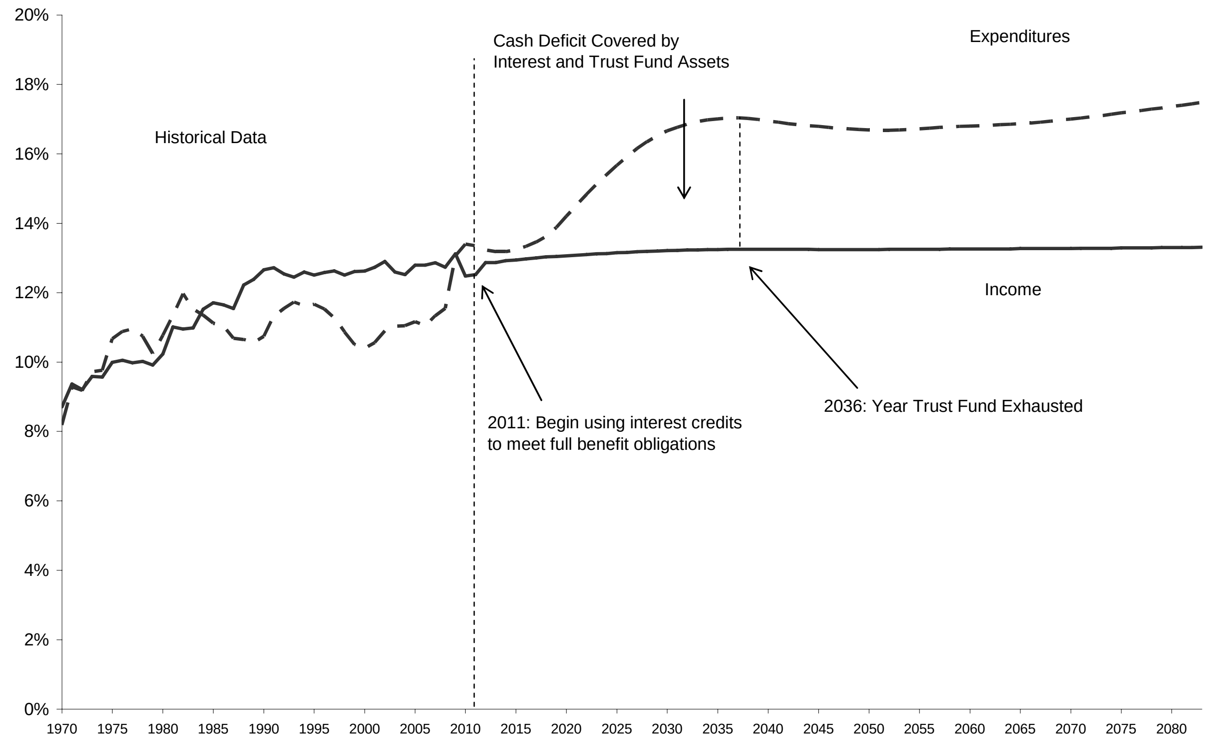
Source: http://www.ssa.gov/OACT/TR/2011/lr6f9.html

Currently, Social Security tax revenues exceed benefit payments and is expected to continue to do so until 2011, 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 increase rapidly and first exceeds the income rate in 2011, producing cashflow deficits thereafter. As described above, surpluses that occur prior to 2016 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 2011, 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 2036, 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 77 percent of scheduled benefits after trust fund exhaustion in 2036 and 74 percent of scheduled benefits in 2085.

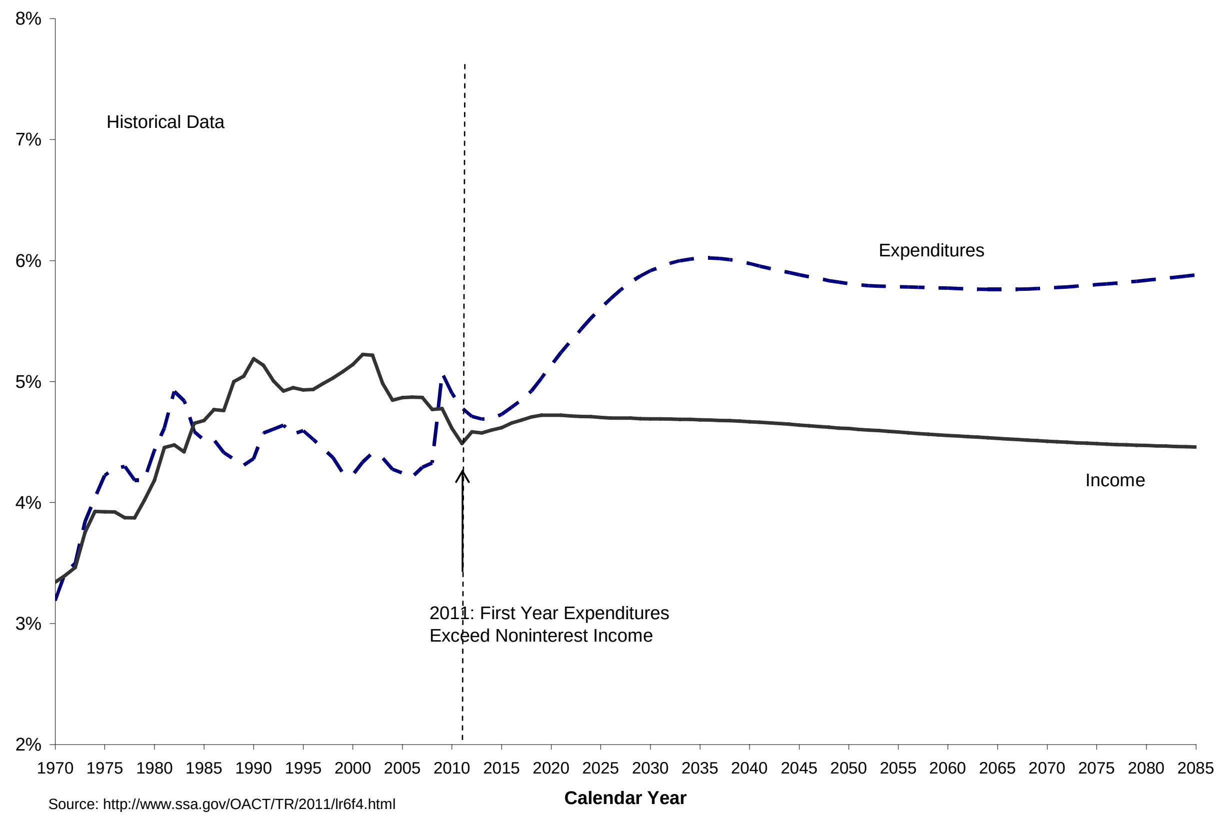
Chart 3—OASDI Income (Excluding Interest) and Expenditures as a Percent of Taxable Payroll 1970-2085



Source: http://www.ssa.gov/OACT/TR/2010/lr4b1.html

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 generally widens with expenditures generally growing as a share of GDP and income declining slightly relative to GDP. Social Security's expenditures are projected to grow from 4.85 percent of GDP in 2011 to 6.01 percent in 2085. In 2085, expenditures are projected to exceed income by 1.46 percent of GDP.

Chart 4—OASDI Income (Excluding Interest) and Expenditures as a Percent of GDP 1970-2085



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

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

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

Table 2 shows the effects of changing individual assumptions on the present value of estimated OASDI expenditures in excess of income (the *shortfall* of income relative to expenditures in present value terms). The assumptions are shown in parentheses. For example, the intermediate assumption for the annual rate of *reduction in age-sex-adjusted death rates* is 0.78 percent. For the low-cost alternative, a slower reduction rate (0.32 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 $9,157 billion to $7,017 billion, a 23 percent smaller shortfall. The high-cost death rate assumption (1.31 percent) results in an increase in the shortfall, from $9,157 billion to $11,244 billion, a 23 percent increase in the shortfall. Clearly, alternative death rate assumptions have a substantial impact on estimated future cashflows in the OASDI Program.

A higher fertility rate means more workers relative to beneficiaries over the projection period, thereby lowering the shortfall relative to the intermediate assumption. An increase in the rate from 2.0 to 2.3 percent results in an 11 percent smaller shortfall (i.e., expenditures less income), from $9,157 billion to $8,179 billion.

Higher real wage growth results in faster income growth relative to expenditure growth. Table 2 shows that a real wage differential that is 0.6 greater than the intermediate assumption of 1.2 results in a drop in the shortfall from $9,157 billion to $7,099 billion, a 22 percent decline.

The CPI change assumption operates in a somewhat counterintuitive manner, as seen in Table 2. A lower rate of change results in a higher shortfall. This arises as a consequence of holding the real wage assumption constant while varying the CPI so that wages (the income base) are affected sooner than benefits. If the rate is assumed to be 2.8 percent rather than 3.8 percent, the shortfall decreases about 6 percent, from $9,157 billion to $8,634 billion.

The effect of net immigration is similar to fertility in that, over the 75-year projection period, higher immigration results in proportionately more workers (taxpayers) than beneficiaries. The low-cost assumption for net immigration results in a 5 percent drop in the shortfall, from $9,157 billion to $8,659 billion, relative to the intermediate case; and the high-cost assumption results in a 5 percent higher shortfall.

Finally, Table 2 shows the sensitivity of the shortfall to variations in the real interest rate or, in present value terminology, the sensitivity to alternative discount rates assuming a higher discount rate results in a lower present value. The shortfall of $7,313 billion is 20 percent lower when the real interest rate is 3.6 percent rather than 2.9 percent, and is 32 percent higher when the real interest rate is 2.1 percent rather than 2.9 percent.

Table 2
Present Values of Estimated OASDI Expenditures in Excess of Income under Various Assumptions, 2011-2085

(Dollar values in billions; values of assumptions shown in parentheses)

	Financing Shortfall Range		
Assumption	**Low**	**Intermediate**	**High**
Average annual reduction in death rates.....	7,017 (0.32)	9,157 (0.78)	11,244 (1.31)
Total fertility rate	8,179 (2.3)	9,157 (2.0)	10,130 (1.7)
Real wage differential	7,099 (1.8)	9,157 (1.2)	10,554 (0.6)
CPI change	8,634 (3.8)	9,157 (2.8)	9,696 (1.8)
Net immigration..	8,659 (1,385,000) [1]	9,157 (1,075,000) [1]	9,645 (785,000) [1]
Real interest rate..	7,313 (3.6)	9,157 (2.9)	12,103 (2.1)

[1] Amounts represent the average annual net immigration over the 75-year projection period.

Source: 2011 OASDI Trustees Report and SSA.

Medicare Projections

Medicare Legislation. The Affordable Care Act as amended by the Health Care and Education Reconciliation Act of 2010 (the "Affordable Care Act" or ACA) significantly improves projected Medicare finances. The most important cost saving provision in the ACA is a revision in payment rates for parts A and B services other than for physicians' services. Relative to payment rates made under prior law that were based on the rate at which prices for inputs used to provide Medicare services increase, the ACA reduces those payment rates by the rate at which productive efficiency in the overall economy increases, which is projected to average 1.1 percent per year. The ACA also achieves substantial cost savings by reducing payment rates for private health plans providing Parts A and B services (Part C or Medicare Advantage) to more closely match per beneficiary costs. Partly offsetting these changes was an increase in prescription drug coverage. In addition, the ACA increases Part A revenues by: (a) taxing high-cost employer-provided health care plans and thereby giving employers incentives to increase the share of compensation paid as taxable earnings, and (b) imposing a new 0.9 percent surtax on earnings in excess of $200,000 (individual tax return filers) or $250,000 (joint tax return filers) starting in 2013.

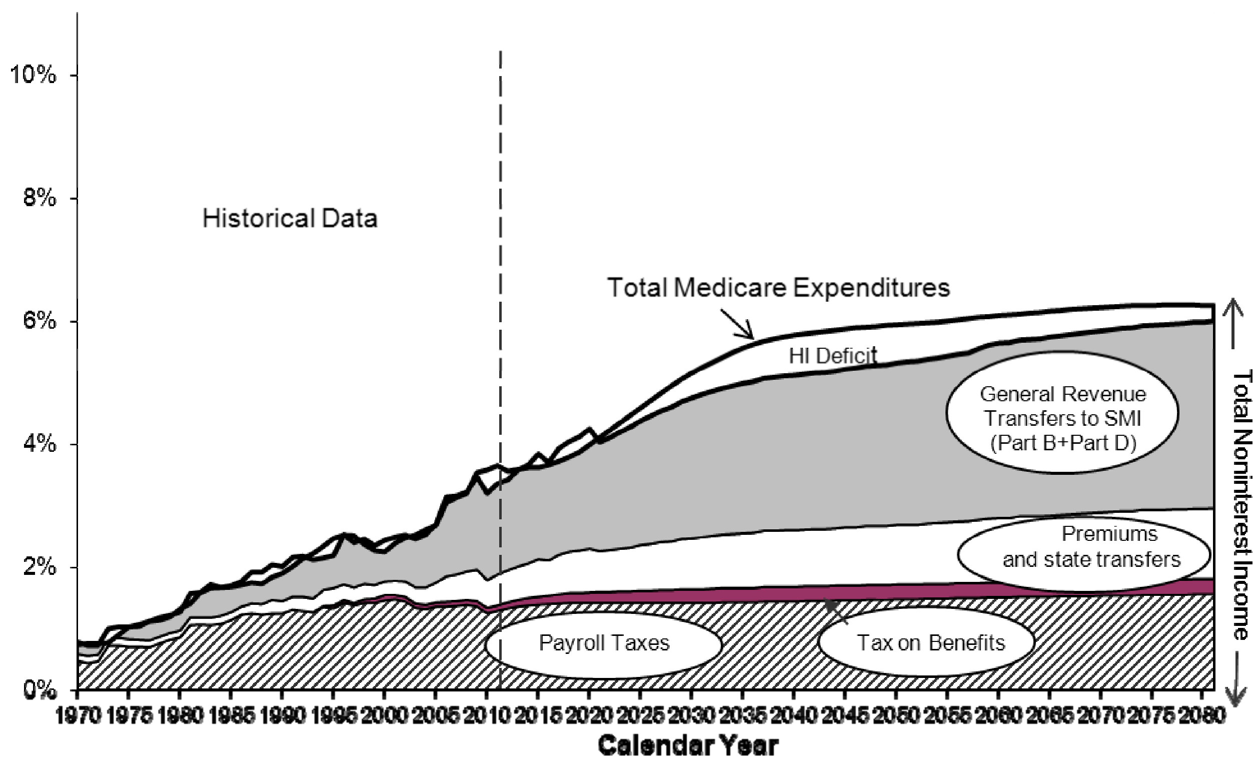
The 2011 Medicare Trustees' Report warns that the "actual future costs for Medicare are likely to exceed those shown by the current-law projections that underlie both the Trustees' Report and this *Financial Report*. This warning is primarily due to the fact that productivity growth in the provisions of Medicare services have in the past been much smaller than productivity growth in the overall economy, which suggests that the new productivity-based downward adjustments to Medicare payment rates may not be sustainable. This concern is reinforced by the fact that similar adjustments to payment rates for Medicare physicians' services mandated by a 1996 Medicare reform have been consistently overridden by new law.

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 that is driven in large part by new technology. Growth in Medicare cost per beneficiary in excess in growth in per capita GDP is referred to as “excess cost growth.” In last year’s *Financial Report*, excess cost growth was assumed to be about 1 percentage point—that is, Medicare expenditures per beneficiary were assumed to grow, on average, about one percentage point faster than per capita GDP over the long range. An assumption for excess cost growth was smaller than in recent history; excess cost growth averaged 1-1/2 percentage points between 1990 and 2007. [5] The combination of more beneficiaries per worker and 1 percent excess cost growth caused projected Medicare expenditures to grow substantially more rapidly than GDP in the 2010 *Financial Report*. In this year’s *Financial Report*, however, long-term excess cost growth is essentially zero because of the productivity adjustments to payment rates called for by the ACA. As a result, the long term projected Medicare spending share of GDP in this Report is driven primarily by the same demographic trends that drive the OASDI spending share of GDP.

[5] Congressional Budget Office, the Long-Term Budget Outlook, June 2011.

Total Medicare. 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 6.24 percent of GDP by 2085. Revenues from taxes and premiums (including State transfers under Part D) are expected to increase from 1.88 percent of GDP in 2011 to 2.99 percent of GDP in 2085. Payroll tax income increases gradually as a percent of GDP because the new tax on earnings in excess of $250,000 for joint tax return filers and $200,000 for individual tax return filers applies to an increasing share of earnings because the $250,000 and $200,000 thresholds are not indexed for price changes. Premiums combined for Parts B and D of SMI are approximately fixed as a share of Parts B and D costs, so they also increase as a percent of GDP. General revenue contributions for SMI, as determined by current law, are projected to rise as a percent of GDP from 1.48 percent to 3.06 percent over the same period. Thus, revenues from taxes and premiums (including State transfers) will fall substantially as a share of total noninterest Medicare income (from 56 percent in 2011 to 49 percent in 2085) while general revenues will rise (from 44 percent to 51 percent). The gap between total noninterest Medicare income (including general revenue contributions) and expenditures begins around 2011 and then steadily continues to widen, reaching 0.2 percent of GDP by 2085.

Chart 5—Total Medicare (HI and SMI) Expenditures and Noninterest Income as a Percent of GDP 1970-2085

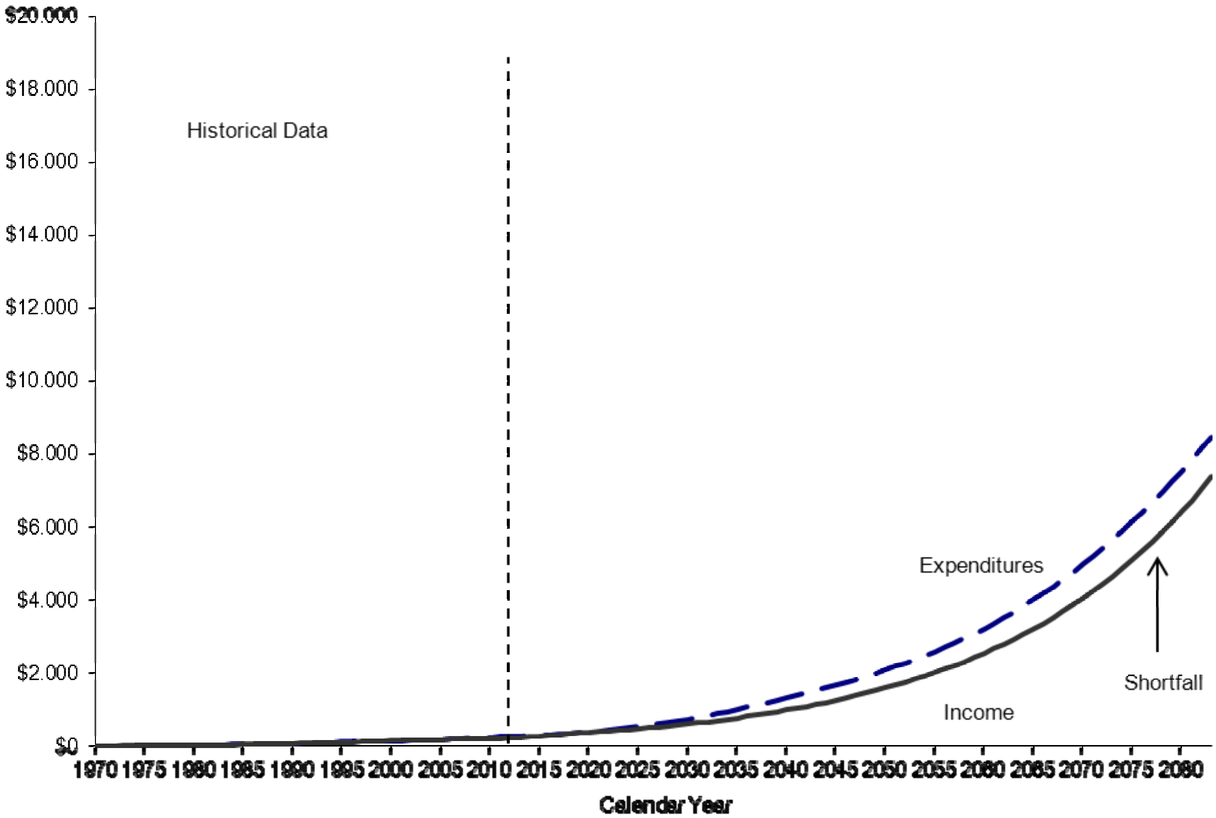


Source: http://www.ssa.gov/OACT/TRSUM/images/LD_ChartC.html

Medicare, Part A (Hospital Insurance)—Nominal Income and Expenditures. Chart 6 shows historical and actuarial estimates of HI annual income (excluding interest) and expenditures for 1970-2085 in nominal dollars. The estimates are for the open-group population.

Chart 6—Medicare Part A Income (Excluding Interest) and Expenditures 1970-2085

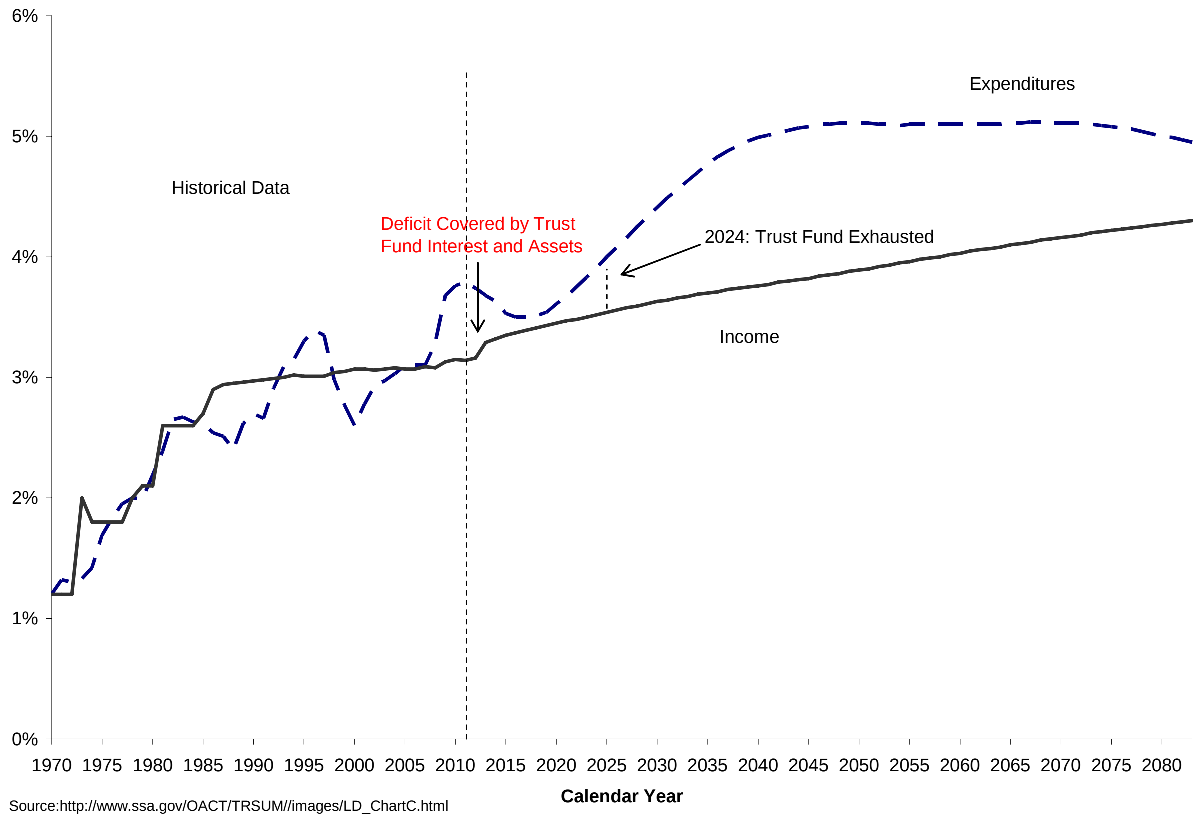
(In billions of dollars)



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

Medicare, Part A Income and Expenditures as a Percent of Taxable Payroll. Chart 7 illustrates income (excluding interest) and expenditures as a percentage of taxable payroll over the next 75 years. The chart shows that the expenditure rate exceeds the income rate in 2008, and cash deficits continue thereafter. Trust fund interest earnings and assets provide enough resources to pay full benefit payments until 2024 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 2024. Present tax rates would be sufficient to pay 90 percent of scheduled benefits after trust fund exhaustion in 2024 and 88 percent of scheduled benefits in 2085.

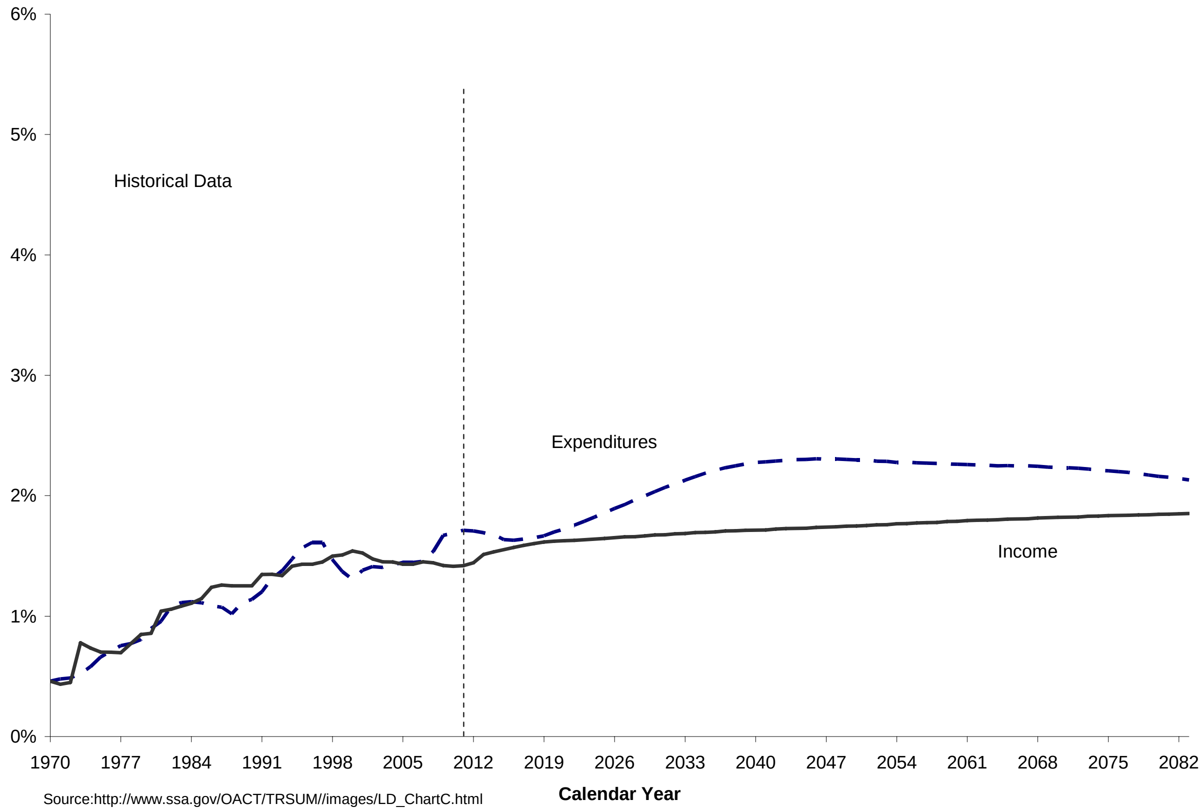
Chart 7—Medicare Part A Income (Excluding Interest) and Expenditures as a Percent of Taxable Payroll 1970-2085



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

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, and 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 1.71 percent of GDP in 2011, to 2.03 percent in 2030, and to 2.11 percent by 2085. The gap between expenditure and income shares of GDP widens and peaks at 0.57 percent in 2046 and then commences a steady decline, reaching 0.25 percent of GDP in 2085.

Chart 8—Medicare Part A Income (Excluding Interest) and Expenditures as a Percent of GDP 1970-2085

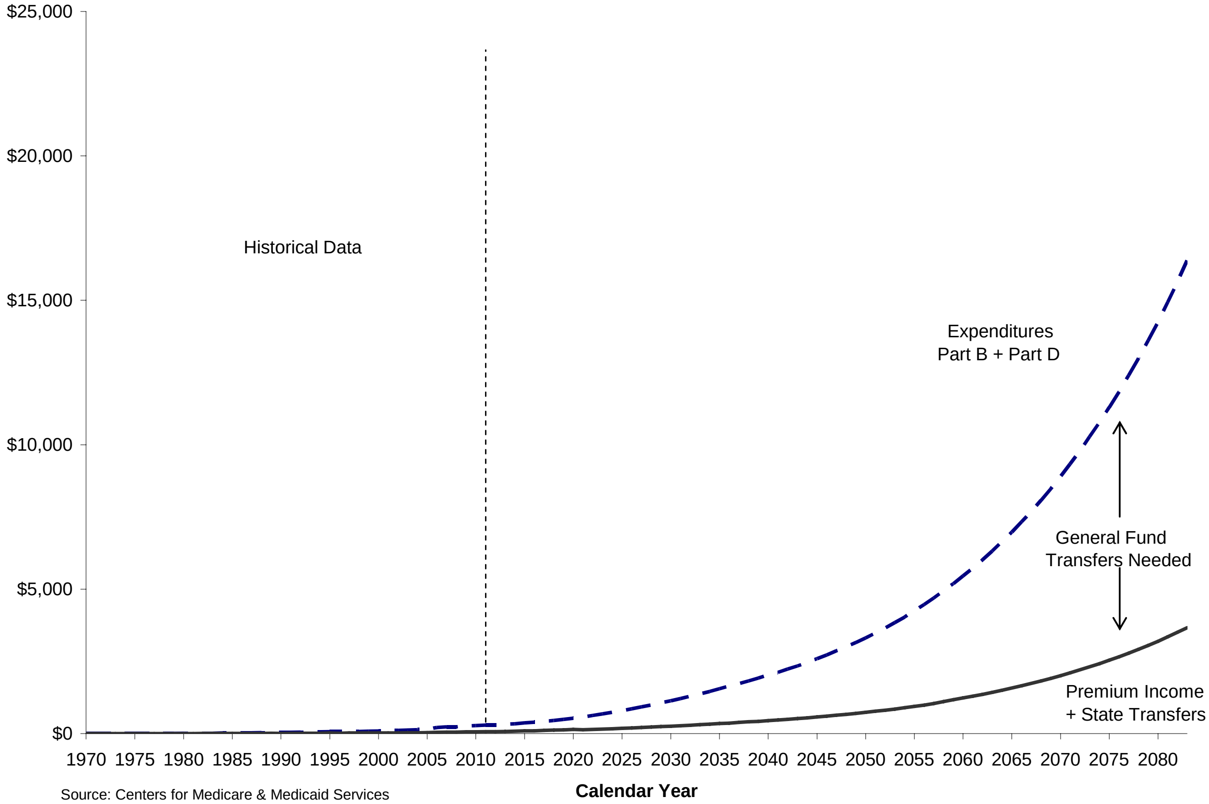


Source:http://www.ssa.gov/OACT/TRSUM//images/LD_ChartC.html

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

Chart 9—Medicare Part B and Part D Premium and State Transfer Income and Expenditures 1970-2085

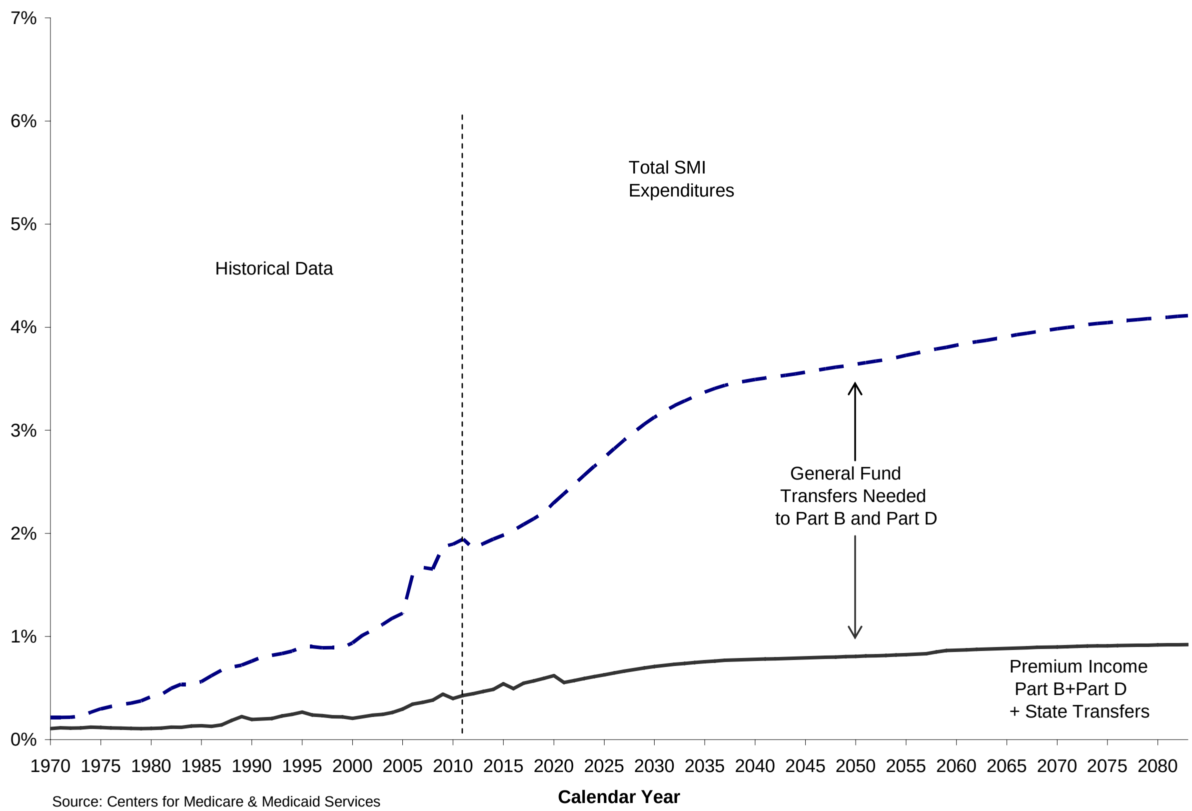
(In billions of dollars)



Source: Centers for Medicare & Medicaid Services

Medicare Part B and Part D Premium and State Transfer Income and Expenditures as a Percent of GDP. Chart 10 shows expenditures for the Supplementary Medical Insurance Program over the next 75 years expressed as a percentage of GDP, providing a perspective on the size of the SMI Program in relation to the capacity of the national economy to sustain it. SMI expenditures as a share of GDP are expected to grow rapidly from 1.94 percent in 2011 to 3.37 percent in 2035, and then grow more slowly reaching 4.13 in 2085. This growth pattern reflects growth in Medicare spending per beneficiary that is positive for the first half of the projection period before turning negative as a result of provisions in the ACA and to population ageing that is rapid through 2035 as the baby boom generation move into their advanced years and then slows to a modest pace consistent with increasing longevity. Premium and State transfer income grows from about 0.49 in 2011 to 1.08 percent in GDP in 2085, so the portion financed by General Fund transfers to SMI is projected to be about 75 percent throughout the projections period.

Chart 10—Medicare Part B and Part D Premium and State Transfer Income and Expenditures as a Percent of GDP 1970-2085



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

Table 3 shows the effects of changing various assumptions on the present value of estimated HI expenditures in excess of income (the *shortfall* of income relative to expenditures in present value terms). The assumptions are shown in parentheses. Clearly, net HI expenditures are extremely sensitive to alternative assumptions about the growth in health care cost. For the low-cost alternative, the slower growth in health costs causes the shortfall to drop from $3,252 billion to a surplus of $1,917 billion, a 159 percent change. The high-cost assumption results in a near quadrupling of the shortfall, from $3,252 billion to $11,445 billion.

Variations in the next four assumptions in Table 3 result in relatively minor changes in net HI expenditures. The higher or lower fertility assumptions cause an approximate 12 and 11 percent, respectively, change in the shortfall relative to the intermediate case. The higher or lower real wage growth rate results in about a 34 and 17 percent respectively, change in the shortfall relative to the intermediate case. Wages are a key cost factor in the provision of health care. Higher wages also result in greater payroll tax income. HI expenditures exceed HI income by a wide and increasing margin in the future (Charts 6 to 8). CPI and net immigration changes have very little effect on net HI expenditures. Higher immigration decreases the net shortfall modestly as higher payroll tax revenue offsets higher medical care expenditures.

Table 3 also shows that the present value of net HI expenditures is 20 percent lower if the real interest rate is 3.6 percent rather than 2.9 percent and 32 percent higher if the real interest rate is 2.1 percent rather than 2.9 percent.

Table 3
Present Values of Estimated Medicare Part A Expenditures in Excess of Income Under Various Assumptions, 2011-2085

(Dollar values in billions; values of assumptions shown in parentheses)

	Financing Shortfall Range		
Assumption[1]	**Low**	**Intermediate**	**High**
Average annual growth in health costs [2]	(1,917) (2.0)	3,252 (3.0)	11,445 (4.0)
Total fertility rate [3]	2,874 (2.3)	3,252 (2.0)	3,623 (1.7)
Real wage differential	2,156 (1.8)	3,252 (1.2)	3,819 (0.6)
CPI change	3,006 (3.8)	3,252 (2.8)	3,478 (1.8)
Net immigration	3,169 (1,385,000) [4]	3,252 (1,075,000) [4]	3,327 (785,000) [4]
Real interest rate	2,589 (3.6)	3,252 (2.9)	4,293 (2.1)

[1] The sensitivity of the projected HI net cashflow to variations in future mortality rates also is of interest. At this time, however, relatively little is known about the relationship between improvements in life expectancy and the associated changes in health status and per beneficiary health expenditures. As a result, it is not possible at present to prepare meaningful estimates of the Part A, mortality sensitivity.
[2] Annual growth rate is the aggregate cost of providing covered health care services to beneficiaries. The low-cost and high-cost alternatives assume that costs increase 1 percent slower or faster, respectively, than the intermediate assumption, *relative to growth in taxable payroll*.
[3] The total fertility rate for any year is the average number of children who would be born to a woman in her lifetime if she were to experience the birth rates by age observed in, or assumed for, the selected year and if she were to survive the entire childbearing period.
[4] Amount represents the average annual net immigration over the 75-year projection period.

Table 4 shows the effects of various assumptions about the growth in health care costs on the present value of estimated SMI (Medicare Parts B and D) expenditures in excess of income. As with HI, net SMI expenditures are very sensitive to changes in the health care cost growth assumption. For the low-cost alternative, the slower assumed growth in health costs reduces the Governmentwide resources needed for Part B from $13,854 billion to $9,985 billion and in Part D from $7,466 billion to $5,228 billion, about a 28 percent and 30 percent difference for Part B and Part D, respectively. The high-cost assumption increases Governmentwide resources needed to $19,890 billion for Part B and to $11,022 billion for Part D, about a 44 percent and a 48 percent difference for Part B and Part D, respectively.

Table 4
Present Values of Estimated Medicare Parts B and D Future Expenditures Less Premium Income and State Transfers Under Three Health Care Cost Growth Assumptions, 2011-2085

(In billions of dollars)

	Governmentwide Resources Needed		
Medicare Program[1]	Low (2)	Intermediate (3)	High (4)
Part B	9,985	13,854	19,890
Part D	5,228	7,466	11,022

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

Source: Centers for Medicare and Medicaid Services.

Sustainability of Social Security and Medicare

75-Year Horizon

According to the 2011 Medicare Trustees Report, the HI Trust Fund is projected to remain solvent until 2024 and, according to the 2011 Social Security Trustees Report, the OASDI Trust Funds are projected to remain solvent until 2036. In each case, some general revenues must be used to satisfy the authorization of full benefit payments until the year of exhaustion. This occurs when the trust fund balances accumulated during prior years are needed to pay benefits, which leads to a transfer from general revenues to the trust funds. Moreover, under current law, General Fund transfers to the SMI Trust Fund will occur into the indefinite future and will continue to grow with the growth in health care expenditures.

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

Table 5 shows the magnitudes of the primary expenditures and sources of financing for the three trust funds computed on an open-group basis for the next 75 years and expressed in present values. The data are consistent with the Statements of Social Insurance included in the principal financial statements. For HI, revenues from the public are projected to fall short of total expenditures by $3,252 billion in present value terms which is the additional amount needed in order to pay scheduled benefits over the next 75 years.[6] From the trust fund perspective, the amount needed is $2,980 billion in present value after subtracting the value of the existing trust fund balances (an asset to the trust fund account but an intragovernmental transfer to the overall budget). For SMI, revenues from the public for Parts B and D combined are estimated to be $21,320 billion less than total expenditures for the two

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

accounts, an amount that, from a budget perspective, will be needed to keep the SMI program solvent for the next 75 years. From the trust fund perspective, however, the present values of total revenues and total expenditures for the SMI Program are roughly equal due to the annual adjustment of revenue from other Government accounts to meet program costs. [7] For OASDI, projected revenues from the public fall short of total expenditures by $9,157 billion in present value dollars, and, from the trust fund perspective, by $6,548 billion.

From the Governmentwide perspective, the present value of the total resources needed for the Social Security and Medicare Programs over and above current-law funding sources (payroll taxes, benefit taxes, and premium payments from the public) is $33,729 billion. From the trust fund perspective, which counts the trust funds ($2,953 billion in present value) and the general revenue transfers to the SMI Program ($21,320 billion in present value) as dedicated funding sources, additional resources needed to fund the programs are $9,456 billion in present value.

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

(In billions of dollars, as of January 1, 2011)

		SMI			
	HI	**Part B**	**Part D**	**OASDI**	**Total**
Revenues from the public:					
Taxes	15,104	-	-	41,603	56,707
Premiums, State transfers	-	5,086	2,484	-	7,570
Total	15,104	5,086	2,484	41,603	64,277
Total costs to the public	18,356	18,940	9,950	50,760	98,006
Net results — budget perspective*	3,252	13,854	7,466	9,157	33,729
Revenues from other Government accounts	-	13,854	7,466	-	21,320
Trust fund balance as of 1/1/2010	272	71	1	2,609	2,953
Net results — trust fund perspective*	2,980	(71)	(1)	6,548	9,456

*Net results are computed as costs less revenues.

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

Source: 2011 OASDI and Medicare Trustees' Reports.

Infinite Horizon

The 75-year horizon represented in Table 5 is consistent with the primary focus of the Social Security and Medicare Trustees' Reports. For the OASDI Program, for example, an additional $9.2 trillion in present value will be needed above currently scheduled taxes to pay for scheduled benefits ($6.5 trillion from the trust fund perspective). Yet, a 75-year projection is not a complete representation of all future financial flows through the infinite horizon. For example, when calculating unfunded obligations, a 75-year horizon includes revenue from some future workers but only a fraction of their future benefits. In order to provide a more complete estimate of the long-run unfunded obligations of the programs, estimates can be extended to the infinite horizon. The open-group infinite horizon net obligation is the present value of all expected future program outlays less the present value of all

[7] The SMI Trust Fund has $72 billion of existing assets.

expected future program tax and premium revenues. Such a measure is provided in Table 6 for the three trust funds represented in Table 5.

From the budget or Governmentwide perspective, the values in line 1 plus the values in line 4 of Table 6 represent the value of resources needed to finance each of the programs into the infinite future. The sums are shown in the last line of the table (also equivalent to adding the values in the second and fifth lines). The total resources needed for all the programs sums to $51.2 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 2011. 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 $0.1 trillion and $9.8 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, from a Governmentwide basis, the substantial gap that exists between premiums and State transfer revenue and program expenditures in the SMI Program ($22.3 trillion and $16.2 trillion) represents future general revenue obligations of the Federal budget.

In comparison to the analogous 75-year number in Table 5, extending the calculations beyond 2085, captures the full lifetime benefits, and taxes and premiums of all current and future participants. The shorter horizon understates financial needs by capturing relatively more of the revenues from current and future workers and not capturing all of the benefits that are scheduled to be paid to them.

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

(In trillions of dollars as of January 1, 2011)

		SMI			
	HI	**Part B**	**Part D**	**OASDI**	**Total**
Present value of future costs less future taxes, premiums, and State transfers for current participants	8.0	11.5	5.4	21.4	46.3
Less current trust fund balance	0.3	0.1	-	2.6	3.0
Equals net obligations for past and current participants...............................	7.7	11.4	5.4	18.8	43.3
Plus net obligations for future participants..	(7.8)	10.9	10.8	(9.0)	4.9
Equals net obligations through the infinite future for all participants	(0.1)	22.3	16.2	9.8	48.2
Present values of future costs less the present values of future income over the infinite horizon	0.2	22.4	16.2	12.4	51.2

Details may not add to totals due to rounding.

Source: 2011 OASDI and Medicare Trustees' Reports.

Railroad Retirement, Black Lung, and Unemployment Insurance

Railroad Retirement

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

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

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

Other sources of program income include: financial interchanges with the Social Security and Medicare trust funds, earnings on investments, Federal income taxes on railroad retirement benefits, and appropriations (provided after 1974 as part of a phase out of certain vested dual benefits). See Note 26—Social Insurance, for additional information on railroad retirement program financing.

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

Since its inception, NRRIT has received \$21.3 billion from RRB (including \$19.2 billion in fiscal year 2003, pursuant to RRSIA) and returned \$11.6 billion. During fiscal year 2011, the NRRIT made net transfers of \$1.7 billion to the RRB to pay retirement benefits. Administrative expenses of the trust are paid out of trust assets. The balance as of September 30, 2011, and 2010, of non-Federal securities and investments of the NRRIT are disclosed in Note 9—Securities and Investments.

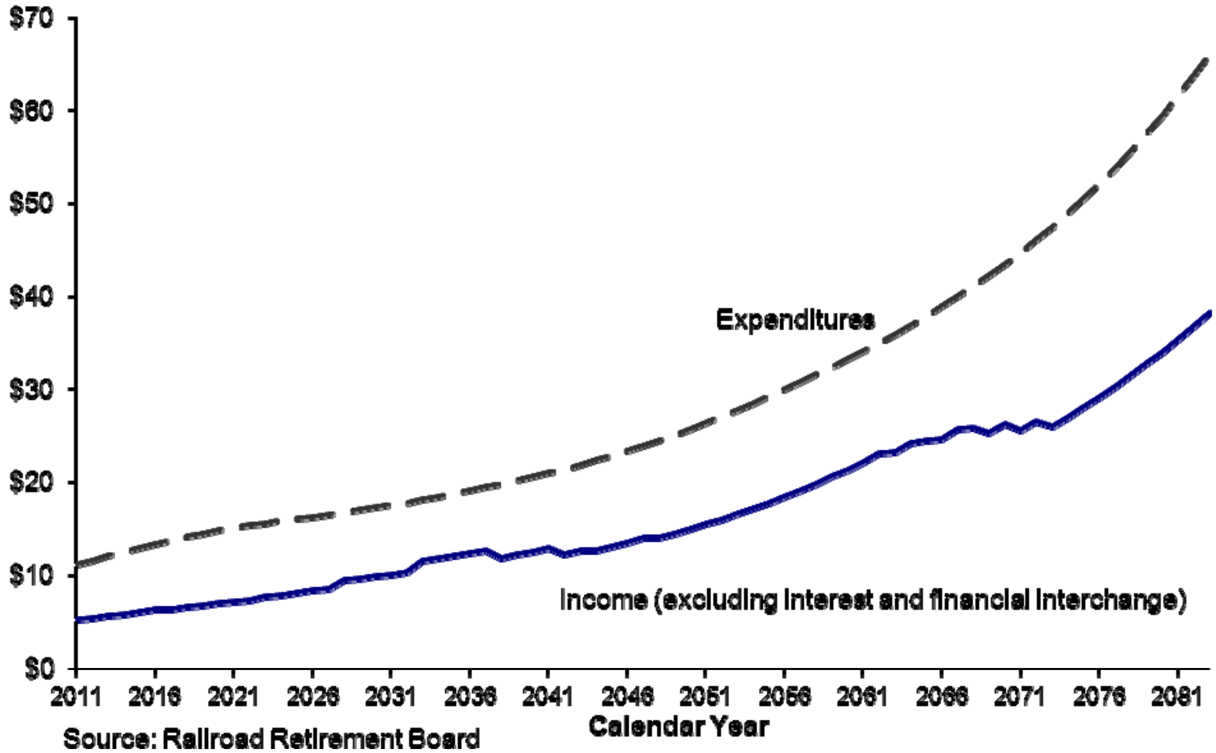
Cashflow Projections

Economic and Demographic Assumptions. The economic and demographic assumptions used for the most recent set of projections are shown in the "Railroad Retirement" section of Note 26—Social Insurance.

Nominal Income and Expenditures. Chart 11 shows, in nominal dollars, estimated railroad retirement income (excluding interest and financial interchange income) and expenditures for the period 2011-2085 based on the intermediate set of assumptions used in the RRB's actuarial evaluation of the program. The estimates are for the open-group population, which includes all persons projected to participate in the Railroad Retirement Program as railroad workers or beneficiaries during the period. Thus, the estimates include payments from, and on behalf of, those who are projected to be employed by the railroads during the period as well as those already employed at the beginning of the period. They also include expenditures made to, and on behalf of, such workers during that period.

Chart 11—Estimated Railroad Retirement Income
(Excluding Interest and Financial Interchange Income) and Expenditures
2011-2085

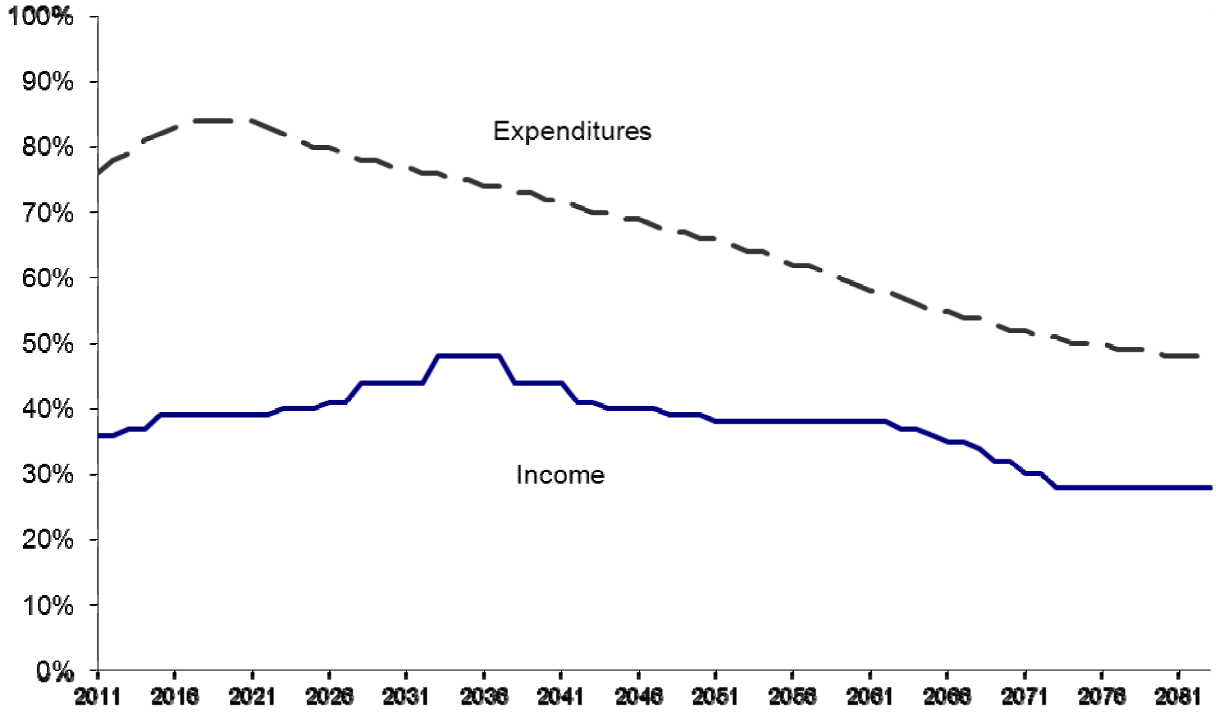
(In billions of dollars)



As Chart 11 shows, expenditures are expected to exceed tax income for the entire projection period. The imbalances continue to widen until about 2022, decrease slightly for next 15 years, and then begin to grow steadily after 2038.

Income and Expenditures as a Percent of Taxable Payroll. Chart 12 shows estimated expenditures and income as a percent of tier II taxable payroll. The imbalances grow until 2021 but then begin to decrease somewhat steadily as expenditures fall. Tax rates begin to decline after 2037, stabilizing in 2073 and after. Compared to last year, projected tax rates are lower, on average. The tier II tax rate is determined from a tax rate table based on the average account benefit ratio.

Chart 12—Estimated Railroad Retirement Income (Excluding Interest and Financial Interchange Income) and Expenditures as a Percent of Tier II Taxable Payroll 2011-2085



Source: Railroad Retirement Board

Sensitivity Analysis. Actual future income from railroad payroll taxes and other sources and actual future expenditures for scheduled benefits and administrative expenses will depend upon a large number of factors as mentioned above. Two crucial assumptions are employment growth and the interest rate. Table 7 shows the sensitivity of the shortfall in the Railroad Retirement Program to variations in these two assumptions. The low-cost employment scenario has a 4.9 percent smaller shortfall of income to expenditures, and the high-cost scenario has a 4.9 percent higher shortfall. A higher discount rate reduces future values relative to a lower rate. As seen in the table, the shortfall is 29 percent lower if the interest rate is 11 percent rather than 7.5 percent and 76.9 percent higher when the interest rate is 4 percent rather than 7.5 percent.

Table 7
Present Values of Railroad Retirement Expenditures in Excess of Income under Various Employment and Interest Rate Assumptions, 2011-2085

(Dollar values in billions; values of assumptions shown in parentheses)

Assumption	Low	Middle	High
Employment [1]	100.8 (-0.5%)	106.0 (-2.0%)	111.2 (-3.5%)
Interest rate...................	75.3 (11%)	106.0 (7.5%)	187.5 (4.0%)

[1] The low and middle employment scenarios have passenger service employment remaining at 44,000 workers per year and the remaining employment base declining at 0.5 percent and 2.0 percent, respectively, for the next 25 years. The high-cost scenario has passenger service employment declining by 500 per workers per year until a level of 35,000 is reached with the remaining employment base declining by 3.5 percent per year for 25 years, at a reducing rate over the next 25 years, and remaining level thereafter.

Source: Railroad Retirement Board

Sustainability of Railroad Retirement

Table 8 shows the magnitudes of the primary expenditures and sources of financing for the Railroad Retirement Program computed on an open-group basis for the next 75 years and expressed in present values as of January 1, 2011. The data are consistent with the Statements of Social Insurance.

From a Governmentwide perspective, revenues are expected to fall short of expenditures by approximately $106.0 billion, which represents the present value of resources needed to sustain the Railroad Retirement Program. From a trust fund perspective, when the trust fund balance and the financial interchange and transfers are included, the combined balance of the NRRIT, the Railroad Retirement Account, and the SSEB Account show a slight surplus.

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

(In billions of present-value dollars as of January 1, 2011)

Estimated future income (excluding interest) [3] received from or on behalf of:	
Current participants who have attained retirement age	5.8
Current participants not yet having attained retirement age	46.3
Those expected to become participants	65.1
All participants	117.2
Estimated future expenditures: [4]	
Current participants who have attained retirement age	109.3
Current participants not yet having attained retirement age	86.2
Those expected to become participants	27.6
All participants	223.1
Net obligations from budget perspective (expenditures less income)	106.0
Railroad Retirement Program assets (mostly investments stated at market) [5]	26.3
Financial interchange from Social Security Trust	80.8
Net obligations from trust fund perspective	(1.1)

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

Note: Detail may not add to totals due to rounding. Employee and beneficiary status are determined as of 1/1/2010, whereas present values are as of 1/1/2011.

Black Lung

The Federal Coal Mine Health and Safety Act of 1969 created the Black Lung Disability Benefit Program to provide compensation, medical, and survivor benefits for eligible coal miners who are totally disabled due to pneumoconiosis (black lung disease) arising out of their coal mine employment. The survivor benefits are available only for eligible survivors of coal miners who died due to pneumoconiosis. DOL operates the Black Lung Disability Benefit Program. The BLDTF provides benefit payments to eligible coal miners totally disabled by pneumoconiosis and to eligible survivors when no responsible mine operator can be assigned the liability. The beneficiary population is a nearly closed universe in which attrition by death exceeds new entrants by a ratio of more than ten to one.

Excise taxes on coal mine operators, based on the sale of coal, are the primary source of financing black lung disability payments and related administrative costs. The Black Lung Benefits Revenue Act provided for repayable advances to the BLDTF from the General Fund of the Treasury, in the event that BLDTF resources were not adequate to meet program obligations. Prior to legislation enacted in 2008 that allowed for the restructuring of BLDTF debt, the trust fund had accumulated large liabilities from significant and growing shortfalls of excise taxes relative to benefit payments and interest expenses.

The Energy Improvement and Extension Act of 2008 (Public Law 110-343), enacted on October 3, 2008, contained several provisions that significantly improved the BLDTF's financial position, including:

- Continuation of a previously-enacted increase in coal excise tax rates for an additional 5 years, through December 2018;
- Provision for the restructuring of BLDTF debt by refinancing the outstanding repayable advances with proceeds from issuing new debt instruments with lower interest rates; and
- Establishment of a one-time appropriation that significantly reduced the outstanding debt of the BLDTF.

This Act also allowed that any debt issued by the BLDTF subsequent to the refinancing may be used to make benefit payments, other authorized expenditures, or to repay debt and interest from the initial refinancing. All debt issued by the BLDTF was effected as borrowing from the Treasury's Bureau of the Public Debt.

On September 30, 2011, total liabilities of the BLDTF exceeded assets by $6.1 billion. Prior to the enactment of Public Law 110-343, this shortfall was funded by repayable advances to the BLDTF, which are repayable with interest. Pursuant to Public Law 110-343, any shortfall will be financed with debt instruments similar in form to zero-coupon bonds.

From the budget or consolidated financial perspective, Chart 13 shows projected black lung expenditures (excluding interest) and excise tax collections for the period 2012-2040. The significant assumptions used in the most recent set of projections are shown in the "Black Lung" section of Note 26—Social Insurance. The projected decrease in cash inflows in the year 2019 and, thereafter, is the result of a scheduled reduction in the tax rate on the sale of coal. This rate reduction is projected to result in a 38.9 percent decrease in the amount of excise taxes collected between the years 2018 and 2019.

Chart 13—Estimated Black Lung Income and Expenditures (Excluding Interest) 2012-2040

(In millions of dollars)

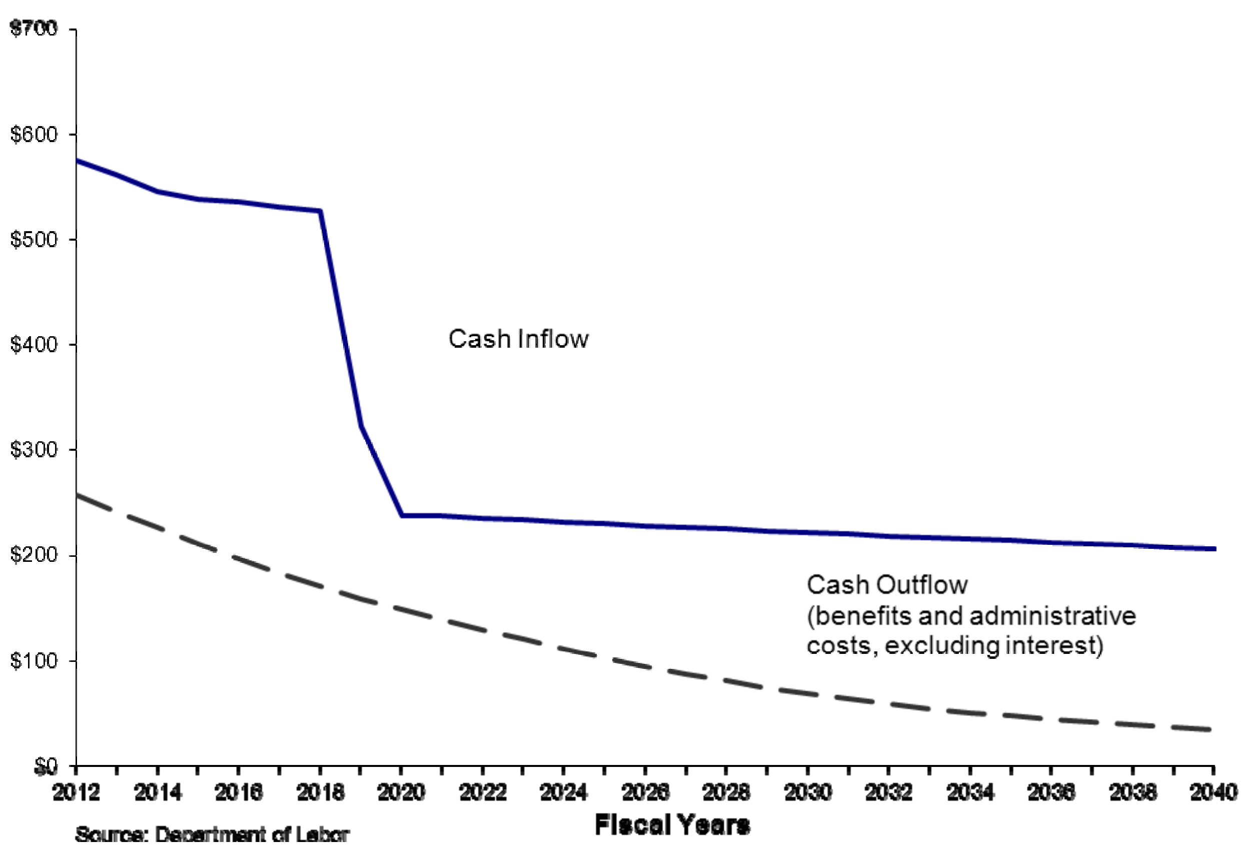


Table 9
Present Values of 29-Year Projections of Expenditures and Revenues for the Black Lung Disability Benefit Program

(In billions of present value dollars, as of September 30, 2011)

Projected future expenditures	2.6
Projected future tax income	6.8
Net obligations from budget perspective (expenditures less income)	(4.2)
Accumulated balance due General Fund	6.1
Net obligations from trust fund perspective	1.9

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

Source: Department of Labor projections and Treasury Department calculations

Table 9 shows present values of 29-year projections of expenditures and revenues for the Black Lung Disability Benefit Program computed as of September 30, 2011. Cashflows were discounted using the rates on the debt in the BLDTF. From a Governmentwide (budget) perspective, the present value of expenditures is expected to be less than the present value of income by $4.2 billion (a surplus). From a trust fund perspective, a large balance ($6.1 billion) is owed to the General Fund. From that perspective, when that accumulated balance is combined with the cashflow surplus, the program has a shortfall of $1.9 billion in present value dollars. This compares to a shortfall of $1.0 billion reported in last year's *Financial Report*.

Unemployment Insurance

The Unemployment Insurance Program was created in 1935 to provide temporary partial wage replacement to workers who lost 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. The program includes the 50 U.S. states and Puerto Rico, U.S. Virgin Islands, and the District of Columbia. 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 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 a negative net cashflow until 2012 followed by positive net cashflow for the remainder of the projection period.

The Worker, Homeownership, and Business Assistance Act of 2009, was enacted on November 6, 2009. This Act extended unemployment benefits to eligible recipients up to 14 additional weeks in all States. It also extended a total of up to 20 additional weeks in States with unemployment of 8.5 percent or greater. It also amended section 3301 of the Internal Revenue Code of 1986 to extend the 0.2 percent Federal Unemployment Tax Act (FUTA) surtax on covered employers through June 30, 2011. No benefits are payable for weeks of unemployment commencing before the date of enactment of the Act.

Public Law 111-205 Unemployment Compensation Extension Act of 2010, enacted on July 22, 2010, amends the Supplemental Appropriation Act, 2008 with respect to the state-established individual emergency unemployment compensation account (EUCA) and to apply to claims for Emergency Unemployment Compensation (EUC) payments the terms and conditions of state unemployment compensation law relating to availability of work, active search for work, and refusal to accept work. The Act extends the final dates for entering a federal-state agreement under the EUC program through November 30, 2010. The Act also postpones the termination of the program until April 30, 2011, and amends the Assistance for Unemployed Workers and Struggling Families Act to extend until December 1, 2010, and requires Federal payments to states cover 100 percent of EUC.

Chart 14—Estimated Unemployment Trust Fund Cashflow
Using Expected Economic Conditions
2012-2021

(In billions of dollars)

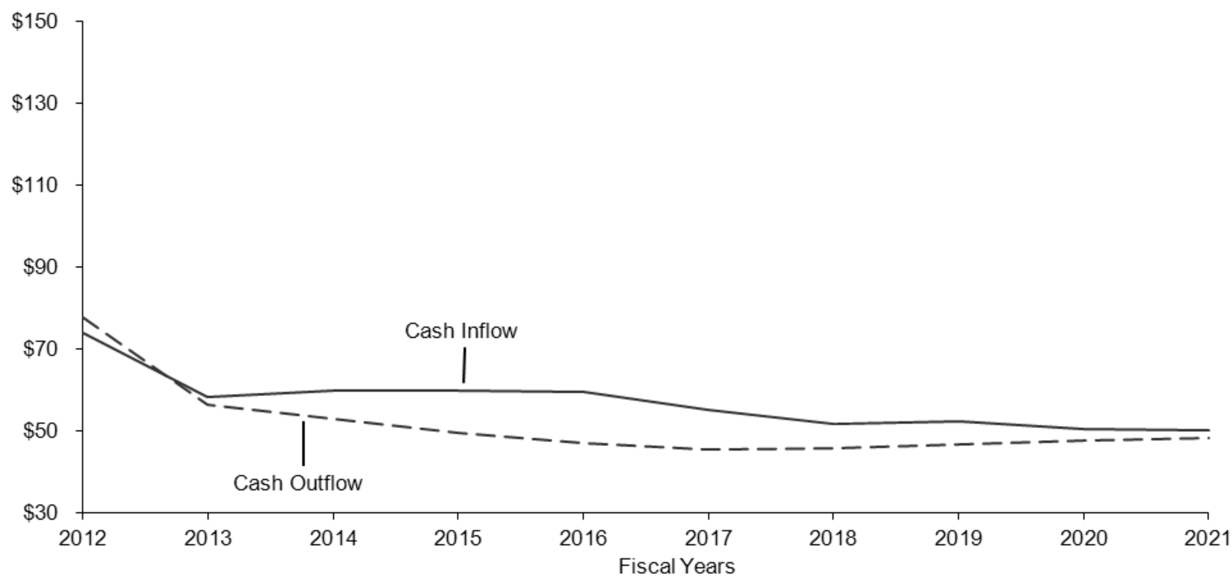


Table 10 shows present values of 10-year projections of revenues and expenditures for the Unemployment Insurance Program using a discount rate of 3.76 percent, the average of the interest rates underlying the 10-year projections. Three sets of numbers are presented in order to show the effects of varying economic conditions as reflected in different assumptions about the unemployment rate. For expected economic conditions, the estimates are based on an unemployment rate of 9.27 percent during fiscal year 2011, decreasing to below 6 percent in fiscal year

2015 and thereafter. Under Recovery Scenario One (lower than expected unemployment rates), the unemployment rate decreases from 7.8 percent in fiscal year 2012 to 6.0 percent after fiscal year 2016. Under Recovery Scenario Two (higher than expected unemployment), the unemployment rate is assumed to reach 10.11 percent in fiscal year 2012 decreasing to below 6 percent in fiscal year 2019 and thereafter.

Each scenario uses an open-group that includes current and future participants of the Unemployment Insurance Program. Table 10 shows the impact on the UTF projections of varying projected unemployment rates. For example, in Recovery Scenario Two, while tax income is projected to increase as higher layoffs result in higher employer taxes, benefit outlays increase even more. From the Governmentwide (budget) perspective, under expected conditions, the present value of income exceeds the present value of expenditures by $42.9 billion. From the same perspective, under Recovery Scenario Two, the present value of expenditures exceeds the present value of income by $7.6 billion. From a trust fund perspective, the program has a ($27.0) billion balance. When combined with the present value of net cash income under expected economic conditions, the program has a surplus of $15.9 billion.

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

(In billions of present value dollars, as of September 30, 2011)

	Economic Conditions		
	Expected	Recovery Scenario One	Recovery Scenario Two
Projected future expenditures	431.2	422.5	508.3
Projected future cash income	474.1	468.0	515.9
Net obligations from budget perspective (expenditures less income)	(42.9)	(45.5)	(7.6)
Trust fund assets	(27.0)	(27.0)	(27.0)
Net obligations from trust fund perspective [1]	(15.9)	(18.5)	19.4

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

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

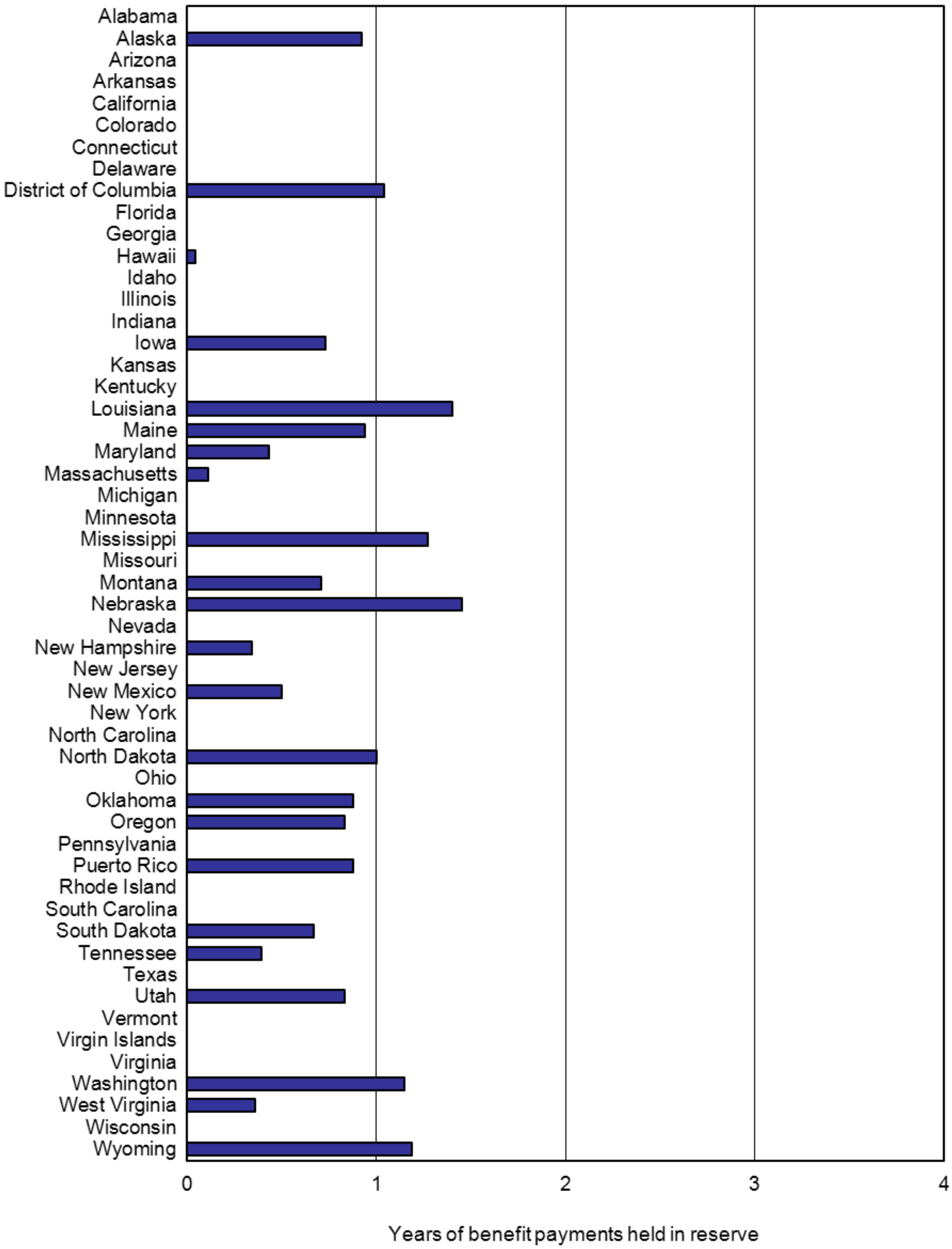
Source: Department of Labor.

Unemployment Trust Fund Solvency

Each state's accumulated UTF net assets or reserve balance should provide a defined level of benefit payments over a defined period. To be minimally solvent, a State's reserve balance should provide for one 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 indicates a state is minimally solvent. States below this level are vulnerable to exhausting their funds in a recession. States exhausting their reserve balance borrow funds from the Federal Unemployment Account (FUA) to make benefit payments. During fiscal year 2011, the balances in the FUA were depleted and the FUA borrowed from the Treasury General Fund.

Chart 15 presents the State by State results of this analysis as of September 30, 2011. As the chart illustrates, 46 state funds were below the minimal solvency ratio of 1.0 at September 30, 2011.

Chart 15—Unemployment Trust Fund Solvency as of September 30, 2011



Deferred Maintenance

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

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

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

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

Some deferred maintenance has been deemed critical. Such amounts and conditions are defined by the individual agencies with responsibility for the safekeeping of these assets. The critical maintenance amount is not included in the low or high estimates amounts and is reported separately. 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, 2011, and 2010

	Deferred Maintenance Cost Range					
	Low Estimate		High Estimate		Critical Maintenance	
(In billions of dollars)	2011	2010	2011	2010	2011	2010
Asset category:						
Buildings, structures and facilities	31.3	129.7	36.4	134.8	97.6	95.0
Furniture, fixtures and equipment	0.1	4.7	0.1	4.7	2.5	4.5
Other general property, plant, and equipment	5.1	5.3	5.1	5.3	0.8	4.9
Heritage assets	0.9	1.9	0.9	1.9	1.2	1.6
Stewardship land	3.6	3.5	5.2	5.2	-	-
Total deferred maintenance	41.0	145.1	47.7	151.9	102.1	106.0

The low and high estimate amounts for 2011 are significantly lower than 2010 due to agencies' incorrect reporting in 2010 that was not adjusted.

Please refer to the individual financial statements of DOI, DOD, USDA, and DOE for detailed significant information on deferred maintenance, including the standards used for acceptable operating condition and changes in asset condition.

Unexpended Budget Balances

The Federal budget and budget process largely use obligational accounting–a distinct administrative control through which Federal agencies control, monitor, and report on the status of funds at their disposal. Unexpended budget balances consist of the unobligated and obligated, but unliquidated, budget balances.

Unobligated budget balances, including amounts for trust funds, are the cumulative amount of budget balances that are not obligated and that remain available for obligation. In 1-year accounts, the unobligated balance is not available for new obligations after the end of the fiscal year. In multiyear accounts, the unobligated balance may be carried forward and remains available for obligation for the period specified. In no-year accounts, the unobligated balance is carried forward until specifically rescinded by law or the head of the agency concerned determines that the purposes for which it was provided have been accomplished and disbursements have not been made against the appropriation for 2 consecutive years. The total unobligated budget balances as of September 30, 2010, and 2009, are $885.1 billion and $1,012.7 billion, respectively.

Obligated budget balances are the cumulative budget balances that have been obligated but not liquidated. The obligated balance can be carried forward for a maximum of 5 years after the appropriation has expired. The total obligated budget balances as of September 30, 2010, and 2009, are $1,503.9 billion and $1,418.1 billion, respectively.

The President's Budget is located at www.whitehouse.gov/omb; unexpended budget balances are shown in the supporting documentation section under "Balances of Budget Authority." The President's Fiscal Year 2012 Budget (issued on February 14, 2011) includes the actual unobligated and obligated amounts for fiscal year 2010. The President's Budget with fiscal year 2011 actual amounts is expected to be published in February 2012.

Tax Burden

The Internal Revenue Code provides for progressive tax rates, whereby higher incomes are generally subject to higher tax rates. The following 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 Liability for Tax Year 2009

Adjusted Gross Income (AGI)	Number of Taxable Returns (In thousands)	AGI (In millions of dollars)	Total Income Tax (In millions of dollars)	Average AGI per Return (In whole dollars)	Average Income Tax per Return (In whole dollars)	Income Tax as a Percentage of AGI
Under $15,000	37,624	76,133	1,354	2,024	36	1.8%
$15,000 under $30,000	30,097	662,180	14,013	22,002	466	2.1%
$30,000 under $50,000	25,168	982,969	45,556	39,056	1,810	4.6%
$50,000 under $100,000	30,159	2,139,407	158,455	70,938	5,254	7.4%
$100,000 under $200,000	13,522	1,801,447	212,291	133,223	15,700	11.8%
$200,000 under $500,000	3,195	905,347	176,322	283,364	55,187	19.5%
$500,000 or more	729	1,058,948	257,958	1,452,604	353,852	24.4%
Total	140,494	7,626,431	865,949			

Corporation Income Tax Liability for Tax Year 2008

Total Assets (In thousands of dollars)	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	13,373	3,870	28.9%
$1 under $500	7,414	1,406	19.0%
$500 under $1,000	3,778	889	23.5%
$1,000 under $5,000	12,785	3,783	29.6%
$5,000 under $10,000	7,846	2,569	32.7%
$10,000 under $25,000	11,898	3,893	32.7%
$25,000 under $50,000	10,343	3,366	32.5%
$50,000 under $100,000	12,766	4,100	32.1%
$100,000 under $250,000	23,043	7,445	32.3%
$250,000 under $500,000	30,685	9,180	29.9%
$500,000 under $2,500,000	107,715	31,935	29.6%
$2,500,000 or more	736,507	156,087	21.2%
Total	978,153	228,523	23.4%

Tax Gap

The tax gap is the difference between what taxpayers should pay and what they actually pay due to not filing tax returns, not paying their reported tax liability on time, or failing to report their correct tax liability. The tax gap, about $345.3 billion based on updated fiscal year 2001 estimates, represents the amount of noncompliance with the tax laws. Underreporting of income tax, employment taxes, and other taxes represents 82 percent of the tax gap. The IRS remains committed to finding ways to increase compliance and reduce the tax gap, while minimizing the burden on the vast majority of taxpayers who pay their taxes accurately and on time.

The tax gap is the aggregate amount of tax (i.e., excluding interest and penalties) that is imposed by the tax laws for any given tax year but is not paid voluntarily and timely. The tax gap arises from three types of noncompliance: not filing required tax returns on time or at all (the nonfiling gap), underreporting the correct amount of tax on timely filed returns (the underreporting gap), and not paying on time the full amount reported on timely filed returns (the underpayment gap). Of these three components, only the underpayment gap is observed; the nonfiling gap and the underreporting gap must be estimated. Each instance of noncompliance by a taxpayer contributes to the tax gap, whether or not the IRS detects it, and whether or not the taxpayer is even aware of the noncompliance. Obviously, some of the tax gap arises from intentional (willful) noncompliance, and some of it arises from unintentional mistakes.

The collection gap is the cumulative amount of assessed tax, penalties, and interest that has been assessed over many years, but has not been paid by a certain point in time and which the IRS expects to remain uncollectible. In essence, it represents the difference between the total balance of unpaid assessments and the net taxes receivable reported on the IRS' balance sheet. The tax gap and the collection gap are related and overlapping concepts, but they have significant differences. The collection gap is a cumulative balance sheet concept for a particular point in time, while the tax gap is like an income statement item for a single year. Moreover, the tax gap estimates include all noncompliance, while the collection gap includes only amounts that have been assessed (a small portion of all noncompliance).

Other Claims for Refunds

Management has estimated amounts that may be paid out as other claims for tax refunds. This estimate represents an amount (principal and interest) that may be paid for claims pending judicial review by the Federal courts or, internally, by appeals. The total estimated payout (including principal and interest) for claims pending judicial review by the Federal courts is $8.1 billion and $8.8 billion for fiscal years 2011 and 2010, respectively. For those under appeal, the estimated payout is $7.5 billion and $8.0 billion for fiscal years 2011 and 2010, respectively. There are also unasserted claims for refunds of certain excise taxes. Although these refund claims have been deemed to be probable, they do not meet the criteria in SFFAS No. 5 for reporting the amounts in the balance sheets or for disclosure in the Notes to the Financial Statements. However, they meet the criteria in SFFAS No. 7 for inclusion as supplemental information. To the extent judgments against the Government for these claims prompt other similarly situated taxpayers to file similar refund claims, these amounts could become significantly greater.

Tax Assessments

The Government is authorized and required to make inquiries, determinations, and assessments of all taxes that have not been duly paid. Unpaid assessments result from taxpayers filing returns without sufficient payment, as well as enforcement programs such as examination, under-reporter, substitute for return and combined annual wage reporting. Assessments with little or no future collection potential are called write-offs. Although compliance assessments and write-offs are not considered receivables under Federal accounting standards, they represent legally enforceable claims of the Government. There is, however, a significant difference in the collection potential between compliance assessments and receivables.

Compliance assessments and pre-assessment work in process are $105.0 billion and $95.4 billion for fiscal years 2011 and 2010, respectively. The amount of allowance for uncollectible amounts pertaining to compliance assessments cannot be reasonably estimated, and thus the net realizable value of the value of the pre-assessment work-in-process cannot be determined. The amount of assessments agencies have statutory authority to collect at the end of the period but that have been written off and excluded from accounts receivable are $106.6 billion and $99.0 billion for fiscal years 2011 and 2010, respectively.

Risk Assumed

Risk assumed information is important for all Federal insurance and guarantee programs, except social insurance, life insurance, and loan guarantee programs. Risk assumed is generally measured by the present value of unpaid expected losses net of associated premiums, based on the risk inherent in the insurance or guarantee coverage in force. In addition to the liability for unpaid insurance claims included in Note 18—Insurance and Guarantee Program Liabilities, for events that have already occurred, the Government also is required to report as supplementary information risk assumed amounts and the periodic changes in those amounts.

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

Please refer to the individual financial statements of the PBGC, USDA, and NCUA for further detailed information, including information as to the indicators of the range of uncertainty around expected estimates and the indicators of the sensitivity of the estimates to changes in major assumptions.

Risk Assumed Information as of September 30, 2011, and 2010

(In billions of dollars)	2011	2010
Present value of unpaid expected losses, net of associated premiums:		
Pension Benefit Guaranty Corporation	250.2	190.0
Department of Agriculture	8.8	7.5
National Credit Union Administration	7.4	7.5
All other	0.9	2.0
Total	267.3	207.0
Periodic changes in risk assumed amounts:		
Pension Benefit Guaranty Corporation	60.2	21.8
Department of Agriculture	1.3	(1.4)
National Credit Union Administration	(0.1)	1.6
All other	(1.1)	0.4
Total	60.3	22.4

Unmatched Transactions and Balances

(In millions of dollars)	Fiscal Year 2011	Fiscal Year 2010
Change in intragovernmental unmatched balances:		
Debt/investment	(6.5)	1,369.9
Interest payable/receivable	(1.5)	3.6
Loans payable/receivable	(27.9)	6,399.2
Benefit program contributions payable/receivable	(44.6)	110.2
Accounts payable/receivable	5,863.4	(4,111.7)
Advances from/to others and deferred credits/prepayments	416.7	(953.8)
Transfers payable/receivable	14.2	80.6
	6,213.8	2,898.0
Unmatched intragovernmental transactions:		
Federal securities interest revenue/expense—investment exchange	1.0	1.3
Borrowings interest revenue/expense—exchange	1.4	(26.3)
Borrowings gains/losses	0.4	(1.7)
Nonexpenditure transfers-in/out	(671.0)	1,683.5
Expenditure transfers-in/out	(26.0)	649.9
Transfers-in/out without reimbursement	328.5	(752.8)
Imputed financing source/cost	5.3	(15.4)
Benefit program revenue/cost	(775.6)	(1,448.3)
	(1,136.0)	90.2
General fund transactions:		
Fund balance with Treasury	13,671.8	(4,697.6)
Appropriations of unavailable special or trust fund receipts—transfers-out/in	146.1	(976.7)
Appropriations received/warrants	(7,486.2)	22,060.4
Other taxes and receipts/trust fund warrants	1,862.7	2,235.1
Custodial and non-entity collections transferred out/in	45,405.0	(713,283.8)
Other General Fund transactions	(45,775.6)	693,163.0
	7,823.8	(1,499.6)
Net intra-agency reporting errors and restatements	2,685.1	(719.2)
Unmatched transactions and balances, net	15,586.7	769.4

( ) Parentheses indicate a decrease to Net Position.

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

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

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United States Government Stewardship Information (Unaudited) for the Years Ended September 30, 2011, and 2010

Stewardship Investments

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

Table 11
Stewardship Investments for the Years Ended September 30, 2007, through 2011

(In billions of dollars)	Fiscal Year 2011	Fiscal Year 2010	Fiscal Year 2009	Fiscal Year 2008	Fiscal Year 2007
Investments in non-Federal physical property	69.9	66.7	65.1	57.8	56.2
Investments in human capital	91.9	122.3	60.3	77.2	76.1
Research and development:					
Investments in basic research	35.7	31.5	27.4	27.6	26.5
Investments in applied research	28.8	26.2	19.1	21.4	22.2
Investments in development	71.7	77.3	101.0	79.2	66.3
Total investments	298.0	324.0	272.9	263.2	247.3

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. Costs for non-Federal physical property programs are included as expenses in the Statements of Net Cost and are reported as investments in Table 11. They are measured on the same accrual basis of accounting used in the *Financial Report* statements. DOT, HUD, and EPA had $55.7 billion (80 percent), $5.6 billion (8 percent), and $4.6 billion (7 percent), respectively, of the total non-Federal physical property investments in fiscal year 2011 as shown in Table 11. Within DOT, the Federal Highway Administration invested $42.9 billion during fiscal year 2011, primarily via reimbursement from the Highway Trust Fund, for States' construction costs of interstate and national highways. The States' contribution is 10 percent for the Interstate System and 20 percent for most other programs.

Human Capital

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

Education, DOL, and VA had $66.8 billion (73 percent), $7.7 billion (8 percent), and $11.8 billion (13 percent), respectively, of the total human capital investments in fiscal year 2011 as shown in Table 11. In comparison over the past 5 years, Education had an increase in human capital investments in fiscal years 2008 and 2010, due to an increase in the net cost for the Federal Family Education Loan, Direct Loan, Grant Programs, and Other Programs, including the *American Recovery and Reinvestment Act of 2009*; while VA increased in fiscal years 2009, 2010, and 2011 due to implementation of the Post 9/11 GI Bill. Education administers a wide variety of programs related to general public education and training programs that are intended to increase or maintain national economic productive capacity. The Office of Federal Student Aid administers need-based financial assistance programs for students pursuing postsecondary education and makes available Federal grants, direct loans, and work-study funding to eligible undergraduate and graduate students.

The significant human capital programs administered by DOL relate to grants for job training and employment programs. The significant human capital programs administered by VA also relate to grants for job training and rehabilitation programs for veterans.

Research and Development

Federal investments in Research and Development (R&D) comprise those expenses for basic research, applied research, and development that are intended to increase or maintain national economic productive capacity or yield other future benefits.

- Investments in basic research are for systematic studies to gain knowledge or understanding of the fundamental aspects of phenomena and of observable facts without specific applications toward processes or products in mind.
- Investments in applied research are for systematic studies to gain knowledge or understanding necessary for determining the means by which a recognized and specific need may be met.
- Investments in development are the systematic use of the knowledge and understanding gained from research for the production of useful materials, devices, systems, or methods, including the design and development of prototypes and processes.

With regard to basic and applied research, HHS had $20.1 billion (56 percent) and $13.6 billion (47 percent), of the total basic and applied research investments, respectively, in fiscal year 2011 as shown in Table 11. HHS also had similar R&D investment amounts (and percentage contributions) in each of the preceding 4 years.

Within HHS, the National Institutes of Health (NIH) conducts almost all (98 percent) of the Department's basic and applied research. The NIH Research Program includes all aspects of the medical research continuum, including basic and disease-oriented research, observational and population-based research, behavioral research, and clinical research, including research to understand both health and disease states, to move laboratory findings into medical applications, to assess new treatments or compare different treatment approaches; and health services research.

The NIH regards the expeditious transfer of the results of its medical research for further development and commercialization of products of immediate benefit to improved health as an important mandate.

With regard to development, the DOD and NASA had $63.4 billion (88 percent) and $4.8 billion (7 percent), respectively, of total development investments in fiscal year 2011, as shown in Table 11. Development is comprised of five stages: advanced technology development, advanced component development and prototypes, system development and demonstration, management support, and operational systems development. Major outputs of DOD development are:

- Hardware and software components, and complete weapon systems ready for operational and developmental testing and field use, and
- Weapon systems finalized for complete operational and developmental testing.

NASA development includes the systematic application of knowledge or understanding directed toward the production of useful materials, devices, and systems or methods, including design, development, and improvement of prototypes and new processes to meet specific requirements. NASA's development activities include those related to space launch systems, earth and planetary sciences, and advanced technologies.

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Appendix A: Significant Government Entities

This appendix lists the organizations and agencies encompassed in the reporting entity for this publication as well as some organizations excluded from the reporting entity. The reporting entity is a specifically defined group of agencies, principally Cabinet departments and other agencies of the executive branch, as stated in the law and accounting guidance.

The determination as to which organizations and agencies will be included in the reporting entity is governed by Federal laws and is also based on guidance issued by the Federal Accounting Standards Advisory Board (the Board) in their Statement of Federal Financial Accounting Concept No. 2, Entity and Display, which provides criteria for determining what should be included in the reporting entity for a consolidated Governmentwide report. The Board is now considering more specific guidance on the reporting entity for this report.

There are a total of 150 organizations and agencies included in the *Financial Report of the United States Government*. The lists below describe three groups of entity/fund types that comprise the reporting entity for the *Financial Report* and include entities from all three branches of Government.

Twenty-Four Chief Financial Officer Act Agencies

Department of Agriculture
www.usda.gov
Department of Commerce
www.doc.gov
Department of Defense
www.defense.gov
Department of Education
www.ed.gov
Department of Energy
www.doe.gov
Department of Health and Human Services
www.hhs.gov
Department of Homeland Security
www.dhs.gov
Department of Housing and Urban Development
www.hud.gov
Department of the Interior
www.doi.gov
Department of Justice
www.usdoj.gov
Department of Labor
www.dol.gov
Department of State
www.state.gov
Department of Transportation
www.dot.gov
Department of the Treasury
www.treasury.gov
Department of Veterans Affairs
www.va.gov
Environmental Protection Agency
www.epa.gov
General Services Administration
www.gsa.gov
National Aeronautics and Space Administration
www.nasa.gov
National Science Foundation
www.nsf.gov
Office of Personnel Management
www.opm.gov
Small Business Administration
www.sba.gov
Social Security Administration
www.ssa.gov
U.S. Agency for International Development
www.usaid.gov
U.S. Nuclear Regulatory Commission
www.nrc.gov

Eleven Additional Significant Entities

Export-Import Bank of the United States
www.exim.gov
Farm Credit System Insurance Corporation
www.fcsic.gov
Federal Communications Commission
www.fcc.gov
Federal Deposit Insurance Corporation
www.fdic.gov
National Credit Union Administration
www.ncua.gov
Pension Benefit Guaranty Corporation
www.pbgc.gov
Railroad Retirement Board
www.rrb.gov
Securities and Exchange Commission
www.sec.gov
Smithsonian Institution
www.si.edu
Tennessee Valley Authority
www.tva.gov
U.S. Postal Service
www.usps.gov

One Hundred Fifteen Additional Entities/Funds

Abraham Lincoln Bicentennial Commission
Administrative Conference of the United States
Advisory Council on Historic Preservation
African Development Foundation
American Battle Monuments Commission
Antitrust Modernization Commission
Appalachian Regional Commission
Appalachian Regional Development Fund
Architect of the Capitol
Architectural and Transportation Barriers Compliance Board
Armed Forces Retirement Home
Barry Goldwater Scholarship and Excellence in Education Foundation
Broadcasting Board of Governors
Bureau of Consumer Financial Protection
Central Intelligence Agency
Chemical Safety Hazard Investigation Board
Christopher Columbus Fellowship Foundation
Commission for the Preservation of America's Heritage Abroad
Commission of Fine Arts
Commission on Civil Rights
Commission on International Religious Freedom
Commission on Security and Cooperation in Europe
Commission on Weapons of Mass Destruction
Committee for Purchase from People Who Are Blind or Severely Disabled
Commodity Futures Trading Commission
Congressional Budget Office
Congressional-Executive Commission on the People's Republic of China
Consumer Product Safety Commission
Corporation for National and Community Service
Council of the Inspectors General on Integrity and Efficiency
Court of Appeals for Veterans Claims
Court Services and Offender Supervision Agency for DC
DC Courts
DC Courts–Defender Services
Defense Nuclear Facilities Safety Board
Delta Regional Authority
Denali Commission
Dwight D. Eisenhower Memorial Commission
Eisenhower Exchange Fellowship Program
Election Assistance Commission
Environmental Dispute Resolution Fund
Equal Employment Opportunity Commission
Executive Office of the President
Farm Credit Administration
Federal Election Commission
Federal Financial Institutions Examination Council Appraisal Subcommittee
Federal Housing Finance Agency
Federal Labor Relations Authority
Federal Maritime Commission
Federal Mediation and Conciliation Service
Federal Mine Safety and Health Review Commission
Federal Trade Commission
Financial Crisis Inquiry Commission
Foreign Military Sales Program
Government Accountability Office
Government Printing Office
Harry S. Truman Scholarship Trust Fund
Indian Law and Order Commission
Institute of Museum and Library Services
Interagency Council on the Homeless
Inter-American Foundation
International Trade Commission
James Madison Memorial Fellowship Foundation
Japan-United States Friendship Commission
John C. Stennis Center
John F. Kennedy Center for the Performing Arts

Library of Congress
Marine Mammal Commission
Medicaid and Children's Health Insurance Program Payment and Access Commission
Medicare Payment Advisory Commission
Merit Systems Protection Board
Millennium Challenge Corporation
Morris K. Udall Scholarship Foundation
National Archives and Records Administration
National Capital Planning Commission
National Commission on Libraries and Information Science
National Council on Disability
National Endowment for the Arts
National Endowment for the Humanities
National Gallery of Art
National Labor Relations Board
National Mediation Board
National Railroad Retirement Investment Trust
National Transportation Safety Board
National Veterans Business Development Corporation
Neighborhood Reinvestment Corporation
Northern Border Regional Commission
Nuclear Waste Technical Review Board
Occupational Safety and Health Review Commission
Office of Compliance
Office of Government Ethics
Office of Navajo and Hopi Indian Relocation
Office of Special Counsel
Office of the Director of National Intelligence
Office of the Federal Coordination for Alaska Natural Gas Transportation Projects
Open World Leadership Center
Overseas Private Investment Corporation
Patient Centered Outcomes Research Trust Fund
Peace Corps
Presidio Trust
Public Defender Service
Ronald Reagan Centennial Commission
Recovery Act Accountability and Transparency Board
Selective Service System
Senate Preservation Fund
St. Lawrence Seaway Development Corporation
State Justice Institute
U.S. Capital Preservation Commission
U.S. China Security Review Commission
U.S. Holocaust Memorial Museum
U.S. Institute of Peace
U.S. Trade and Development Agency
Vietnam Education Foundation
White House Commission on the National Moment of Remembrance
Woodrow Wilson International Center for Scholars

Legislative and Judicial Branches

There are no legal or other requirements for the legislative or judicial branches to prepare consolidated audited financial statements or to provide accrual-based accounting data for inclusion in the Governmentwide financial statements. Therefore, these consolidated statements do not include accrual-based accounting data for such entities as the U.S. Courts or the Congress. Some legislative branch entities voluntarily prepare and submit such information (e.g., Government Accountability Office, Government Printing Office, and Library of Congress). The President's Budget includes cash-based outlay data for the legislative and judicial branches and, to a limited extent, this outlay data is also a part of the information contained in this report.

Entities Excluded from These Statements

The following entities are not part of the Governmentwide reporting entity based on an assessment of these entities in accordance with the indicative criteria stated in SFFAC No. 2, Entity and Display. However, this list is not all inclusive of all entities excluded from these statements.

American International Group (AIG)
Board of Governors of the Federal Reserve System (Including the Federal Reserve Banks)
Citigroup
Federal Home Loan Banks
Federal Home Loan Mortgage Corporation (Freddie Mac)
Federal National Mortgage Association (Fannie Mae)
Thrift Savings Fund
The Financing Corporation
GMAC Financial (Ally Financial)
National Railroad Passenger Corporation (does business as Amtrak)
Public-Private Investment Funds (PPIF)
Resolution Funding Corporation
Student Loan Marketing Association (SLMA or Sallie Mae)

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Appendix B: Acronyms

This appendix lists the acronyms used in the Financial Statements and Notes to the Financial Statements section of this *Financial Report*.

ABS	Asset-Backed Securities
ACA	Affordable Care Act
AICPA	American Institute of Certified Accountants
AIFP	Automotive Industry Financing Program
AIG	American International Group, Inc.
AGP	Asset Guarantee Program
AMT	Alternative Minimum Tax
ARRA	American Recovery and Reinvestment Act of 2009
ASC	Accounting Standards Codification
BLDTF	Black Lung Disability Trust Fund
CBLI	Consumer and Business Lending Initiative
CCC	Commodity Credit Corporation
CDs	Certificates of Deposits
CDCI	Community Development Capital Initiative
CERCLA	Comprehensive Environmental Response, Compensation, and Liability Act
CMS	Centers for Medicare and Medicaid
COLA	Cost of Living Adjustments
CPI	Consumer Price Index
CPIM	Consumer Price Index–Medical
CPP	Capital Purchase Program
CSRDF	Civil Service Retirement and Disability Fund
CSRS	Civil Service Retirement System
DHS	Department of Homeland Security
DI	Disability Insurance
DIF	Deposit Insurance Fund
DIP	Debtor in Possession
DOC	Department of Commerce
DOD	Department of Defense
DOE	Department of Energy
DOI	Department of the Interior
DOJ	Department of Justice
DOL	Department of Labor
DOT	Department of Transportation
ECASLA	Ensuring Continued Access to Student Loans Act of 2008
Education	Department of Education
EESA	Emergency Economic Stabilization Act of 2008
EPA	Environmental Protection Agency
ESF	Exchange Stabilization Fund
EUC	Unemployment Account
EUCA	Unemployment Compensation Account
Ex-Im Bank	Export-Import Bank
FAA	Federal Aviation Administration
Fannie Mae	Federal National Mortgage Association
FASAB	Federal Accounting Standards Advisory Board
FCC	Federal Communications Commission
FCRA	Federal Credit Reform Act of 1991
FDIC	Federal Deposit Insurance Corporation
FECA	Federal Employees' Compensation Act
FEGLI	Federal Employees' Group Life Insurance
FEHB	Federal Employees Health Benefits Program

FEMA	Federal Emergency Management Agency
FERS	Federal Employees' Retirement System
FERSA	Federal Employees' Retirement System Act of 1986
FFAS	Farm and Foreign Agricultural Services
FFEL	Federal Family Education Loan
FHA	Federal Housing Administration
FHFA	Federal Housing Financing Agency
FHWA	Federal Highway Administration
FICA	Federal Insurance Contribution Act
FR	Financial Report of the United States Government
FRBNY	Federal Reserve Bank of New York
FRBs	Federal Reserve banks
Freddie Mac	Federal Home Loan Mortgage Corporation
FRTIB	Federal Retirement Thrift Investment Board
FSA	Farm Service Agency
FUA	Federal Unemployment Account
FUTA	Federal Unemployment Tax Act
GAAP	U.S. Generally Accepted Accounting Principles
GAO	U.S. Government Accountability Office
GDP	Gross Domestic Product
Ginnie Mae	Government National Mortgage Association
GM	General Motors
GSA	General Services Administration
GSE	Government-Sponsored Enterprises
HBP	Health Benefits Program
HERA	Housing and Economic Recovery Act of 2008
HFA	Housing Financing Agencies
HHS	Department of Health and Human Services
HI	Hospital Insurance
HMO	Health Maintenance Organization
HUD	Department of Housing and Urban Development
IMF	International Monetary Fund
IPO	Initial Public Offering
IRS	Internal Revenue Service
LAC	Latest Acquisition Cost
LSAPs	Large-Scale Asset Purchase Programs
MAC	Moving Average Cost
MBS	Mortgage-Backed Securities
MDBs	Multilateral Development Banks
MERHCF	Medicare Eligible Retiree Health Care Fund
MMA	Medicare Prescription Drug, Improvement, and Modernization Act
MRF	Military Retirement Fund
NASA	National Aeronautics and Space Administration
NAV	Net Asset Value
NCUA	National Credit Union Administration
NFIP	National Flood Insurance Program
NIBP	New Issue Bond Program
NIH	National Institutes of Health
NPV	Net Present Value
NRRIT	National Railroad Retirement Investment Trust
NSLI	National Service Life Insurance
NTIA	National Telecommunications and Information Administration
OASDI	Old-Age, Survivors, and Disability Insurance
OASI	Old-Age and Survivors Insurance
OCO	Overseas Contingency Operations
OMB	Office of Management and Budget
OPEB	Other Postemployment Benefits

OPM	Office of Personnel Management
ORB	Other Retirement Benefits
PBGC	Pension Benefit Guaranty Corporation
PCF	Periodic Commitment Fee
PEFCO	Private Export Funding Corporation
PMAs	Power Marketing Authorities
PP&E	Property, Plant, and Equipment
PPIF	Public Private Investment Funds
PPIP	Public Private Investment Program
PPO	Preferred Provider Organization
PSRHB	Postal Service Retiree Health Benefits
QFI	Qualified Financial Institution
R&D	Research and Development
RCRA	Resource Conservation and Recovery Act
RD	Rural Development
REDUX	Military Retirement Reform Act of 1986
RRB	Railroad Retirement Board
RRSIA	Railroad Retirement and Survivors Improvement Act
SAFETEA-LU	Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users
SAFRA	Student Aid and Fiscal Responsibility Act
Sallie Mae	Student Loan Marketing Association
SBA	Small Business Administration
SCSIA	Statement of Changes in Social Insurance Amounts
SDRs	Special Drawing Rights
SDRCs	SDR Certificates
SEC	Securities and Exchange Commission
SECA	Self-Employment Contributions Act
SFFAC	Statement of Federal Financial Accounting Concept
SFFAS	Statement of Federal Financial Accounting Standards
SFP	Supplementary Financing Program
SLMA	Student Loan Marketing Association
SMI	Supplementary Medical Insurance
SOMA	System Open Market Account
SOSI	Statement of Social Insurance
SPSPA	Senior Preferred Stock Purchase Agreements
SSA	Social Security Administration
SSEB	Social Security Equivalent Benefit
SSP	Stable Share Price
TALF	Term Asset-Backed Loan Facility
TARP	Troubled Asset Relief Program
TCLP	Temporary Credit Liquidity Program
TFL	TRICARE for Life
TIP	Targeted Investment Program
TIPS	Treasury Inflation-Protected Securities
Treasury	Department of the Treasury
TRIA	Terrorism Risk Insurance Act
TSP	Thrift Savings Plan
TVA	Tennessee Valley Authority
TVARS	Tennessee Valley Authority Retirement System
USACE	U.S. Army Corps of Engineers
U.S.C.	United States Code
USDA	United States Department of Agriculture
USPS	United States Postal Service
UTF	Unemployment Trust Fund
VA	Department of Veterans Affairs
VRI	Veterans Reopened Insurance
VSLI	Veterans Special Life Insurance

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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, is required to annually submit financial statements for the U.S. government to the President and the Congress. GAO is required to audit these statements.[1] This is (1) our report on the accompanying U.S. government's accrual-based consolidated financial statements for the fiscal years ended September 30, 2011 and 2010; the 2011, 2010, 2009, 2008, and 2007 Statements of Social Insurance; and the 2011 Statement of Changes in Social Insurance Amounts; and (2) our associated reports on internal control over financial reporting and on compliance with selected provisions of laws and regulations. As used in this report, accrual-based financial statements refer to all of the consolidated financial statements and notes, except for those related to the Statements of Social Insurance and the Statement of Changes in Social Insurance Amounts.[2]

Management of 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 evaluating internal control to provide reasonable assurance that the control objectives of the Federal Managers' Financial Integrity Act (FMFIA)[3] are met; and (3) complying with laws and regulations. Also, the 24 Chief Financial Officers (CFO) Act agencies are responsible for implementing and maintaining financial management systems that substantially comply with the requirements of the Federal Financial Management Improvement Act of 1996 (FFMIA).[4] Appendix I discusses the objective, scope, and methodology of our work.

[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 accrual-based consolidated financial statements for the fiscal years ended September 30, 2011 and 2010 consist of the (1) Statements of Net Cost, (2) Statements of Operations and Changes in Net Position, (3) Reconciliations of Net Operating Cost and Unified Budget Deficit, (4) Statements of Changes in Cash Balance from Unified Budget and Other Activities, and (5) Balance Sheets, including the related notes to these financial statements. Most revenues are recorded on a modified cash basis. The 2011, 2010, 2009, 2008, and 2007 Statements of Social Insurance, including the related notes, are also included in the consolidated financial statements. In addition, in fiscal year 2011, the federal government adopted Statement of Federal Financial Accounting Standards No. 37, "Social Insurance: Additional Requirements for Management's Discussion and Analysis and Basic Financial Statements," which calls for a new basic financial statement, the Statement of Changes in Social Insurance Amounts, that is included, along with the related notes, in the consolidated financial statements. The Statement of Changes in Social Insurance Amounts presents the components of the changes of the open group measure (total present value of future expenditures in excess of future revenue), presented in the 2011 and 2010 Statements of Social Insurance. Both the Statements of Social Insurance and the Statement of Changes in Social Insurance Amounts do not interrelate with the accrual-based consolidated financial statements.
[3]31 U.S.C. 3512 (c), (d) (commonly referred to as FMFIA). This act requires executive agency heads to evaluate and report annually to the President and the Congress on the adequacy of their internal control and accounting systems and on actions to correct significant problems.
[4]31 U.S.C. 3512 note (Federal Financial Management Improvement Act).

In summary, we found the following:

- Certain material weaknesses[5] in internal control over financial reporting and other limitations on the scope of our work[6] resulted in conditions that continued to prevent us from expressing an opinion on the accompanying accrual-based consolidated financial statements for the fiscal years ended September 30, 2011 and 2010.[7]

- Significant uncertainties (discussed in Note 26 to the consolidated financial statements), primarily related to the achievement of projected reductions in Medicare cost growth reflected in the 2011 and 2010 Statements of Social Insurance, prevented us from expressing an opinion on those statements as well as on the 2011 Statement of Changes in Social Insurance Amounts. The Statements of Social Insurance for 2009, 2008, and 2007[8] are presented fairly, in all material respects, in conformity with GAAP.

- Material weaknesses resulted in ineffective internal control over financial reporting (including safeguarding of assets).

- Our work to test compliance with selected provisions of laws and regulations in fiscal year 2011 was limited by the material weaknesses and other scope limitations discussed in this report.

Significant Matters of Emphasis

Before discussing our conclusions on the consolidated financial statements, the following key items deserve emphasis in order to put the information contained in the financial statements and the Management's Discussion and Analysis section of the *2011 Financial Report of the United States Government* (*2011 Financial Report*) into context.

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[5]A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis.

[6]Three major impediments continued to prevent us from rendering an opinion on the accrual-based consolidated financial statements: (1) serious financial management problems at the Department of Defense (DOD) that have prevented DOD's financial statements from being auditable, (2) the federal government's inability to adequately account for and reconcile intragovernmental activity and balances between federal entities, and (3) the federal government's ineffective process for preparing the consolidated financial statements. In addition, the Department of Homeland Security (DHS) received a qualified opinion on its Balance Sheet and Statement of Custodial Activity for fiscal year 2011; also, the remainder of its financial statements for fiscal year 2011 (consisting of the Statements of Net Cost, Changes in Net Position, and Budgetary Resources) and all of DHS's financial statements for fiscal year 2010 were not auditable or not subjected to audit by agency auditors. Further, the financial statements of the National Aeronautics and Space Administration for fiscal year 2010 and the Department of State for fiscal years 2011 and 2010 were not fully auditable. Also, in our audit report on the U.S. government's consolidated financial statements for fiscal year 2010, we reported that the financial statements of the Department of Labor (Labor) for fiscal year 2010 were not auditable or not subjected to audit by agency auditors. However, subsequent to our report, the agency's auditors issued an unqualified opinion in a revised audit report on Labor's reissued financial statements for fiscal year 2010. According to the May 2011 auditor's report, Labor's implementation of a new accounting and reporting system hindered its ability to assure the accuracy and completeness of the consolidated financial statement balances that received a disclaimer of opinion in November 2010. Further, the audit report states that Labor was subsequently able to prepare consolidated financial statements and provide sufficient support so that it received an unqualified opinion on its financial statements for fiscal year 2010.

[7]We previously reported that certain material weaknesses prevented us from expressing an opinion on the consolidated financial statements of the U.S. government for fiscal years 1997 through 2006 and on the accrual-based consolidated financial statements of the U.S. government for fiscal years 2007 through 2010.

[8]The valuation date is January 1 for all social insurance programs except the Black Lung program, which has a valuation date of September 30.

The Federal Government's Actions to Stabilize Financial Markets and to Promote Economic Recovery

The accrual-based consolidated financial statements for fiscal year 2011 include, as they did for fiscal year 2010, substantial assets and liabilities resulting from the federal government's actions to stabilize financial markets and to promote economic recovery. Key actions that the federal government has taken to stabilize financial markets and to promote economic recovery are discussed in the Management's Discussion and Analysis section of the *2011 Financial Report* and related Notes to the consolidated financial statements.

The ultimate cost of all of the federal government's market stabilization and economic recovery actions and the effect of such actions on its financial condition will not be known for some time. As of September 30, 2011, the federal government's actions to stabilize the financial markets and to promote economic recovery resulted in reported federal government assets of over $295 billion (e.g., the Troubled Asset Relief Program (TARP) equity investments,[9] investments in the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), and mortgage-backed securities guaranteed by them),[10] which is net of about $95 billion in valuation losses. In addition, the federal government reported incurring significant liabilities as of September 30, 2011 (e.g., about $316 billion related to estimated future payments to Fannie Mae and Freddie Mac) resulting from these actions. In valuing these assets and liabilities, management considered and selected assumptions and data that it believed provided a reasonable basis for the estimated values reported in the accrual-based consolidated financial statements. However, as discussed in Note 1 to the consolidated financial statements, there are many factors affecting these assumptions and estimates that are inherently subject to substantial uncertainty arising from the uniqueness of certain transactions and the likelihood of future changes in general economic, regulatory, and market conditions. As such, there will be differences between the estimated values as of September 30, 2011, and the actual results, and such differences may be material. These differences will also affect the ultimate cost of the federal government's actions.

Long-Term Fiscal Challenges

Although the economy is still fragile, there is wide agreement on the need to take steps to address the federal government's long-term fiscal challenges. The comprehensive long-term fiscal projections presented in this *2011 Financial Report* show that—absent policy changes—the federal government continues to face an unsustainable fiscal path. Largely as a result of the provisions in the Budget Control Act of 2011,[11] the fiscal outlook has improved. However, rising health care costs and the aging of the U.S. population continue to create budgetary pressure. The oldest members of the baby boom generation are now eligible for early Social Security retirement benefits and for Medicare benefits. In addition, debt held by the public continues to grow as a share of the economy; this means the current structure of the federal budget is unsustainable over the longer term.

These comprehensive projections, with regard to Social Security and Medicare, are based on the same assumptions underlying the information presented in the Statement of Social Insurance and assume that the provisions in law designed to slow the growth of Medicare costs are sustained and remain effective

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[9]TARP was established by the Department of the Treasury (Treasury) under authority provided in the Emergency Economic Stabilization Act of 2008 (Pub. L. No. 110-343). The act requires the U.S. Comptroller General to audit TARP's financial statements as well as report every 60 days on a variety of areas associated with oversight of TARP. For the TARP financial statement audits and the 60-day reports, see GAO's website at www.gao.gov.

[10]The Housing and Economic Recovery Act of 2008 (Pub. L. No. 110-289) authorized Treasury to purchase, until December 31, 2009, any amount of Fannie Mae or Freddie Mac securities, whether debt or equity.

[11]Pub. L. No. 112-25, 125 Stat. 240 (Aug. 2, 2011).

throughout the projection period. GAO also prepares long-term fiscal simulations for the U.S. government.[12] Under GAO's Alternative simulation, which modifies the revenue assumptions used in the above noted projections and uses the Centers for Medicare and Medicaid Services (CMS) actuary's alternative health care cost projections, projected spending in excess of receipts would be greater and debt held by the public as a share of gross domestic product (GDP) would grow more quickly than the projections in the *2011 Financial Report*. For example, under GAO's Alternative simulation, debt held by the public as a share of GDP would exceed the historical high reached in the aftermath of World War II by 2027,[13] 10 years earlier than the projections in the *2011 Financial Report*. The federal government faces increasing pressures, yet a shrinking window of opportunity, for making policy changes regarding these challenges.

<u>Equity Interests in Certain Financial Organizations and Commercial Entities</u>

As discussed in Note 1 to the consolidated financial statements, such financial statements do not include the assets, liabilities, or results of operations of any financial organizations or commercial entities in which Treasury holds either a direct, indirect, or beneficial equity interest. Treasury and the Office of Management and Budget (OMB) have determined that none of these organizations or entities meet the criteria for a federal entity. The federal government's investments in and any liabilities to such organizations and entities, however, are valued and reported on the Balance Sheet.

Disclaimers of Opinion on the Accrual-Based Consolidated Financial Statements

Because of the federal government's inability to demonstrate the reliability of significant portions of the U.S. government's accompanying accrual-based consolidated financial statements for fiscal years 2011 and 2010, principally resulting from limitations related to certain material weaknesses in internal control over financial reporting and other limitations on the scope of our work, we are unable to, and we do not, express an opinion on such accrual-based consolidated financial statements. As a result of these limitations, readers are cautioned that amounts reported in the accrual-based consolidated financial statements and related notes may not be reliable.

The federal government did not maintain adequate systems or have sufficient, reliable evidence to support certain material information reported in the accompanying accrual-based consolidated financial statements. The underlying material weaknesses in internal control, which generally have existed for years, contributed to our disclaimer of opinion on the accrual-based consolidated financial statements. The material weaknesses that contributed to our disclaimer of opinion on the accrual-based consolidated financial statements 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 accrual-based consolidated financial statements;

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[12]GAO, *The Federal Government's Long-Term Fiscal Outlook: Fall 2011 Update*, GAO-12-28SP (Washington, D.C.: Oct. 24, 2011).

[13]GAO's Alternative simulation incorporates the CMS Office of the Actuary's alternative projections for health care cost growth, which assume physician payments are not reduced as specified under current law and certain cost controls are not maintained over the long term. Also in this simulation, expiring tax provisions other than the Social Security payroll tax reductions are extended to 2021 and the alternative minimum tax exemption amount is indexed to inflation through 2021; revenues are then brought back to the 40-year historical average as a share of GDP. Discretionary spending follows the Congressional Budget Office's baseline for the first 10 years, which reflect the discretionary spending caps in the Budget Control Act of 2011, and thereafter gradually increases to the historical average share of GDP. Automatic procedures in the Budget Control Act of 2011 that reduce spending by $1.2 trillion are applied to total annual deficits evenly from 2013 to 2021 and remain a constant share of GDP thereafter.

- 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 reported total net cost of operations, most notably related to DOD, and adequately reconcile disbursement activity at certain federal entities;

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

- ensure that the federal government's accrual-based consolidated financial statements were (1) consistent with the underlying audited entities' financial statements, (2) properly balanced, and (3) in conformity with GAAP; and

- identify and either resolve or explain material differences between (1) certain components of the budget deficit reported in Treasury's records that are used to prepare the Reconciliation of Net Operating Cost and the Unified Budget Deficit, the Statement of Changes in Cash Balance from Unified Budget and Other Activities, and the Fiscal Projections for the U.S. Government (included in Supplemental Information) and (2) related amounts reported in federal entities' financial statements and underlying financial information and records.

These material weaknesses continued to (1) hamper the federal government's ability to reliably report a significant portion of its assets, liabilities, costs, and other related information; (2) affect the federal government's ability to reliably measure the full cost as well as the financial and nonfinancial performance of certain programs and activities; (3) impair the federal government's ability to adequately safeguard significant assets and properly record various transactions; and (4) hinder the federal government from having reliable financial information to operate in an efficient and effective manner. Due to the material weaknesses and other limitations on the scope of our work discussed above, there may also be additional issues that could affect the accrual-based consolidated financial statements that were not identified. Appendix II describes these material weaknesses in more detail and highlights the primary effects of these material weaknesses on the accompanying accrual-based consolidated financial statements and on the management of federal government operations.

Disclaimers of Opinion on the Statements of Social Insurance for 2011 and 2010 and Unqualified Opinions for 2009, 2008, and 2007, and Disclaimer of Opinion on the Statement of Changes in Social Insurance Amounts for 2011

Because of significant uncertainties (discussed in Note 26 to the consolidated financial statements), primarily related to the achievement of projected reductions in Medicare cost growth reflected in the 2011 and 2010 Statements of Social Insurance, we were unable to obtain sufficient evidence to support the amounts presented in the 2011 and 2010 Statements of Social Insurance and the 2011 Statement of Changes in Social Insurance Amounts. Consequently, we are unable to, and we do not, express opinions on the 2011 and 2010 Statements of Social Insurance as well as on the 2011 Statement of Changes in Social Insurance Amounts. The Statement of Social Insurance presents the actuarial present value of the federal government's estimated future revenue to be received from or on behalf of participants and estimated future expenditures to be paid to or on behalf of participants, based on benefit formulas in current law and using a projection period sufficient to illustrate the long-term sustainability of the social insurance programs.[14]

The significant uncertainties, discussed in further detail in Note 26 to the consolidated financial statements, include:

- Medicare projections in the 2011 and 2010 Statements of Social Insurance were based on full implementation of the provisions of the Patient Protection and Affordable Care Act, as amended (PPACA),[15] including a significant decrease in projected Medicare costs from the 2009 Statement of Social Insurance, related to (1) reductions in physician payment rates (totaling almost 30 percent in January 2012) and (2) productivity improvements for most other categories of Medicare providers. However, there are significant uncertainties concerning the achievement of these projected decreases in Medicare costs.

- Management has noted that actual future costs for Medicare are likely to exceed those shown by the current-law projections presented in the 2011 and 2010 Statements of Social Insurance due to the likelihood of modifications to the scheduled reductions.[16] The extent to which actual future costs exceed the projected current-law amounts due to changes to the physician payments and productivity adjustments depends on both the specific changes that might be legislated and on whether legislation would include other provisions to help offset such costs.

- Management has developed an illustrative alternative projection intended to provide additional context regarding the long-term sustainability of the Medicare program and to illustrate the uncertainties in the Statement of Social Insurance projections. The present value of future estimated expenditures in excess of future estimated revenue for Medicare included in the illustrative alternative projection exceeds the $24.6 trillion estimate in the 2011 Statement of Social Insurance by $12.4 trillion.

Projections of Medicare costs are sensitive to assumptions about future decisions by policymakers and about the behavioral responses of consumers, employers, and health care providers as policy, incentives, and the health care sector change over time. For example, behavioral responses of health care providers could affect Medicare beneficiaries' access to care. Such secondary impacts are not reflected in the Statement of Social Insurance projections but could be expected to influence the excess cost growth rate[17] used in the projections. Key drivers of uncertainty about the excess cost growth rate include the future development and deployment of medical technology, the evolution of personal income, and the cost and availability of insurance, as well as federal policy change such as the PPACA. The work of the 2010 Technical Review Panel on the Medicare Trustees Report[18] could provide additional guidance to management concerning ways to incorporate secondary impacts into future Statement of Social Insurance projections and related disclosures.

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[14]The projection period used for the Social Security, Medicare, and Railroad Retirement social insurance programs is 75 years. For the Black Lung program, the projections are through September 30, 2040.
[15]Patient Protection and Affordable Care Act, Pub. L. No. 111-148, 124 Stat. 119 (Mar. 23, 2010), as amended by Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029 (Mar. 30, 2010).
[16]The Medicare and Medicaid Extenders Act of 2010, Pub. L. No. 111-309, § 101, overrode the scheduled reductions in physician payments through December 2011 and reduced non-Medicare outlays by limiting a health insurance tax credit.
[17]The excess cost growth rate is the increase in health care spending per person relative to the growth of GDP per person after removing the effects of demographic changes on health care spending.
[18]In August 2010, the Secretary of the Department of Health and Human Services, working on behalf of the Board of Trustees, established an independent panel of expert actuaries and economists to review the assumptions and methods used by the Trustees to make projections of the financial status of the trust funds.

As a result of the uncertainties discussed previously, readers are cautioned that amounts reported in the 2011 and 2010 Statements of Social Insurance and related Notes to such financial statements may not fairly present, in all material respects, the financial condition of the federal government's social insurance programs, in conformity with GAAP. The uncertainties related to the 2011 and 2010 Statements of Social Insurance also affect the projected Medicare and Medicaid costs reported in the Fiscal Projections for the U.S. government, which is presented in Supplemental Information and is summarized in Management's Discussion and Analysis and other accompanying information.

In addition, the Supplemental Information section of the *2011 Financial Report* includes unaudited information concerning how changes in various assumptions would change the present value of future estimated expenditures in excess of future estimated revenue. As discussed in that section, Medicare projections are very sensitive to changes in the health care cost growth assumption.

In our opinion, the Statements of Social Insurance for 2009, 2008, and 2007 present fairly, in all material respects, the financial condition of the federal government's social insurance programs, in conformity with GAAP.

In preparing the Statements of Social Insurance, management considers and selects assumptions and data that it believes provide a reasonable basis for the assertions in the statement. However, because of the large number of factors that affect the Statement of Social Insurance and the fact that such assumptions are inherently subject to substantial uncertainty—arising from the likelihood of future changes in general economic, regulatory, and market conditions, as well as other more specific future events, such as legislative changes (e.g., changes in benefits or provider payments), other significant uncertainties, and contingencies—there will be differences between the estimates in the Statement of Social Insurance and the actual results, and those differences may be material. In addition to the inherent uncertainty that underlies the expenditure projections prepared for all parts of Medicare, the Supplementary Medical Insurance Part D projections have an added uncertainty in that they were prepared using very little program experience upon which to base the estimates.

The scheduled future benefits presented in the Statement of Social Insurance are based on benefit formulas in current law. However, consistent with the respective annual Trustees Reports, the Social Security and Medicare programs are not sustainable under current financing arrangements. Also, the law concerning these programs can be changed at any time by the Congress. In fact, payment of Social Security and Medicare Hospital Insurance (Part A) benefits are limited by law to the balances in the respective trust funds. Consequently, future scheduled benefits are limited to future revenues plus existing trust fund assets. As discussed in the Supplemental Information section of the *2011 Financial Report*, the Social Security and Medicare Hospital Insurance (Part A) trust funds are, based on achievement of the cost reductions discussed above, projected to be exhausted in 2036 and 2024, respectively, at which time the full amount of scheduled future benefits will be unable to be paid. For Social Security, projected future revenues as of January 1, 2011 would be sufficient to pay 77 percent of scheduled benefits in 2036, the year of trust fund exhaustion, and decreasing to 74 percent of scheduled benefits in 2085. Similarly, for Medicare Hospital Insurance (Part A), projected future revenues as of January 1, 2011 would be sufficient to pay 90 percent of scheduled benefits in 2024, the year of trust fund exhaustion, declining to 76 percent in 2050 and then increasing to 88 percent of scheduled benefits in 2085.

Other Limitations on the Scope of Our Work

For fiscal years 2011 and 2010, there were limitations on the scope of our work in addition to the material weaknesses that contributed to our disclaimer of opinion on the accrual-based consolidated financial statements. Treasury and OMB depend on representations from certain federal entities to provide their representations to us regarding the U.S. government's consolidated financial statements. Treasury and OMB were unable to provide us with adequate representations regarding the U.S. government's accrual-based consolidated financial statements for fiscal years 2011 and 2010 primarily because of insufficient representations provided to them by certain federal entities.

Material Weaknesses Resulted in Ineffective Internal Control over Financial Reporting

The material weaknesses discussed in this report resulted in ineffective internal control over financial reporting. Consequently, the federal government's internal control did not provide reasonable assurance that misstatements, losses, or noncompliance material in relation to the consolidated financial statements would be prevented or detected and corrected on a timely basis. The federal government is responsible for establishing and maintaining effective internal control over financial reporting and evaluating its effectiveness. Internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, the objectives of which are to provide reasonable assurance that (1) transactions are properly recorded, processed, and summarized to permit the preparation of the financial statements 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.

In planning and performing our audit, we considered internal control over financial reporting. We did not consider all internal controls relevant to operating objectives as broadly established under FMFIA, such as those controls relevant to preparing statistical reports and ensuring efficient operations. We do not express an opinion on the effectiveness of internal control over financial reporting because the purpose of our work was to determine our procedures for auditing the financial statements, not to express an opinion on internal control. Based on the scope of our work and the effects of the other limitations on the scope of our audit noted throughout this report, our internal control work would not necessarily identify all deficiencies in internal control, including those that might be material weaknesses or significant deficiencies.[19]

In addition to the material weaknesses that contributed to our disclaimer of opinion on the accrual-based consolidated financial statements, which were discussed previously, we found the following three other material weaknesses in internal control. These other material weaknesses were the federal government's inability to

- determine the full extent to which improper payments occur and reasonably assure that appropriate actions are taken to reduce improper payments,
- identify and resolve information security control deficiencies and manage information security risks on an ongoing basis, and
- effectively manage its tax collection activities.

These material weaknesses are discussed in more detail in appendix III, including the primary effects of the material weaknesses on the accompanying accrual-based consolidated financial statements and on the management of federal government operations.

[19]A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

We also found two significant deficiencies in the federal government's internal control related to implementing effective internal controls at certain federal entities for the following areas:

- loans receivable and loan guarantee liabilities, which for the most part, involve credit subsidy estimation and related financial reporting processes; and

- federal grants management.

These significant deficiencies are discussed in more detail in appendix IV.

Further, individual federal entity financial statement audit reports identified additional control deficiencies that were reported by the entity's auditors as either material weaknesses or significant deficiencies at the individual entity level. We do not consider these additional deficiencies to represent material weaknesses or significant deficiencies with respect to the consolidated financial statements.

Compliance with Laws and Regulations

Our work to test compliance with selected provisions of laws and regulations that have a direct and material effect on the consolidated financial statements was limited by the material weaknesses and other scope limitations discussed in this report. U.S. generally accepted government auditing standards and OMB guidance require auditors to report on entities' compliance with selected provisions of laws and regulations. Certain individual entity audit reports contain instances of noncompliance. None of these instances were deemed to be reportable noncompliance with regard 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 laws and regulations.

Other Information Included in the Financial Report

Management's Discussion and Analysis, Stewardship Information, Supplemental Information, and other accompanying information, including the Citizen's Guide, included in the *2011 Financial Report* contain a wide range of information, some of which is not directly related to the consolidated financial statements. We did not audit and we do not express an opinion on this information.

Readers are cautioned that the material weaknesses and scope limitations discussed in this audit report, including those related to our disclaimers of opinion on the 2011 and 2010 Statements of Social Insurance and the 2011 Statement of Changes in Social Insurance Amounts, affect the reliability of certain information contained in the Management's Discussion and Analysis, Stewardship Information, Supplemental Information, and other accompanying information that is taken from the same data sources as the accrual-based consolidated financial statements, the 2011 and 2010 Statements of Social Insurance, and the 2011 Statement of Changes in Social Insurance Amounts.

CFO Act Agency Financial Management Systems

The federal government's ability to efficiently and effectively manage and oversee its day-to-day operations and programs relies heavily on the ability of entity financial management systems[20] to produce complete, reliable, timely, and consistent financial information for use by executive branch agencies and the Congress. FFMIA was designed to lead to system improvements that would result in CFO Act agency managers routinely having access to reliable, useful, and timely financial-related information to measure performance and increase accountability throughout the year. FFMIA requires auditors, as part of the 24 CFO Act agencies' financial statement audits, to report whether those 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 (SGL) at the transaction level. For fiscal years 2011 and 2010, auditors for 11 and 10 of the 24 CFO Act agencies, respectively, reported that the agencies' financial management systems did not substantially comply with one or more of the three FFMIA requirements. Agency management at the 24 CFO Act agencies also annually report on FFMIA compliance. For both fiscal years 2011 and 2010, agency management at 7 of the CFO Act agencies reported that their agencies' financial management systems were not in substantial compliance with one or more of the three FFMIA requirements. The differences in the assessments of substantial compliance between the auditors and agency management reflected differences in views between management and the auditors on the impact reported deficiencies had on agencies' financial management systems. Long-standing financial management systems weaknesses at several large CFO Act agencies, along with the size and complexity of the federal government, continue to present a formidable management challenge in providing accountability to the nation's taxpayers and have contributed significantly to the material weaknesses and other limitations that have resulted in our disclaimers of opinion on the accrual-based consolidated financial statements.

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We provided a draft of this report to Treasury and OMB officials, who provided technical comments, which have been incorporated as appropriate. Treasury and OMB officials expressed their continuing commitment to address the problems this report outlines.

Robert F. Dacey

Robert F. Dacey
Chief Accountant
U.S. Government Accountability Office

December 12, 2011

[20] The term financial management systems includes the financial systems and the financial portions of mixed systems necessary to support financial management, including automated and manual processes, procedures, controls, data, hardware, software, and support personnel dedicated to the operation and maintenance of system functions.

APPENDIX I

Objective, Scope, and Methodology

Our objective was to audit the consolidated financial statements for the fiscal years ended September 30, 2011 and 2010, including the new Statement of Changes in Social Insurance Amounts for 2011, and the 2009, 2008, and 2007 Statements of Social Insurance, along with reporting on internal control over financial reporting and on compliance with selected provisions of laws and regulations.

The Government Management Reform Act of 1994 expanded the requirements of the Chief Financial Officers (CFO) Act of 1990 by making the inspectors general of 24 major federal agencies[21] responsible for annual audits of agencywide financial statements prepared by these agencies and GAO responsible for the audit of the U.S. government's consolidated financial statements. The Accountability of Tax Dollars (ATD) Act of 2002[22] requires most other executive branch entities to prepare and have audited annual financial statements. The Office of Management and Budget (OMB) and the Department of the Treasury (Treasury) have identified 35 federal entities[23] that are significant to the U.S. government's consolidated financial statements, consisting of the 24 CFO Act agencies, several other federal executive branch agencies, and some government corporations (35 significant entities). Our work was performed in coordination and cooperation with the inspectors general and independent public accountants for these 35 significant entities to achieve our respective audit objectives. Our audit approach regarding the accrual-based consolidated financial statements focused on determining the current status of the material weaknesses that contributed to our disclaimer of opinion on the accrual-based consolidated financial statements and the other material weaknesses affecting internal control that we had reported in our report on the consolidated financial statements for fiscal year 2010.[24] We also separately audited the financial statements of certain federal entities and federal agency components including the following:

- We audited and expressed an unqualified opinion on the Internal Revenue Service's (IRS) fiscal years 2011 and 2010 financial statements.[25] In fiscal years 2011 and 2010, IRS collected about $2.4 trillion and $2.3 trillion, respectively, in tax payments and paid about $416 billion and $467 billion, respectively, in refunds to taxpayers. For fiscal year 2011, we continued to report material weaknesses that resulted in ineffective internal control over financial reporting. In addition, we continued to find a significant deficiency in IRS's internal control over tax refund disbursements, which resulted in the payment of erroneous tax refunds to taxpayers. Our tests of IRS's compliance in fiscal year 2011 with selected provisions of laws and regulations disclosed one area of noncompliance. We also found that IRS's financial management systems did not substantially comply with the requirements of FFMIA.

- 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, 2011 and 2010.[26] For these 2 fiscal years, the Schedules reported (1) approximately $10.1 trillion (2011) and

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[21]31 U.S.C. 901(b), 3521(e). The 1994 act authorized the Office of Management and Budget to designate agency components that also would receive a financial statement audit. See 31 U.S.C. 3515(c).
[22]Pub. L. No. 107-289, 116 Stat. 2049 (Nov. 7, 2002); see 31 U.S.C. 3515.
[23]See *Treasury Financial Manual*, volume I, part 2, chapter 4700, for a listing of the 35 entities.
[24]For our report on the U.S. government's consolidated financial statements for fiscal year 2010, see U.S. Department of the Treasury, *2010 Financial Report of the United States Government* (Washington, D.C.: December 2010), pp. 221-249, which can be found on GAO's website at www.gao.gov/financial.html.
[25]GAO, *Financial Audit: IRS's Fiscal Years 2011 and 2010 Financial Statements*, GAO-12-165 (Washington, D.C.: Nov. 10, 2011).
[26]GAO, *Financial Audit: Bureau of the Public Debt's Fiscal Years 2011 and 2010 Schedules of Federal Debt*, GAO-12-164 (Washington, D.C.: Nov. 8, 2011).

$9.0 trillion (2010) of federal debt held by the public;[27] (2) about $4.7 trillion (2011) and $4.5 trillion (2010) of intragovernmental debt holdings;[28] and (3) about $251 billion (2011) and $215 billion (2010) of interest on federal debt held by the public. We reported that as of September 30, 2011, BPD had effective internal control over financial reporting relevant to the Schedule of Federal Debt. Further, we reported that we found no reportable noncompliance in fiscal year 2011 with selected provisions of laws related to the Schedules of Federal Debt we tested.

- We audited and expressed unqualified opinions on the fiscal years 2011 and 2010 financial statements of the United States Securities and Exchange Commission (SEC) and its Investor Protection Fund (IPF).[29] We also reported that as of September 30, 2011, although internal controls could be improved, SEC had effective internal control over financial reporting for both the entity as a whole and the IPF. In addition, we reported that we found no reportable noncompliance for either SEC or IPF in fiscal year 2011 with the selected provisions of laws and regulations we tested.

- We audited and expressed an unqualified opinion on the fiscal years 2011 and 2010 financial statements of the Federal Housing Finance Agency (FHFA).[30] We reported that FHFA had effective internal control over financial reporting as of September 30, 2011, and we found no reportable noncompliance in fiscal year 2011 with the selected provisions of laws and regulations we tested.

- We audited and expressed an unqualified opinion on the Office of Financial Stability's (OFS) fiscal years 2011 and 2010 financial statements for the Troubled Asset Relief Program (TARP).[31] We reported that although certain internal controls could be improved, OFS had effective internal control over financial reporting as of September 30, 2011. We also reported that we found no reportable noncompliance for fiscal year 2011, with the selected provisions of laws and regulations we tested.

- We audited and expressed an unqualified opinion on the fiscal year 2011 financial statements of the Bureau of Consumer Financial Protection (CFPB).[32] We reported that CFPB had effective internal control over financial reporting as of September 30, 2011, and we found no reportable noncompliance for fiscal year 2011 with the selected provisions of laws and regulations we tested.

- We audited and expressed unqualified opinions on the December 31, 2010 and 2009, financial statements of two funds administered by the Federal Deposit Insurance Corporation (FDIC), including the Deposit Insurance Fund (DIF) and the Federal Savings and Loan Insurance Corporation

[27]The public holding federal debt is comprised of individuals, corporations, state and local governments, the Federal Reserve Banks, foreign governments, and central banks.
[28]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.
[29]GAO, *Financial Audit: Securities and Exchange Commission's Financial Statements for Fiscal Years 2011 and 2010*, GAO-12-219 (Washington, D.C.: Nov. 15, 2011).
[30]GAO, *Financial Audit: Federal Housing Finance Agency's Fiscal Years 2011 and 2010 Financial Statements*, GAO-12-161 (Washington, D.C.: Nov. 15, 2011).
[31]GAO, *Financial Audit: Office of Financial Stability (Troubled Asset Relief Program) Fiscal Years 2011 and 2010 Financial Statements*, GAO-12-169 (Washington, D.C.: Nov. 10, 2011).
[32]GAO, *Financial Audit: Bureau of Consumer Financial Protection's Fiscal Year 2011 Financial Statements*, GAO-12-186 (Washington, D.C.: Nov. 15, 2011). CFPB was established in Title X of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, Title X, 124 Stat. 1376, 1955 (July 21, 2010), as the federal entity charged with the responsibility of regulating the offering and provision of consumer financial products or services under the federal consumer financial laws. While CFPB began operations in 2010, fiscal year 2011 was its first full year of operations and the first year for which it prepared financial statements. Consequently, CFPB's fiscal year 2011 financial statements do not present comparative information for the prior year.

(FSLIC) Resolution Fund.[33] We reported that as of December 31, 2010, FDIC had effective internal control over financial reporting, and we found no reportable noncompliance for calendar year 2010 with the selected provisions of laws and regulations we tested.

In addition, we considered the CFO Act agencies' and certain other federal entities' fiscal years 2011 and 2010 financial statements and the related auditors' reports prepared by the inspectors general or contracted independent public accountants. Financial statements and audit reports for these significant entities provide information about the operations of each of these entities. The entity audit reports also contain details regarding any audit findings and related recommendations for the respective entity. We did not audit, and we do not express an opinion on, any of these individual federal entity financial statements.

We considered the Department of Defense's (DOD) assertion in the *DOD Agency Financial Report for Fiscal Year 2011* regarding its noncompliant financial systems and lack of reasonable assurance that internal controls over financial reporting were effective. In addition, in the DOD Inspector General's fiscal year 2011 report on internal control over financial reporting, the Inspector General cited material weaknesses in several areas including (1) property, plant, and equipment; (2) inventory and operating material and supplies; (3) environmental liabilities; (4) intragovernmental eliminations; and (5) material amounts of unsupported accounting entries needed to prepare DOD's annual consolidated financial statements.

Because of the significance of the amounts presented in the Statement of Social Insurance and Statement of Changes in Social Insurance Amounts related to the Social Security Administration (SSA) and the Department of Health and Human Services (HHS), our audit approach regarding these statements focused primarily on these two agencies. For each federal entity preparing a Statement of Social Insurance and Statement of Changes in Social Insurance Amounts,[34] we considered the entity's 2011, 2010, 2009, 2008, and 2007 Statements of Social Insurance and the 2011 Statement of Changes in Social Insurance Amounts as well as the related auditor's reports prepared by the inspectors general or contracted independent public accountants. We believe our audit, including internal control and substantive audit procedures, reperformance procedures, and review of the other auditors' Statement of Social Insurance-related audit work, provides a reasonable basis for our opinions on the 2009, 2008, and 2007 Statements of Social Insurance.

We performed sufficient audit work to provide this report on the consolidated financial statements, internal control, and compliance with selected provisions of laws and regulations. We considered the limitations on the scope of our work regarding the accrual-based consolidated financial statements, the 2011 and 2010 Statements of Social Insurance, and the 2011 Statement of Changes in Social Insurance Amounts in forming our conclusions. Our work was performed in accordance with U.S. generally accepted government auditing standards.

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[33]GAO, *Financial Audit: Federal Deposit Insurance Corporation Funds' 2010 and 2009 Financial Statements*, GAO-11-412 (Washington, D.C.: Mar. 18, 2011).
[34]These entities consist of SSA, HHS, the Railroad Retirement Board, and the Department of Labor.

APPENDIX II

Material Weaknesses Contributing to Our Disclaimer of Opinion on the Accrual-Based Consolidated Financial Statements

The continuing material weaknesses discussed below contributed to our disclaimer of opinion on the federal government's accrual-based consolidated financial statements. The federal government did not maintain adequate systems or have sufficient, reliable evidence to support information reported in the accompanying accrual-based 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 accrual-based 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. Certain entities reported continued deficiencies in internal control procedures and processes related to PP&E.

Deficiencies in internal control over such assets could affect the federal government's ability to fully know the assets it owns, including their location and condition, and its ability to effectively (1) safeguard assets from physical deterioration, theft, or loss; (2) account for acquisitions and disposals of such assets and reliably report asset balances; (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 any related to treaties and other international agreements entered into to further the federal 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, deficiencies in internal control supporting the process for estimating environmental and disposal liabilities could result in improperly stated liabilities as well as adversely 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, to the extent disclosures of commitments and contingencies are incomplete or incorrect, reliable information is not available about the extent of the federal government's obligations.

Cost of Government Operations and Disbursement Activity

The previously discussed material weaknesses in reporting assets and liabilities; material weaknesses in financial statement preparation, as discussed below; and the lack of adequate disbursement reconciliations at certain federal entities affected reported net costs. As a result, the federal government was unable to support significant portions of the reported total net cost of operations, most notably those related to DOD.

With respect to disbursements, DOD and certain other federal entities reported continued material weaknesses and significant deficiencies in reconciling disbursement activity. For fiscal years 2011 and 2010, there was unreconciled disbursement activity, including unreconciled differences between federal entities' and the Department of the Treasury's (Treasury) records of disbursements and unsupported federal entity 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 or authorized. If disbursements are improperly recorded, this could result in misstatements in the financial statements and in certain data provided by federal entities for inclusion in *The Budget of the United States Government* (President's Budget) concerning obligations and outlays.

Accounting for and Reconciliation of Intragovernmental Activity and Balances

Although progress has been made, federal entities continue to be 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 significant entities to reconcile, on a quarterly basis, selected intragovernmental activity and balances with their trading partners. In addition, these entities are required to report to Treasury, the entity's inspector general, and GAO on the extent and results of intragovernmental activity and balance-reconciliation efforts as of the end of the fiscal year.

A substantial number of the entities did not adequately perform the required year-end reconciliations for fiscal years 2011 and 2010. For these fiscal years, based on trading partner information provided to Treasury in the 35 significant entities' closing packages, Treasury provided a *Material Differences Report* to each entity showing amounts for certain intragovernmental activity and balances that significantly differed from those of the entity's corresponding trading partners as of the end of the fiscal year. Entities are required to complete their *Material Differences Reports*, which includes providing explanations of the reasons for certain differences. Based on our review of completed *Material Differences Reports* for fiscal year 2011, we continue to note that amounts reported by federal entity trading partners for certain intragovernmental accounts were not in agreement by significant amounts. We noted that a significant number of CFOs continue to cite differing accounting methodologies, accounting errors, and timing differences for material differences with their trading partners. Some CFOs indicated that they did not know the reason for the differences. In addition, some CFOs confirmed the balance or activity, however, differences continued to exist. Further, there continue to be hundreds of billions of dollars of unreconciled differences between the General Fund of the U.S. Government and federal entity trading partners related to appropriation and other intragovernmental transactions. The ability to reconcile such transactions is hampered because only some of the General Fund of the U.S. Government is reported in the Department of the Treasury's financial statements. As a result of these circumstances, the federal government's ability to determine the impact of these differences on the amounts reported in the accrual-based consolidated financial statements is significantly impaired.

During fiscal year 2011, Treasury furthered its commitment to resolve differences in intragovernmental activity and balances, which included several short- and long-term initiatives. For example, Treasury expanded focus groups' monitoring and outreach efforts that included quarterly analysis and ongoing collaboration with entities to resolve intragovernmental differences.[35] Such focus groups made significant progress in understanding reasons for material differences and determining corrective actions to be taken, which resulted in adjustments to eliminate certain differences. Also, Treasury identified deficiencies in the intragovernmental process and is planning to develop government-wide systems to improve intragovernmental transactions data. Further, Treasury is currently working to develop a complete set of financial statements for the General Fund, including intragovernmental transactions. Resolving the intragovernmental transactions problem remains a difficult challenge and will require a strong and sustained commitment by federal entities, as well as continued strong leadership by OMB and Treasury.

Preparation of Consolidated Financial Statements

While Treasury, in coordination with OMB, implemented corrective actions during fiscal year 2011 to address certain internal control deficiencies detailed in our previously issued report, the federal government continued to have inadequate systems, controls, and procedures to ensure that the consolidated financial statements are consistent with the underlying audited entity financial statements, properly balanced, and in conformity with U.S. generally accepted accounting principles (GAAP). During our fiscal year 2011 audit, we found the following:[36]

- Treasury's process for compiling the consolidated financial statements generally demonstrated that amounts in the Statement of Social Insurance and the Statement of Changes in Social Insurance Amounts were consistent with the underlying federal entities' financial statements and that the Balance Sheet and the Statement of Net Cost were also consistent with the 35 significant federal entities' financial statements prior to eliminating intragovernmental activity and balances. However, Treasury's process did not ensure that the information in the remaining three principal financial statements was fully consistent with the underlying information in the 35 significant federal entities' audited financial statements and other financial data.

- For fiscal year 2011, auditors reported significant internal control deficiencies at several entities that impacted the preparation of the respective entities' closing packages. Further, Treasury had to record significant adjustments to correct errors found in federal entities' audited closing package information. To ensure consistency of underlying entity information and financial data with the U.S. government's consolidated financial statements, entity auditors are required to separately audit and report on the financial information sent by the 35 significant federal entities to Treasury through closing packages.

- Treasury is unable to fully identify and quantify all components of unreconciled activities. To make the fiscal years 2011 and 2010 consolidated financial statements balance, Treasury recorded net increases of $15.6 billion and $0.8 billion, respectively, to net operating cost on the Statements of Operations and Changes in Net Position, which were identified as "Unmatched transactions and

[35]Beginning in 2008, Treasury established three focus groups to work with federal entity personnel to identify and resolve reported differences related to benefits, transfers, and buy/sell transactions.
[36]Most of the issues we identified in fiscal year 2011 existed in fiscal year 2010, and many have existed for a number of years. Most recently, in May 2011, we reported the issues we identified to Treasury and OMB and provided recommendations for corrective action in GAO, *Management Report: Improvements Needed in Controls over the Preparation of the U.S. Consolidated Financial Statements*, GAO-11-525 (Washington, D.C.: May 26, 2011).

balances."[37] Treasury recorded an additional net $6.0 billion and $3.8 billion of unmatched transactions in the Statement of Net Cost for fiscal years 2011 and 2010, respectively.

- The federal government continues to be unable to determine the impact of unreconciled intragovernmental activity and balances on the accrual-based consolidated financial statements. Treasury's elimination of certain intragovernmental activity and balances continues to be impaired by the federal entities' problems in handling their intragovernmental transactions. As a result, Treasury recorded the net differences in intragovernmental elimination entries as part of the "Unmatched transactions and balances" discussed above.

- The federal government could not demonstrate that it had fully identified and reported all items needed to reconcile the operating results to the budget results. Typical reconciling items would include both accrual-based costs that are not yet recognized in the unified budget deficit and budget costs that are not yet recognized in the net operating cost.

- The federal government has not established and implemented effective processes and procedures for identifying and reporting all items needed to prepare the Statement of Changes in Cash Balance from Unified Budget and Other Activities.

- Over the past several years, significant actions have been taken to assist in ensuring that financial information is reported or disclosed in the consolidated financial statements in conformity with GAAP. However, Treasury's reporting of certain financial information required by GAAP continues to be impaired. Due to certain control deficiencies noted in this report—for example, commitments and contingencies related to treaties and other international agreements—Treasury is precluded from determining if additional disclosure is required by GAAP in the consolidated financial statements, and we are precluded from determining whether the omitted information is material. Further, Treasury's ability to report information in conformity with GAAP will also remain impaired until federal entities, such as DOD, can provide Treasury with complete and reliable information required to be reported in the consolidated financial statements.

- The consolidated financial statements include financial information for the executive, legislative, and judicial branches, to the extent that federal entities within those branches have provided Treasury such information. However, as we have reported in past years, there continue to be undetermined amounts of assets, liabilities, costs, and revenues that are not included, and the federal government did not provide evidence that the excluded financial information was immaterial.

- Other internal control deficiencies existed in the process for preparing the consolidated financial statements, involving (1) inadequate design and ineffective implementation of policies and procedures related to certain areas, and (2) inadequate processes for monitoring and assessing internal controls over the preparation of the consolidated financial statements. As a result, we identified numerous errors in draft consolidated financial statements that were subsequently corrected.

- As in previous years, Treasury did not have adequate systems and personnel to address the magnitude of the fiscal year 2011 financial reporting challenges it faced, such as control deficiencies in its process for preparing the consolidated financial statements noted above. We found that personnel at Treasury's Financial Management Service had excessive workloads that required an extraordinary

[37]Although Treasury was unable to determine how much of the unmatched transactions and balances, if any, relate to net operating cost, it reported this amount as a component of net operating cost in the accompanying consolidated financial statements.

amount of effort and dedication to compile the consolidated financial statements. Further, there were not enough personnel with specialized financial reporting experience to help ensure reliable financial reporting by the reporting date. In addition, the federal government does not perform interim compilations at the governmentwide level, which leads to almost all of the compilation effort being performed during a condensed time period at the end of the year.

Until these internal control deficiencies have been fully addressed, the federal government's ability to ensure that the consolidated financial statements are consistent with the underlying audited federal entities' financial statements, properly balanced, and in conformity with U.S. GAAP will be impaired. Resolving some of these internal control deficiencies will be a difficult challenge and will require a strong and sustained commitment from Treasury and OMB as they continue to execute and implement their corrective action plans.

Components of the Budget Deficit

Both the Reconciliation of Net Operating Cost and Unified Budget Deficit and the Statement of Changes in Cash Balance from Unified Budget and Other Activities report a unified budget deficit for fiscal years 2011 and 2010 of about $1.3 trillion and $1.3 trillion, respectively.[38] The budget deficit is calculated by subtracting actual budget outlays (outlays) from actual budget receipts (receipts). Also, the Fiscal Projections for the U.S. Government included in Supplemental Information use such outlays and receipts.

For several years, we have been reporting significant unreconciled differences between the total net outlays reported in selected federal entities' Statements of Budgetary Resources (SBR) and Treasury's central accounting records used to compute the budget deficit[39] reported in the consolidated financial statements. Unreconciled net outlays of about $31 billion and $40 billion existed for fiscal years 2011 and 2010, respectively. OMB and Treasury have recognized that it will take a coordinated effort to establish effective processes and procedures for identifying, resolving, and explaining material differences in this and other components of the deficit between Treasury's central accounting records and information reported in entity financial statements and underlying entity financial information and records. Until these types of differences are timely reconciled by the federal government, their effect on the U.S. government's consolidated financial statements will continue to be unknown.

In fiscal year 2011, we again noted that several entities' auditors reported internal control deficiencies (1) affecting the entities' SBRs and (2) related to monitoring, accounting, and reporting of budgetary transactions. These control deficiencies could affect the reporting and calculation of the net outlay amounts in the entities' SBRs. In addition, such deficiencies may also affect the entities' ability to report reliable budgetary information to Treasury and OMB and may affect the unified budget deficit reported in the accrual-based consolidated financial statements. The unified budget deficit is also reported by Treasury in its *Combined Statement of Receipts, Outlays, and Balances*,[40] and in other federal government publications.

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[38]The budget deficit, receipts, and outlays amounts are reported in Treasury's *Monthly Treasury Statement* and the President's Budget.

[39]See GAO, *Financial Audit: Process for Preparing the Consolidated Financial Statements of the U.S. Government Needs Improvement*, GAO-04-45 (Washington, D.C.: Oct. 30, 2003).

[40]Treasury's *Combined Statement of Receipts, Outlays, and Balances* presents budget results and cash-related assets and liabilities of the federal government with supporting details. Treasury represents this report as the recognized official publication of receipts and outlays of the federal government based on entity reporting.

APPENDIX III

Other Material Weaknesses

Material weaknesses in internal control discussed in this report resulted in ineffective controls over financial reporting. In addition to the material weaknesses discussed in appendix II that contributed to our disclaimer of opinion on the accrual-based consolidated financial statements, we found the following three other material weaknesses in internal control.

Improper Payments

During fiscal year 2011, the federal government continued to make progress in reporting on improper payments. Entities reported on 12 additional programs' improper payments estimated amounts in fiscal year 2011 when compared to fiscal year 2010.[41] Most notably, the Department of Health and Human Services (HHS) reported an estimated improper payment amount for Medicare Part D of $1.7 billion. Nevertheless, the federal government continues to face challenges in determining the full extent of improper payments. For example, 3 federal entities did not report fiscal year 2011 estimated improper payment amounts for 4 risk-susceptible programs, including HHS's Children's Health Insurance Program and Temporary Assistance for Needy Families. The Improper Payments Information Act of 2002 (IPIA),[42] as amended by the Improper Payments Elimination and Recovery Act of 2010 (IPERA),[43] requires federal executive branch entities to (1) review all programs and activities, (2) identify those that may be susceptible to significant improper payments,[44] (3) estimate and report the annual amount of improper payments for those programs, and (4) implement actions to reduce improper payments. IPERA also established additional requirements related to recovery auditing. OMB issued implementing guidance in fiscal year 2011.

Federal entities reported estimates of improper payment amounts that totaled $115.3 billion in fiscal year 2011, a decrease from the prior year revised estimate of $120.6 billion.[45] These estimates represented about 4.7 percent and 5.3 percent of reported outlays for the associated programs in fiscal years 2011 and 2010, respectively. Decreases in reported estimates of improper payments were mostly attributable to three major programs: (1) Department of Labor's Unemployment Insurance program, (2) Department of the Treasury's Earned Income Tax Credit Program, and (3) HHS' Medicare Advantage program. The decreases in the estimates for these programs primarily related to a decrease in reported outlays for the Unemployment Insurance program and decreases in reported error rates[46] for the Earned Income Tax Credit and Medicare Advantage programs. It is important to note that reported improper payment estimates include overpayments, underpayments, and payments for which adequate documentation was not found, and may also include amounts of payments for years prior to the current fiscal year.

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[41]Of the 12 programs, 3 programs have been excluded from the governmentwide totals to avoid distortion of the governmentwide error rate because those programs were refining their estimating methodologies.
[42]Pub. L. No. 107-300, 116 Stat. 2350 (Nov. 26, 2002).
[43]Pub. L. No. 111-204, 124 Stat. 2224 (July 22, 2010).
[44]Improper payments are defined as any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements. It includes any payment to an ineligible recipient, any payment for an ineligible good or service, any duplicate payment, any payment for good or service not received (except for such payments where authorized by law), and any payment that does not account for credit for applicable discounts.
[45]In their fiscal year 2011 Performance and Accountability Reports (PAR) and Annual Financial Reports (AFR), 4 federal entities updated their fiscal year 2010 improper payment estimates to reflect changes since issuance of their fiscal year 2010 PARs and AFRs. These updates decreased the governmentwide improper payment estimate for fiscal year 2010 from $125.4 billion to $120.6 billion.
[46]Reported error rates reflect the estimated improper payments as a percentage of total program outlays.

Entity auditors reported some internal control deficiencies over financial reporting, such as financial system limitations and information system control weaknesses, that significantly increase the risk that improper payments may occur and not be detected promptly. Until the federal government has implemented effective processes to determine the full extent to which improper payments occur and reasonably assure that appropriate actions are taken across entities and programs to effectively reduce improper payments, the federal government will not have reasonable assurance that the use of taxpayer funds is adequately safeguarded.

Information Security

Although progress has been made, serious and widespread information security control deficiencies reported during fiscal year 2011 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. Specifically, control deficiencies were identified related to (1) security management; (2) access to computer resources (data, equipment, and facilities); (3) changes to information system resources; (4) segregation of incompatible duties; and (5) contingency planning. We have reported information security as a high-risk area across government since February 1997.

Such information security control deficiencies unnecessarily increase the risk that the reliability and availability of data that are recorded in or transmitted by federal financial management systems could be compromised. A primary reason for these deficiencies is that federal entities generally have not yet fully institutionalized comprehensive security management programs, which are critical to identifying information security control deficiencies, resolving information security problems, and managing information security risks on an ongoing basis. The federal government has taken important actions to improve information security, such as deploying continuous monitoring capabilities, and enhancing performance measures and reporting processes. However, until entities identify and resolve information security control deficiencies and manage information security risks on an ongoing basis, federal data and systems, including financial information, will remain at risk.

Tax Collection Activities

During fiscal year 2011, material weaknesses and systemic deficiencies continued to affect the federal government's ability to effectively manage its tax collection activities. Due to errors and delays in recording taxpayer information, assessments, payments, and other activities, the federal government's records did not always reflect the correct amount that taxpayers owed and this contributed to the federal government's inability to timely release federal tax liens against taxpayers who fully satisfied or were otherwise relieved of their tax liability. Such errors and delays may cause undue burden and frustration to taxpayers who either have already paid taxes owed or who owe significantly lower amounts. In addition, deficiencies in internal control over tax refunds increased the risk of the federal government issuing duplicate or otherwise erroneous tax refunds to which individuals or businesses are not entitled. Collectively, these deficiencies indicate that internal controls over the financial reporting process were not effective in (1) ensuring that reported amounts of taxes receivable and tax assessments were accurate on an ongoing basis and could be relied upon by management as a tool to aid in making and supporting resource allocation decisions; (2) supporting timely and reliable financial statements, accompanying notes, and required supplemental and other accompanying information without extensive supplemental procedures and adjustments; and (3) safeguarding the federal government's resources.

APPENDIX IV

Significant Deficiencies

In addition to the material weaknesses discussed in appendices II and III, we found two significant deficiencies in the federal government's internal control related to implementing effective internal controls at certain federal entities, as described below. Also, the significant deficiency in fiscal year 2010 relating to deficiencies in certain controls over spreadsheets used by the Department of Health and Human Services (HHS) to prepare its Statement of Social Insurance is no longer considered to be a significant deficiency as of September 30, 2011. HHS, which administers the Medicare programs, contributes the majority of the amounts reported on the consolidated Statement of Social Insurance.

Loans Receivable and Loan Guarantee Liabilities

Internal control deficiencies were identified at certain federal entities accounting for the majority of the reported balances for loans receivable and a significant amount of the reported balances for loan guarantee liabilities. The deficiencies, for the most part, involved credit subsidy estimation and related financial reporting processes. The issues and the complexities associated with estimating the costs of lending and other loan-related financing activities significantly increase the risk that misstatements in entity and governmentwide financial statements could occur and go undetected. Further, these control deficiencies can 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.

Federal Grants Management

The federal government reported grant outlays to states and local governments of over $600 billion in fiscal year 2010—almost one-fifth of the fiscal year 2010 federal budget. In fiscal year 2011, federal grants management internal control deficiencies, primarily regarding inadequate monitoring and oversight of grant programs, were identified at several federal entities. For example, the auditor for one federal entity that awards and manages significant amounts of grants reported issues regarding action and follow-up with noncompliant grantees, as well as inadequate procedures to identify noncompliant grantees. These internal control deficiencies could adversely affect the federal government's ability to ensure that grant funds are being spent in accordance with applicable program laws and regulations.

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