A MESSAGE FROM THE SECRETARY OF THE TREASURY

Our objective in preparing the fiscal year *2005 Financial Report of the U.S. Government* is to give the Congress and the American people a timely and useful report on the cost of the Federal Government's operations, the sources used to fund them, and the implications of our long-term financial commitments and obligations.

As Treasury and the Office of Management and Budget reported in October in our 2005 fiscal-year-end budget report, the growing economy brought 2005 revenues to a level of $2.2 trillion. This increase of almost $275 billion over 2004 revenues was nearly a 15 percent increase and was also the largest year-over-year percentage increase in receipts in over 20 years. These increased revenues resulted in a much lower-than-expected 2005 budget deficit. While deficits are never welcome, the 2005 deficit of $319 billion, when expressed as a percent of Gross Domestic Product, was lower than the deficits in 16 of the last 25 years.

In comparison with the October budget report, the *Financial Report* presents the government's accrual-based net operating cost, which was $760 billion in 2005. There is a difference in the amounts reported for the budget deficit and the net operating cost because of the distinct methods of accounting used. This year, the difference of $441 billion is due principally to a $198 billion increase in Veterans Affairs' actuarial costs, mainly a reflection of changes in interest rate assumptions.

In addition to looking at the financial results of this past year, this report looks toward our nation's fiscal future. An important measure of the government's fiscal position is the cost of its responsibilities for social insurance programs such as Social Security and Medicare. Including these future financial responsibilities in this report gives a more complete and long-range look at the government's finances.

These government-wide financial statements reflect the Treasury Department's long-standing responsibility and commitment to report on the Nation's finances and our desire to inform and support the financial decision making that is critical to the nation's fiscal future.

John W. Snow

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MANAGEMENT'S DISCUSSION AND ANALYSIS

Introduction

The accompanying *2005 Financial Report of the United States Government (Financial Report)* provides the President, Congress, and the American people information about the financial results and position of the Federal Government. It provides, on an accrual basis of accounting as prescribed by U. S. generally accepted accounting principles (GAAP) for Federal entities, a broad, comprehensive view of the Federal Government's finances. This report states the Government's financial position and condition, its revenues and costs, assets and liabilities, and other obligations and commitments. Finally, it discusses important financial issues and significant conditions that may affect future operations.

The *Financial Report,* required by 31 U.S.C. § 331(e)(1), is to be submitted to Congress by March 31 and is subject to audit by the Government Accountability Office (GAO). The Office of Management and Budget (OMB) accelerated its issue date to December 15 beginning with fiscal year 2004. Material deficiencies in financial reporting (which also represent material weaknesses in internal control) and other limitations on the scope of its work resulted in conditions that continued to prevent GAO from forming and expressing an opinion on the U.S. Government's consolidated financial statements for the fiscal years ended September 30, 2005 and 2004. See GAO's disclaimer of opinion on pages 135-154 for a full explanation of this and other material weaknesses that relate to this report.

Some of the significant agencies included in the *Financial Report* received unqualified opinions on their fiscal year 2005 financial statements. For example, the Department of the Treasury (Treasury), which accounts for substantially all of the Federal Government's revenues and Federal debt, received an unqualified audit opinion on its fiscal year 2005 financial statements. Moreover, the Department of Veterans Affairs (VA), the Office of Personnel Management (OPM), and the Department of Defense's (DOD) Military Retirement Fund, which account for significant amounts included in this report for employee and veteran benefits, all received unqualified audit opinions on their fiscal year 2005 financial statements. Lastly, the *Financial Report's* Statements of Social Insurance include disclosed amounts subject to considerable scrutiny by the process used by the Trustees to prepare the numbers. These amounts will be audited for the first time starting for fiscal year 2006.

The *Financial Report* consists of Management's Discussion and Analysis, Statements of Net Cost, Statements of Operations and Changes in Net Position, Reconciliations of Net Operating Cost and Unified Budget Deficit, Statements of Changes in Cash Balance from Unified Budget and Other Activities, Balance Sheets, Stewardship Information, Notes to the Financial Statements, Supplemental Information, and Auditor's Report. The *Financial Report*'s five financial statements are interrelated and work together. Chart A, on page 5, provides an overview of the statements and how selected parts of them tie together.

Management's Discussion and Analysis (MD&A) provides management's perspectives on the information presented in the Federal Government's financial statements and social insurance responsibilities. Table 1 is the table of contents for this MD&A.

Table 1: MD&A's Table of Contents
(Fiscal Year 2005)

Accrual-Based Results and Basis of Accounting

Each year, the Administration issues two reports that detail financial results for the Federal Government: the President's Budget on the cash basis and the *Financial Report* on the accrual basis. The two reports complement each other. The budget report contains mainly cash receipt and outlay information and compares the results to the appropriations for the current fiscal year. The *Financial Report* uses those transactions as its base and also contains noncash-based revenues and expenses. For example, revenue accruals produce accounts receivable balances and the expense accruals produce liabilities for items such as pensions for Government workers, accounts payable, and environmental cleanup costs. As a result, this *Financial Report* is intended to provide the results of the Federal Government's financial operations, its financial condition, its revenues and costs, assets and liabilities, and other obligations and commitments. As such, it can be used with the budget as a planning and control tool not only for the current fiscal year but with a longer term focus as well.

The information in the financial statements (pages 36-40) was prepared based on U.S. GAAP standards developed by the Federal Accounting Standards Advisory Board (FASAB). GAAP for the Federal Government is tailored to the U.S. Government's unique characteristics and special needs. For example, the Stewardship Information section of this report contains important information about diverse subjects such as land set aside for the use and enjoyment of present and future generations, heritage assets, and social insurance programs such as Social Security and Medicare.

Limitations of the Financial Statements

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

It must be noted that the audit opinions of several significant agencies are disclaimed. This means that the data could not be satisfactorily audited and may be incorrect, perhaps materially so. This report includes the balances provided by all agencies including those with disclaimed opinions. However, 18 of the 24 major Chief Financial Officers Act (CFO) agencies that are consolidated in this report received unqualified audit opinions.

Reporting Entity

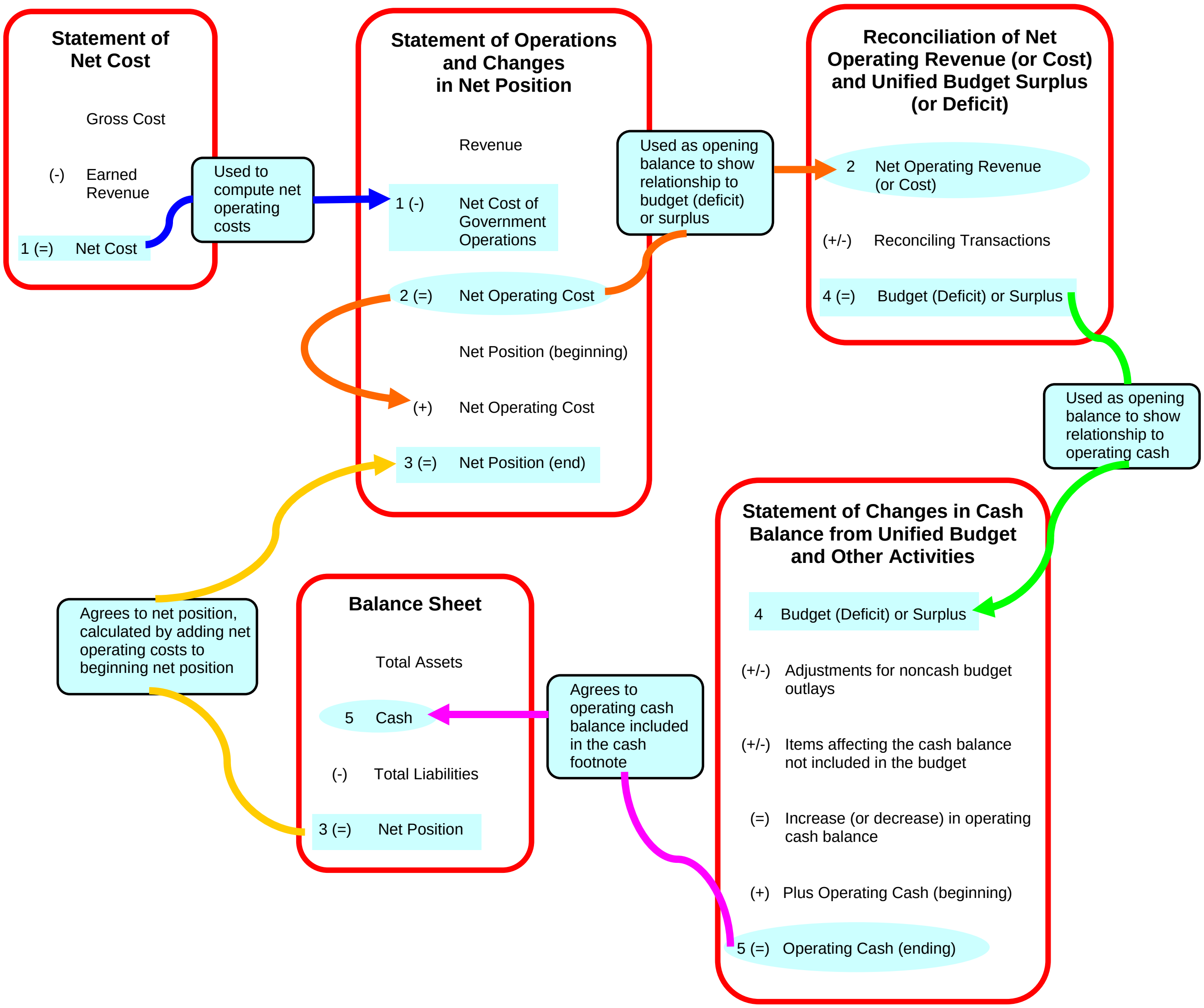
These financial statements cover the three branches of the U.S. Federal Government. A list of the significant entities included in these financial statements is in the Appendix. Information from the judicial branch is limited to budgetary activity because its entities are not required by law to submit and do not submit comprehensive financial statement information to the Treasury. Even though the legislative branch is not required by law to submit comprehensive financial statement information to the Treasury, parts of it do so voluntarily while the information for other parts is limited to budgetary activity. The Federal Reserve System is excluded because it is an independent entity having both public purposes and private aspects. The Federal Retirement Thrift Investment Board is excluded because it is fiduciary in nature. Moreover, Government-sponsored but privately-owned enterprises (e.g., the Federal Home Loan Banks, the Federal National Mortgage Association, and the Federal Home Loan Mortgage Corporation) are also excluded.

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

Federal accrual accounting has many similarities with accrual accounting used by virtually any entity, both private and public throughout the globe. On the next page, Chart A depicts how the Government's statements interrelate with each other and how each statement supports the next.

The Government uses several statements the average reader may not be familiar with. For example, items normally found on a private corporation's income statement are shown on two different statements. Expenses are shown on the Government's Statements of Net Cost (net of programmatic revenues), and general governmental revenues are shown on the Statements of Operations and Changes in Net Position. The Reconciliation of Net Operating Revenue (or Cost) and Unified Budget Surplus (or Deficit) statement and the Statements of Changes in Cash Balance from Unified Budget and Other Activities are both unique to the Federal Government. They are extremely important because they show how the budget deficit was funded and how it varies from the accrual results. In the private sector, when costs exceed revenues it is called a loss; in the Federal accrual world, we call this the Net Operating Cost. On the next page, Chart A shows how the statements fit together and which numbers are shown on more than one statement.

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



Notes

1 The total operating expense, called Net Cost, presented in the Statement of Net Cost is used in the Statement of Operations and Changes in Net Position to determine whether the Federal Government's financial operations (revenue less expenses) resulted in net operating cost or net operating revenue for the year.

2 The operating result from the Statement of Operations and Changes in Net Position explains the change in the Federal Government's net position. It is also the beginning balance in the Reconciliation of Net Operating Revenue (or Cost) and Unified Budget Surplus (or Deficit).

3 The Net Position from the Statement of Operations and Changes in Net Position agrees to the Net Position on the Balance Sheet, which is based on the difference between the Federal Government's reported assets and liabilities.

4 The unified budget result is used in the Reconciliation of Net Operating Revenue (or Cost) and Unified Budget Surplus (or Deficit) and the Statement of Changes in Cash Balance from Unified Budget and Other Activities to show how the Federal Government's financial operations and changes in operating cash are connected to the unified budget results.

5 The Federal Government's ending operating cash balance from the Statement of Changes in Cash Balance from Unified Budget and Other Activities is the same as the operating cash component of the "Cash and other monetary assets" line on the Balance Sheet. The operating cash amount can be found in the Balance Sheet note for Cash and other monetary assets.

Source: Government Accountability Office.

Executive Summary

Why the Accrual-Based Net Operating Cost Worsened While the Budget Deficit Improved

Net operating cost is the excess of expenses over revenues. In fiscal year 2005, net operating cost was $760 billion, which represented an *increase* of $144 billion from the $616 billion reported in fiscal year 2004. As was the case in 2004, most of the variability in net cost was driven by the change in the noncash veteran benefits actuarial costs at the VA.

Fiscal year 2005's budget deficit improved. The budget deficit, or the cash-based cost required to run the Government's operations, is a result of cash outlays exceeding cash receipts. The Federal budget deficit was $319 billion in fiscal year 2005, which represented an *improvement* of $93 billion, from the $412 billion reported in fiscal year 2004. Larger receipts were the main reason the budget deficit picture improved. Receipts rose by almost $274 billion to $2,153 billion, an increase of 14.6 percent, which more than offset the increase in outlays of $179 billion to $2,473 billion, or 7.9 percent.

As seen in Table 2, most of this year's net operating cost increase was caused by the significant increase in actuarial costs at the VA. The $228 billion increase in these costs explains why the net operating cost worsened while the budget results were significantly improved. These costs have experienced wide fluctuations over the past 6 years. For example, this noncash cost decreased by $52 billion in 2003, decreased by another $136 billion in 2004, and then increased by $228 billion this year.

Table 2: VA Actuarial Cost Impact on Net Operating Cost in Fiscal Year 2005
(In billions of dollars)

Impact on Net Operating Cost	$ Change
Budget Deficit Decline ($412-319)	$ 93
VA Actuarial Cost Increases	(228)
Other Net Cost Increases, Net	(9)
Net Operating Cost Increase ($616-760)	($144)

Social Insurance Responsibilities

In fiscal year 2005, the President began a discussion with the American people and Congress about reforming the 70-year-old Social Security Program. For 2005, the trustees again concluded that they "do not believe the currently projected long run growth rates of Social Security and Medicare are sustainable under current financing arrangements." Go to pages 13-14 to get a better understanding of what the trust funds are and the trustees short- and long-range outlooks for them. A summary of the trustees' 2005 Annual Reports may be found at www.socialsecurity.gov/OACT/TRSUM/trsummary.html.

Federal Hurricane Relief Effort

In response to the catastrophe of the Gulf Coast region caused by the hurricanes, Congress appropriated a little over $62 billion. Congress also temporarily increased the Federal Emergency Management Agency's (FEMA) National Flood Insurance Fund borrowing authority by $17.0 billion to a total of $18.5 billion.

For fiscal year 2005, FEMA's Disaster Relief Fund expended $3.5 billion related to Hurricanes Katrina and Rita. In addition, FEMA has accrued just over $23 billion this year related to the hurricanes, including a major increase in its flood insurance liability. The final Federal amount that will be required to restore the Gulf Coast region has not yet been determined.

Financial Results & Social Insurance Responsibilities

Statement of Net Cost Summary

The purpose of the Statement of Net Cost is to show how much it costs to operate the Federal Government by Federal agency and department, and in total. It provides costs on an accrual basis, which recognizes expenses when they happen, regardless of when the cash is paid. As a result, it provides cost information for the accounting period that can be related to the goods produced, services rendered, and the outcomes of the Federal Government's agencies and departments for the same period.

For fiscal year 2005, the Government reported a total gross cost of $3,174.6 billion. This was an increase of $442.6 billion or 16.2 percent over last year's reported gross cost. An important concept of the Statement of Net Cost is that the revenue earned by Federal components from their operations, such as admissions to national parks and fees paid for postal services and stamps, is subtracted from their gross cost of operations to get to the components' Net Cost. In fiscal year 2005, the Government earned $224.8 billion from this type of revenue. This compares to $207.1 billion earned in fiscal year 2004 for an increase of $17.7 billion (or 8.5 percent). The $3,174.6 billion gross cost minus the $224.8 billion in earned revenue resulted in a total net cost of $2,949.8 billion in 2005 compared to the $2,524.9 billion net cost reported in fiscal year 2004. Net cost is the amount to be financed from tax revenue and, as needed, borrowing. Net cost is also impacted by the variability of the costs that result from the change in actuarial liabilities.

Chart B: Net Cost Comparison
(In billions of dollars)

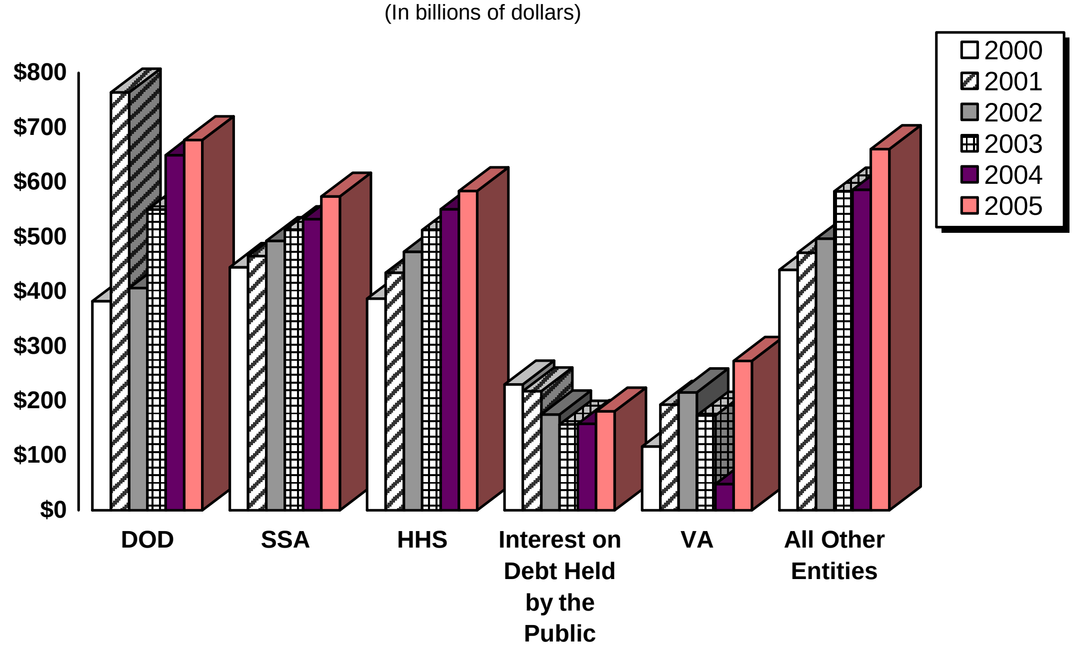


Chart B compares the major net cost elements over the past 6 fiscal years. Along with interest on debt held by the public, the source of over three-quarters of the Government's net cost comes from four Federal entities. For fiscal year 2005, the Government's total net cost increased by $424.9 billion over fiscal year 2004. And once again, these five major elements accounted for more than three-quarters or $2,289.3 billion of the Government's total $2,949.8 billion net cost.

In all fiscal years, except 2000 and 2002, DOD incurred the highest net cost. Most of DOD's net cost increases have been due to increases in the continued global war on terror and the actuarial liabilities related to its Military Retirement Fund and Military Retirement Health Benefits.

The total costs at the Department of Health and Human Services (HHS) and the Social Security Administration (SSA) together make up 39.3 percent or $1,157.9 billion of the Government's total net cost and continued their upward trend during fiscal year 2005. These increased net costs were mainly due to increases in benefit payments, operating expenses, and the number of beneficiaries. Some of the increases in operating expenses were related to the Medicare Prescription Drug Program. At SSA, its disability program experienced the most growth in its net cost (19.1 percent), benefit payments (19.4 percent), and number of beneficiaries (5 percent). To read more about the social insurance programs managed by these agencies, see the MD&A's Social Insurance Responsibilities section and the *Financial Report's* Statements of Social Insurance in the Stewardship Information section.

The VA again incurred the most variability in its year-over-year change in reported net costs. This year, VA's net cost grew by $225.3 billion, mainly due to an increase in the noncash actuarial cost of future veteran compensation and burial benefits as seen in Table 3. The changes in these costs have been due to assumption changes to VA's actuarial model used to calculate the related liability. Examples of the assumptions that impact the amount of the liability include: the number of veterans and dependents receiving payments, discount rates, cost of living adjustments, and life expectancy.

Table 3: The Change in VA's Total Actuarial Cost from 1999 to 2005
(In billions of dollars)

Year	Total Actuarial Cost	$ Change from Prior Year
1999	($95)	–
2000	$69	$164
2001	$139	$70
2002	$157	$18
2003	$106	($52)
2004	($30)	($136)
2005	$198	$228

Note: Table 3's data is from VA's 2000 to 2005 net cost statements and Treasury's analysis of them. Also, totals may not add due to rounding.

Also in fiscal year 2005, costs at the Department of Homeland Security (DHS), the Department of Agriculture (USDA), the Department of Education, and the Department of Energy experienced growth that increased net cost by $76.6 billion toward the reported $424.9 billion total increase in net cost. Among other things, these cost increases were related to the disasters caused by the hurricanes, protecting the homeland, the enhancement of post secondary and adult education, and changes in unfunded environmental liability estimates. However, these increases were somewhat offset by decreases in other areas.

Statement of Operations and Changes in Net Position Summary

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

Similar to a corporation's income statement, the Statement of Operations and Changes in Net Position shows the financial results of the Federal Government's annual operations. This equals revenue less net cost. It also shows the impact—improvement or deterioration—these results had on the Government's net financial position.

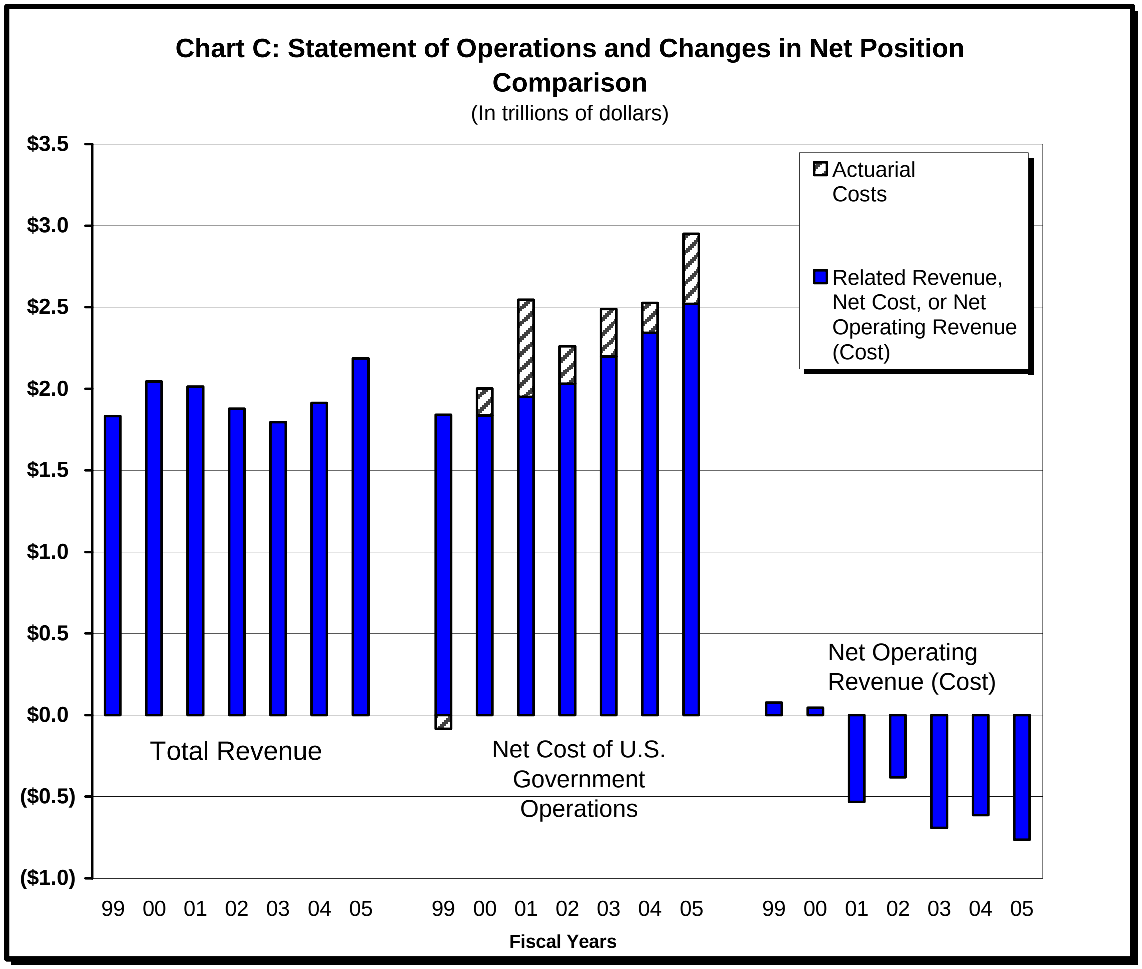
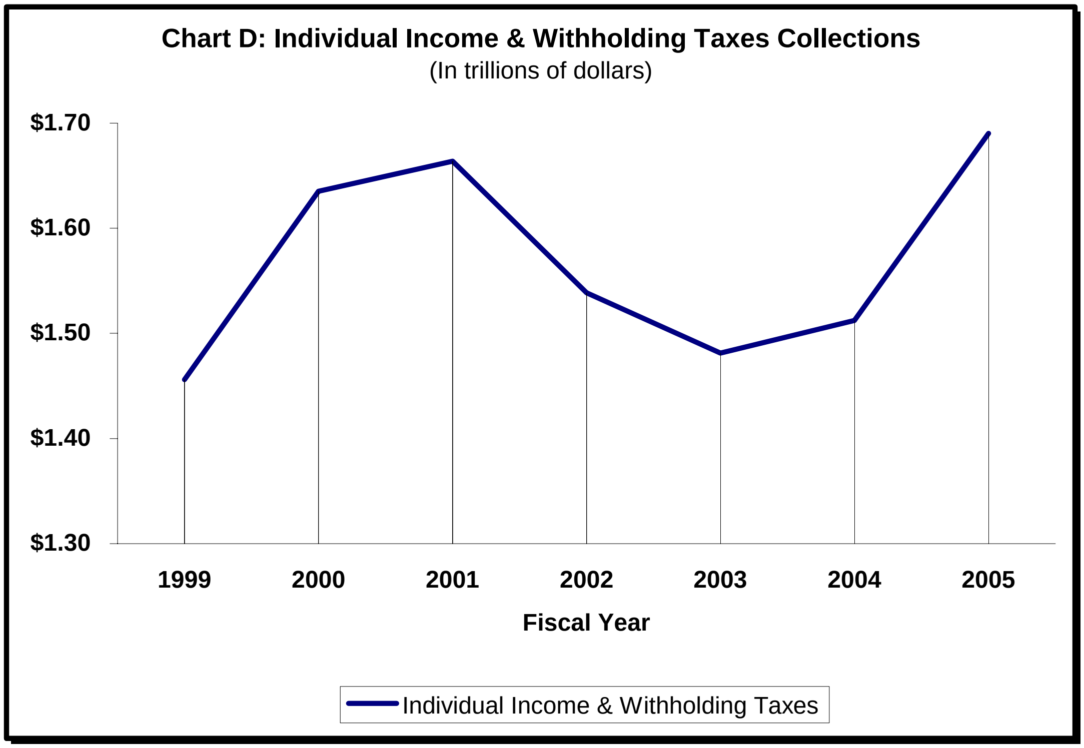


Chart C shows the Government's total revenue (its net operating cost, including the amount attributable to actuarial costs), and its resulting net operating revenue (cost) for the past 7 years. In fiscal years 1999 and 2000, the Government's total revenue exceeded its net cost and resulted in net operating revenue of $101.3 billion and $39.6 billion for these years, respectively. However, in fiscal years 2001 through 2005, the Government's net cost exceeded its revenue and resulted in net operating costs of $514.8 billion, $364.9 billion, $667.6 billion, $615.6 billion, and $760.0 billion, respectively.

This chart also shows that, absent the actuarially computed accruals, total costs have increased steadily throughout the period. The large variability in actuarial costs, as discussed previously, is largely attributed to assumption changes at the VA.

The Statements of Operations and Changes in Net Position also shows how much tax revenue the Government generated in total and from its various categories of taxes and the extent to which this tax revenue covered the Government's net cost. Fiscal year 2005's total revenues of $2.2 trillion were 14.3 percent higher than in 2004, the highest increase in revenues in over 20 years. Tax revenue increased in all categories, mainly due to large increases in both personal income and corporate profits.

Chart D shows the amount of individual income and withholding taxes the Government has collected over the past 7 years. During this time, individual income and withholding collections ranged between $1.46 trillion to $1.66 trillion. However, this year they experienced their highest collection amount to $1.69 trillion.



Reconciliation of Net Operating Cost and Budget Deficit Summary

The purpose of this statement is to reconcile the accrual-based net operating cost to the more widely-known budget deficit. The main components of the net operating cost that are not included in the budget deficit are the changes in accrued expenses related to employee and veteran benefits. The main component of the budget deficit that is not included in the net operating cost is the amount related to purchases of capitalized fixed assets. Table 4 is a condensed version of the Reconciliations of Net Operating Cost and Budget Deficit for fiscal years 2005 and 2004.

Table 4: Condensed Reconciliations of Net Operating Cost and Budget Deficits for 2005 and 2004
(In billions of dollars)

	2005	2004
Net Operating Cost	($760)	($616)
+/- Employee Benefits	+232	+212
+/- Veterans Benefits	+198	-30
+/- Other, Net	+11	+22
Budget Deficit	($319)	($412)

Statement of Changes in Cash Balance from Budget and Other Activities Summary

The primary purpose of the Statements of Changes in Cash Balance from Unified Budget and Other Activities is to report how the annual unified budget surplus or deficit relates to the Federal Government's borrowing and changes in operating cash. It explains how a budget surplus or deficit normally affects changes in debt balances.

For fiscal years 2005 and 2004, the Federal Government reported that it increased net borrowings from the public by $296.7 billion and $379.7 billion to help finance the $319 billion and $412 billion budget deficits, respectively. As can be seen, debt increases financed over 90 percent of the deficits in these years; however, the debt operations of the Federal Government are much more complex than this would imply. That is, each year trillions of dollars of debt matures and new debt takes its place. For example, in fiscal year 2005, new borrowings were $4.6 trillion and maturing debts were $4.3 trillion.

Balance Sheet Summary

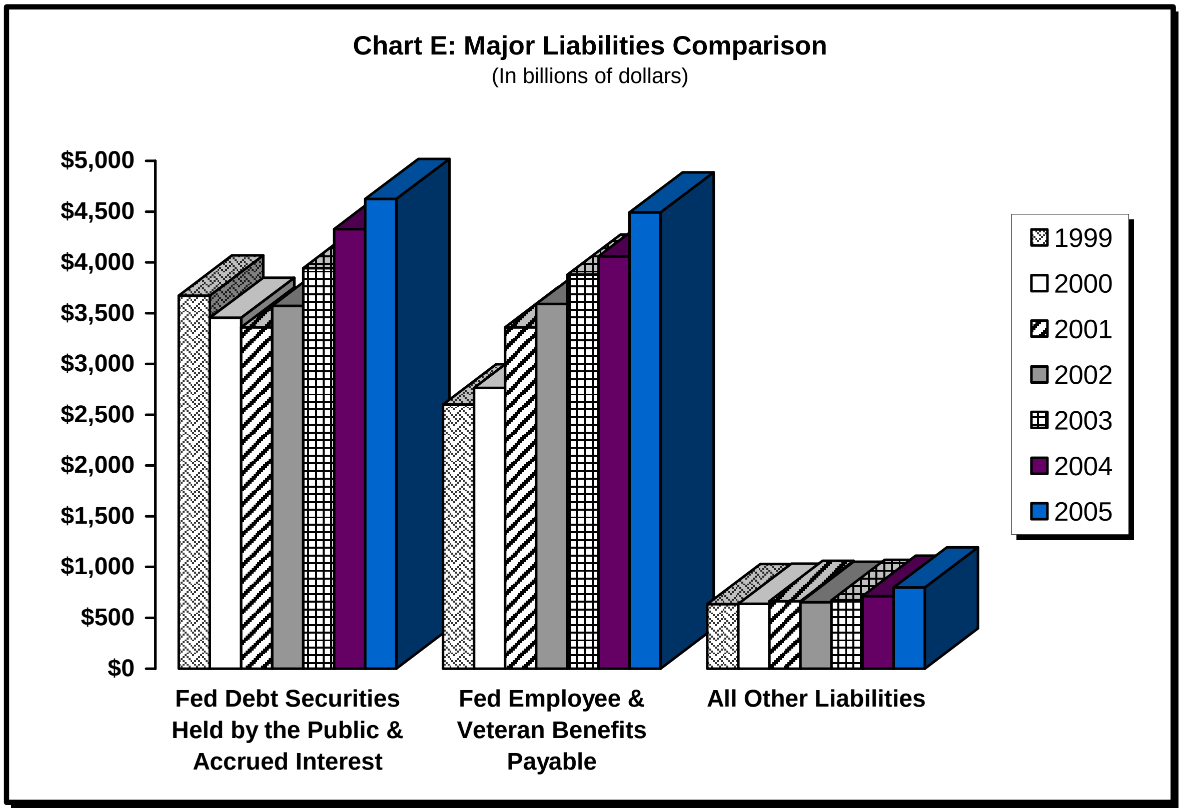
The balance sheet shows an end-of-year view of the Federal Government's overall financial position, its assets, liabilities, and the difference between the two. This difference is called net position. It is important to note that the balance sheet excludes the Government's sovereign powers to tax, regulate commerce, and set monetary policy. It also excludes its control over nonoperational resources, including national and natural resources, over which the Government is a steward. Moreover, the Government's responsibilities are broader than the liabilities presented on the balance sheet, including the Government's future Social Insurance Responsibilities (e.g., Social Security and Medicare), as well as other programs and contingencies. These responsibilities are discussed in this section's Social Insurance Responsibilities and the *Financial Report's* Stewardship section.

Assets

The Government's total assets increased from $1,397.3 billion as of the end of fiscal year 2004 to $1,456.1 billion as of the end of fiscal year 2005. This increase was due to increases in all of the Government's assets except its cash and other monetary assets, which declined slightly. Representing almost 50 percent of total assets this fiscal year, net property, plant, and equipment has been the Government's largest asset over the past 7 fiscal years. In fact, the reported value of these assets increased substantially in fiscal year 2003 as a result of a change in Federal accounting standards. This change resulted in the recognition of a net book value of $325.1 billion in military equipment being presented on the balance sheet for the first time.

Liabilities

Chart E is a 7-year comparison of the major components of liabilities, or what the Government owes, reported on the balance sheets as of September 30, for fiscal years 1999 through 2005. At the end of fiscal year 2005, the U.S. Government's liabilities increased 8.9 percent from $9,107.1 billion to $9,914.8 billion.



Over the past 7 fiscal years, Federal debt securities held by the public and accrued interest have tended to vary with the budget results. In years with budget surpluses, there have been reductions and in years with budget deficits, there have been corresponding increases. By contrast, Federal employee and veteran benefits payable have been increasing dramatically. From $2,600.7 billion as of the end of fiscal year 1999, this amount stands at $4,491.8 billion as of 2005. Together these amounts make up over 90 percent of the Government's total reported liabilities.

Increases in other liabilities were mainly due to the increases in insurance programs. In fact, the liability related to the National Flood Insurance Program that DHS' FEMA administers increased by $22 billion, from $1.4 billion in 2004 to $23.4 billion in 2005. This sharp rise was due to the disasters caused by the hurricanes. Other liabilities also increased as a result of the increase in pension benefit liabilities at the Pension Benefit Guaranty Corporation. This liability went from $60.8 billion in 2004 to $69.8 billion in 2005 (see Note 14 on page 104 for additional details).

Other Responsibilities

The 2005 balance sheet shows liabilities of $9,915 billion. In addition, the Government's responsibilities to make future payments for social insurance and certain other programs are not shown as liabilities according to Federal accounting standards; however, they are measured in other contexts. These programmatic commitments remain Federal responsibilities and as currently structured will have a significant claim on budgetary resources in the future.

The net present value for all of the responsibilities (for current participants over a 75-year period) is $49,403 billion, including Medicare and Social Security payments, pensions and benefits for Federal employees and veterans, and other financial responsibilities. The $49,403 billion includes amounts disclosed in the Statements of Social Insurance for the Social Security, Medicare, and Railroad Retirement programs on pages 41-43 (these amounts do not include future participants), as well as amounts disclosed in Notes 19 (Contingencies) and 20 (Commitments) that are not presented on the balance sheet.

Featured Balance Sheet Item: Civilian Federal Employee Benefits Payable

This section of the balance sheet summary is meant to feature one of the many items the U.S. Government owns or is responsible for. This year's featured item is civilian Federal employee benefits payable. Civilian Federal employee benefits payable is actually one part of Federal employee and veteran benefits payable (see Note 11 on page 97) that made up almost 50 percent of all the Government's reported liabilities in fiscal years 2005 and 2004.This is about twice as much, percentage-wise, when compared to the U.S. Government's northern neighbor, the Canadian Government.

The OPM administers the largest civilian pension plan. It covers about 90 percent of all Federal civilian employees and includes two components of defined benefits: the Civil Service Retirement System (CSRS) and the Federal Employees' Retirement System (FERS). The CSRS is a defined benefit plan that covers employees hired before 1984, and the FERS is a combined defined benefit-defined contribution plan that covers mainly employees hired after 1983. The CSRS covers 664,000 current employees and 2.2 million annuitants and the FERS covers 1.9 million current employees and 241,000 annuitants. The basic benefit components of both plans are paid by the Civil Service Retirement and Disability Fund (CSRDF). Funding sources for the CSRDF include: 1) Federal civilian employees' contributions, 2) agencies' contributions on behalf of employees, 3) appropriations, and 4) interest earned on investments in Treasury securities.

In addition to the basic benefit components of both plans, the Government also offers the Thrift Savings Plan (TSP) as an especially important element of the FERS plan. FERS employees may contribute up to 15 percent of their base pay and the Government matches up to 5 percent. CSRS employees may contribute up to 10 percent of their base pay with no Government match. Both FERS and CSRS contributions are capped by IRS limits (generally $14,000 for 2005). The Federal Retirement Thrift Investment Board, an independent Government agency, administers the TSP. These financial statements exclude the TSP because the CSRS and FERS employees own its assets and the program is fully funded from its investment income.

Not only does the Government offer pensions to its civilian employees, it also offers post-retirement health and other benefits. At the end of fiscal year 2005, civilian Federal employee benefits payable was $1,613.0 billion or 35.9 percent of total Federal employee and veteran benefits payable. This was a 4.0 percent increase over fiscal year 2004. The $1,613.0 billion liability included $1,273.8 billion of pensions, $290.7 billion of health, and $48.5 billion of other benefits.

Social Insurance Responsibilities

Social Insurance Trust Funds

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

There are four separate trust funds. For Social Security, the Old-Age and Survivors Insurance (OASI) Trust Fund pays retirement and survivors benefits, and the Disability Insurance (DI) Trust Fund pays disability benefits. (The combined trust funds are described as OASDI.) For Medicare, the Hospital Insurance (HI) Trust Fund pays for inpatient hospital and related care. The Supplementary Medical Insurance (SMI) Trust Fund is composed of Part B, which pays for physician and outpatient services, and effective in 2004, Part D, which provides a prescription drug benefit. Medicare benefits are provided to most people age 65 and over and to most workers who are receiving Social Security disability benefits.

Trustees Report on the Trust Funds

Each year the six trustees of the Social Security and Medicare Trust Funds—the Secretary of the Treasury, the Secretary of Labor, the Secretary of Health and Human Services, the Commissioner of Social Security, and two members appointed by the President and confirmed by the Senate to represent the public—report on the current status and projected condition of the funds over the next 75 years and the indefinite future. That is, short-range (10-year), long-range (75-year), and indefinite future estimates are reported for all funds. The estimates are based on current law and assumptions about all of the factors that affect the income and outgo of each trust fund.

Assumptions include economic growth, wages, inflation, unemployment, fertility, immigration, and mortality, as well as factors relating to disability incidence and the cost of hospital, medical, and prescription drug services.

Because the future is uncertain, three sets of economic and demographic assumptions are used to show a range of possibilities. The intermediate assumptions reflect the trustees' best estimate of future experience. The low-cost assumptions are more optimistic for trust fund financing, and the high-cost assumptions more pessimistic; they show trust fund projections for more and less favorable economic and demographic conditions for trust fund financing than the best estimate. The assumptions are reexamined each year in light of recent experience and new information about future trends, and are revised as needed. In general, greater confidence can be placed in the assumptions and estimates for near-term projection years than for years in the distant future.

Trustees Short-Range Outlook (2005-2014)

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

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

Trustees Long-Range Outlook (2005-2079)

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

Thus, a good way to view the projected cost of Social Security and Medicare is in relation to gross domestic product (GDP), the most frequently used measure of the total U.S. economy. Medicare's cost is projected to exceed Social Security's in 2024. Social Security outgo amounted to 4.3 percent of GDP in 2004 and is projected to increase to 6.4 percent of GDP in 2079. Medicare's cost amounted to 2.6 percent of GDP in 2004 and is projected to grow more than fivefold to 13.6 percent of GDP in 2079. The two together, absent reform, will almost triple as a percentage of the U.S. economy, from just under 7 percent last year to 20 percent by 2079.

Economy, Federal Budget, & Federal Debt

Growth in the U.S. economy remained favorable and well balanced through fiscal year 2005. Real GDP increased throughout the fiscal year, led by steady growth in personal consumption expenditures and business fixed investment. Productivity growth continued and real hourly compensation increased. Job creation was robust during most of the fiscal year and the unemployment rate fell to a 4-year low. Federal outlays for the continuing costs of operations in Iraq and Afghanistan and hurricane relief are expected to raise the budget deficit in the short term, affecting budget results in fiscal year 2006. In the medium to long term, the additional burden of the deficit from defense operations and the storm damage is not expected to undermine efforts at deficit reduction. Long-term efforts at deficit reduction will be shaped by the actions taken to address the actuarial imbalances in Social Security and Medicare noted in the *Financial Report's* Stewardship Information section.

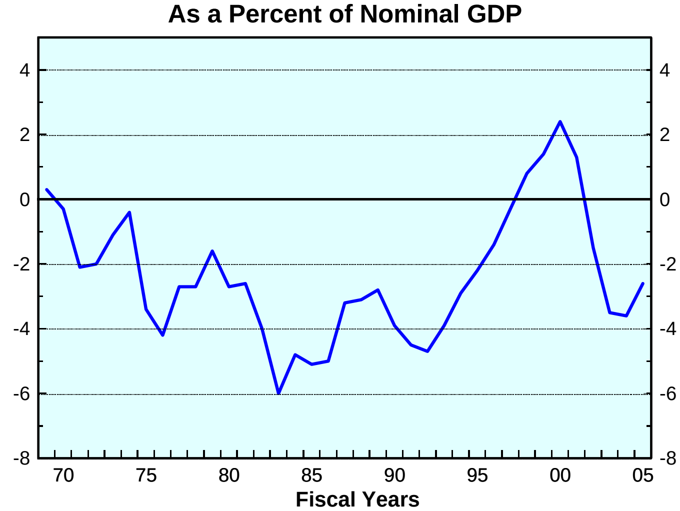
Economy

Real GDP increased 3.7 percent over the four quarters of fiscal year 2005, a little less than the 3.8 percent increase over the four quarters of fiscal year 2004. Growth was led by a 3.9 percent increase in real personal consumption expenditures over the year and by a year-over-year gain of 10.6 percent in real equipment and software investment. Corporate profits and cash flow rose during the fiscal year, helping to support the growth in business investment. Labor markets improved substantially in fiscal year 2005, with more than 2.2 million new payroll jobs created. The unemployment rate fell from 5.4 percent at the start of the fiscal year to 5.1 percent in the final month, and the 5.0 percent average for the last quarter of the fiscal year was the lowest quarterly rate in 4 years. The overall consumer price index (CPI) rose 4.7 percent over the year, well above the 2.5 percent increase during fiscal year 2004 as energy prices increased significantly in fiscal year 2005. The "core" CPI (which excludes food and energy prices) remained benign, up just 2.0 percent over the 12 months of fiscal year 2005.

Federal Budget

The Federal budget deficit declined to $319 billion in fiscal year 2005, from $412 billion in fiscal year 2004. The deficit in the latest fiscal year represented 2.6 percent of nominal GDP, smaller than the percentages of the deficits in relation to GDP in 16 of the last 25 years. Stronger receipts are the main reason the deficit picture has improved. In fiscal year 2005, actual tax collections have come in higher than expected as both individual income and corporate profits have strengthened. Receipts rose by 14.6 percent and outlays rose by 7.9 percent.

Chart F: Federal Budget Surplus(+)/Deficit(-) As a Percent of Nominal GDP



Federal outlays for the continuing costs of operations in Iraq and Afghanistan and hurricane relief are expected to raise the deficit in the short term, affecting budget results in fiscal year 2006. In the medium to long term, the additional burden of the deficit from defense operations and the storm damage is not expected to undermine efforts at deficit reduction. Long-term efforts at deficit reduction will be shaped by the actions taken to address the actuarial imbalances in Social Security and Medicare noted in the *Financial Report's* Stewardship Information section.

Debt held by the public, not including accrued interest of $35 billion, rose by $293 billion or 6.8 percent in fiscal year 2005. Publicly held debt, not including accrued interest, represented a relatively moderate 37.6 percent of GDP. That compares to the average 44.5 percent share that prevailed from the late 1980s through most of the 1990s.

Federal Debt

Currently, the largest liability for the Federal Government is the Federal debt held by the public and accrued interest, which was $4,624 billion at the end of 2005. This was an increase of $295 billion over the 2004 debt of $4,329 billion. However, this $295 billion increase in Federal debt was actually 23 percent smaller than fiscal year 2004's reported increase of $385 billion. The Government borrowed a smaller amount of cash from the public this year to finance its operations because of the sharp increase in tax revenues that helped to offset somewhat the increase in its costs.

Composition of the Federal Debt

There are two kinds of Federal debt: debt held by the public and the debt the Government owes to itself. At the end of fiscal year 2005, the total of these two kinds of debt were $7,970 billion.

The first kind of Federal debt is debt held by (or owed to) the public. It includes all Treasury securities (bills, notes, bonds, inflation-protected, and other securities) held by individuals, corporations, Federal Reserve banks, foreign governments, and other entities outside the U.S. Government. This debt is included as a liability on the balance sheet. The second kind is debt the Government owes to itself (intra-governmental debt), primarily in the form of special nonmarketable securities held by various parts of the Government. The laws establishing Government trust funds generally require the excess receipts of the trust funds to be invested in these special securities. This debt is not included on the balance sheet because these payments are claims of one part of the Government against another and are eliminated for consolidation purposes (see Note 10 on page 94).

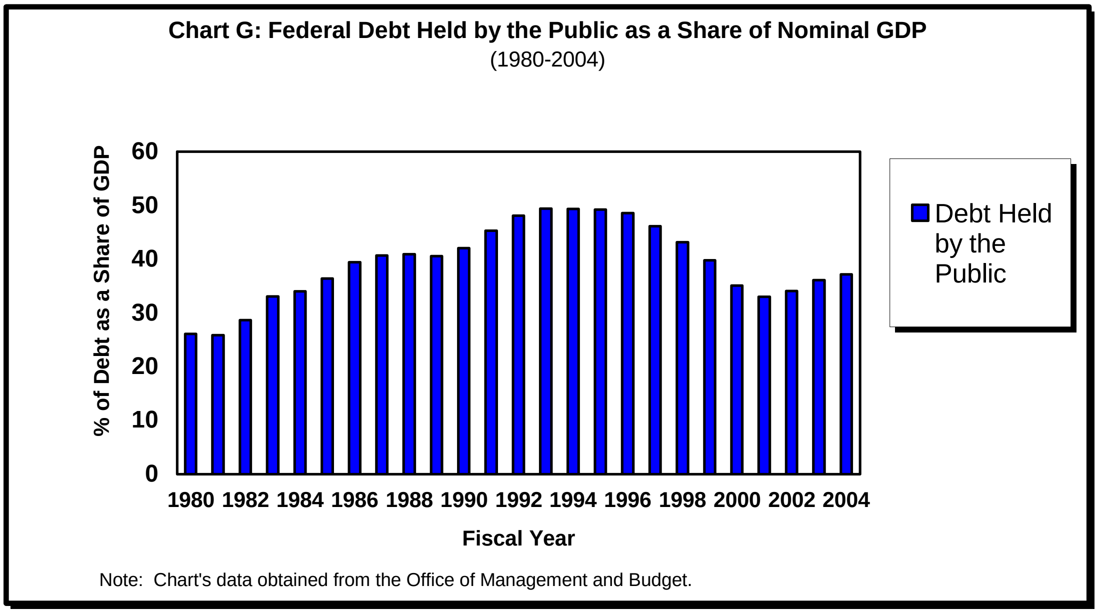
Federal debt is subject to a statutory ceiling that is known as the debt limit. Prior to 1917, the Congress approved each issuance of debt. In 1917, to facilitate planning in World War I, the law established a dollar ceiling for Federal borrowing, which has been periodically increased over the years. On November 19, 2004, legislation became effective raising the current limit to $8,184 billion from the previous $7,384 billion limit. The gross debt, excluding some adjustments, is the measure that is subject to the Federal debt limit. At the end of fiscal year 2005, the amount of debt subject to the limit was $7,871 billion. As a result, $313 billion of the $8,184 billion remained as the amount the Government could borrow to finance its operations.

How the Federal Budget is related to the Federal Debt

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

Federal Debt Held by the Public as a Percentage of GDP

The Federal debt held by the public as a share of GDP is a useful measure because it reflects how much of the Nation's wealth is absorbed by the Federal Government to finance its obligations. Chart G shows debt held by the public as a share of GDP from 1980 through 2004. Starting in the late 1970s, increasing budget deficits spurred a corresponding increase in debt held by the public, which essentially doubled as a share of GDP over a 15-year period throughout the mid-1990s and reached about 50 percent in 1993. The budget controls instituted by the Congress and the President, together with economic growth, contributed to the budget surpluses at the end of the 1990s. These surpluses led to a decline in the debt held by the public, and from fiscal years 1998 through 2001, the debt-to-GDP measure declined from about 43 percent to about 33 percent.



In fiscal years 2002 through 2004, the debt-to-GDP ratio started to rise slightly. This increase was due to many factors, including increased spending for homeland security and defense commitments, the decline in receipts owing to the recession and lower stock market value, as well as tax cuts, and the expiration of the budget controls that once helped instill spending discipline. By the end of fiscal year 2004, the debt-to-GDP ratio had risen to about 37 percent. This is still lower, however, than the roughly 50 percent of GDP reached in the mid-1990s.

U.S. Government's Mission & Organizational Structure

Mission & Organization

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

U.S. Government's Organization

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

THE UNITED STATES GOVERNMENT

THE CONSTITUTION

LEGISLATIVE BRANCH

THE CONGRESS
SENATE HOUSE

Architect of the Capitol
United States Botanic Garden
Government Accountability Office
Government Printing Office
Library of Congress
Congressional Budget Office

EXECUTIVE BRANCH

THE PRESIDENT
THE VICE PRESIDENT
EXECUTIVE OFFICE OF THE PRESIDENT

White House Office
Office of the Vice President
Council of Economic Advisers
Council on Environmental Quality
National Security Council
Office of Administration
Office of Management and Budget
Office of National Drug Control Policy
Office of Policy Development
Office of Science and Technology Policy
Office of the U.S. Trade Representative

JUDICIAL BRANCH

THE SUPREME COURT OF THE UNITED STATES

United States Courts of Appeals
United States District Courts
Territorial Courts
United States Court of International Trade
United States Court of Federal Claims
United States Court of Appeals for the Armed Forces
United States Tax Court
United States Court of Appeals for Veterans Claims
Administrative Office of the United States Courts
Federal Judicial Center
United States Sentencing Commission

DEPARTMENT OF AGRICULTURE *
DEPARTMENT OF COMMERCE *
DEPARTMENT OF DEFENSE *
DEPARTMENT OF EDUCATION *
DEPARTMENT OF ENERGY *
DEPARTMENT OF HEALTH AND HUMAN SERVICES *
DEPARTMENT OF HOMELAND SECURITY *
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT *
DEPARTMENT OF THE INTERIOR *
DEPARTMENT OF JUSTICE *
DEPARTMENT OF LABOR *
DEPARTMENT OF STATE *
DEPARTMENT OF TRANSPORTATION *
DEPARTMENT OF THE TREASURY *
DEPARTMENT OF VETERANS AFFAIRS *

INDEPENDENT ESTABLISHMENTS AND GOVERNMENT CORPORATIONS

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

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

Featured Agency: The U.S. Department of Agriculture

Representing 3.1 percent of the Government's net cost in 2005, the USDA's mission is to provide leadership on food, agriculture, natural resources, and related issues based on sound public policy, the best-available science, and efficient management. The USDA achieves its mission through its more than 100,000 employees who deliver in excess of $75 billion in public services through approximately 300 USDA worldwide programs.

The USDA was originally founded in 1862 to help farmers who needed good seeds and information to grow their crops. Today, the USDA remains committed to helping American farmers and ranchers and does so mainly through its Farm and Foreign Agricultural Services. The USDA also helps all Americans through its other six mission areas: 1) Natural Resources and Environment, 2) Rural Development, 3) Food Safety, 4) Research, Education, and Economics, 5) Marketing, and Regulatory Programs, and 6) Food, Nutrition, and Consumer Services.

As part of the Food, Nutrition, and Consumer Services mission area, the Center for Nutrition Policy and Promotion (CNPP) was established in 1994 to improve the nutrition and well-being of Americans. One of the tools the CNNP developed to improve the nutrition and well-being of Americans was the "Food Pyramid." This past April, the CNNP transformed the Food Pyramid into Mypyramid.gov (see above right). To learn more about the USDA and its seven mission areas, including Mypyramid.gov, visit www.usda.gov and www.mypyramid.gov, respectively.

Significant Performance Accomplishments

The President's Management Agenda: Managing for Results

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

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

Strategic Management of Human Capital

The Strategic Management of Human Capital Initiative recognizes that the men and women employed by the Government represent more than mere entries on a balance sheet. Rather, it focuses Government's efforts on maximizing the value of its most important resource, its workforce.

The demographics of the Federal workforce are changing, requiring agencies to identify successful succession management systems and strategies to ensure continuity of service and mission. Agencies are working to pinpoint pending competency gaps in mission critical occupations and develop and implement successful strategies to close them.

Agencies have made significant progress in establishing and implementing personnel management practices to better achieve their missions. They are deploying and improving performance management systems which better link individual performance to agency mission and results. The establishment of strong performance management systems will provide the foundations for establishing new compensation systems that reward performance instead of time on the job.

Federal executives can play a key role as change agents when it comes to enhancing or replacing performance management systems. Over the past year, agencies have improved their senior executive service performance plans, particularly in the way performance measures are established. These programs aim not only to ensure that potential future managers are waiting in the wings, but that those individuals have the proper skills to work in today's changing work environment.

An ultimate goal of the initiative is to "imbed" the strategic management of human capital into an agency's daily management operations. To accomplish this, agencies must transition to a system of strong self-accountability whereby agency leaders will use human capital results in strategic decision making.

Competitive Sourcing

The Government is conducting studies to determine whether commercial goods and services are best provided by Federal employees or by the private sector. These competitions help agencies reduce costs, improve performance, and achieve a better alignment between its mission and workforce through the redirection of resources to fill mission critical skill gaps. In fiscal year 2004, the PMA agencies completed 217 competitions involving approximately 12,500 jobs. These competitions are expected to generate $22,000 in annualized net savings for every job examined, or a reduction in costs of about 27 percent, regardless of who won the competition. Federal employees won approximately 91 percent of the work competed in fiscal year 2004. Savings were greatest when there was robust participation in the competition, demonstrating that the combination of competition and reengineering, rather than reengineering alone, is the key driver of savings.

Improved Financial Performance

The ultimate goal of the Improved Financial Performance initiative of the PMA is that managers have access to timely and accurate financial information for decision-making. Audited financial statements provide assurance that agencies are accounting for the taxpayers' money in a reliable manner. This year, all of the 24 major Federal agencies issued their Performance and Accountability Reports, including financial statements on or before November 15. This marks a significant milestone in Federal financial management since only a few years ago agencies took up to 5 months to produce similar information. Meeting this goal required agencies to implement new financial management controls and processes, which are the foundation for more reliable information to support day-to-day management.

By establishing greater financial discipline, agencies are producing financial reports faster and with greater reliability. Since the beginning of 2001, the number of auditor-reported material weaknesses Governmentwide has decreased. Fewer material weaknesses translate to greater confidence that financial information is correct. As agencies improve their financial business practices and install new financial management systems and reporting tools, data timeliness and reliability will continue to improve.

Under the PMA, agencies are increasingly focused on using timely and accurate financial information to make decisions about program management. To be rated ‘Yellow’ under the Improving Financial Performance Scorecard, agencies must have an unqualified audit, meet reporting deadlines, have no material weaknesses, and be in substantial compliance with financial system requirements. To be rated ‘Green’ agencies must demonstrate how they use financial information in daily decision making and also have a plan to expand the use of financial information to additional areas. By using timely financial information for decision making and program management, agencies are taking steps toward improving their financial performance and overall management of Federal dollars.

Expanded Electronic Government

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

Most agencies have improved their IT management since fiscal year 2003. Over 62 percent of major systems now include measurable program objectives in their justifications, a 29 percent increase. Also, 77 percent of agency IT systems have been certified and accredited, up from 62 percent the previous year. In addition, currently about 96 percent of agencies have an effective enterprise architecture, an integral part of ensuring their IT investments support overall agency goals and do not duplicate Governmentwide IT investments; last year it was only 20 percent. Such improvements are central ingredients in developing a more focused and results-oriented approach to IT investment across agencies.

Specific improvements in service delivery are being achieved through the E-Gov Initiatives. For instance, Grants.gov makes it easier for potential recipients to obtain information about Federal grants by creating a single, online site to find and apply for all Federal grants. Also, e-Travel, the new Governmentwide travel management service, may allow the Government to save nearly $300 million over the next 10 years on travel-related activities.

Centers of Excellence are being launched under the Financial Management Line of Business (FMLOB) initiative. The FMLOB Initiative will replace the department/agency-centered model with Centers of Excellence hosting financial systems. Centers of Excellence are expected to improve the quality and integrity of financial information through standardized business process and data definitions, and integrated core financial and subsidiary systems. Moreover, establishing Centers of Excellence could save the Federal Government $4 billion over 10 years by reducing system redundancy and lowering system development, maintenance, and enhancement costs. Currently, four agencies—the General Services Administration and the Departments of Interior, Transportation, and the Treasury—have attained the Center of Excellence designation.

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

Budget and Performance Integration

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

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

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

Eliminating Improper Payments

During fiscal year 2005, the Federal Government made substantial progress in meeting the President's goal to eliminate improper payments. Most notably, the Governmentwide improper payments total reported last year decreased by approximately $7.5 billion due to dramatic improvements implemented by HHS in the stewardship of Medicare funds. In addition, agencies demonstrated improved error detection and measurement, providing improper payment data on programs for which no improper payment statistics had been available in the past.

Despite their best efforts, certain agencies have not been able to establish a baseline improper payment measurement for some of their risk susceptible programs. These programs are very large and complex, providing agencies with significant challenges in their efforts to obtain baseline and annual rates. However, OMB continues to work with these agencies to ensure that the required measurements will be produced within the next few years.

Much of this success can be attributed to the PMA initiative to eliminate improper payments, which established an effective accountability framework for ensuring that Federal agencies initiate all necessary financial management improvements for addressing this critical problem area. With agencies working to deploy more innovative and sophisticated approaches for addressing improper payments, the prospects for additional and significant improper payments reductions in the coming years are promising. The Chief Financial Officers' Council continues to play a critical role in these efforts by ensuring that agency best practices (such as those employed by HHS in the Medicare Program) are disseminated and employed at other agencies.

Asset Management

Agencies continue to make significant progress in implementing both the requirements of Executive Order (EO) 13327, Federal Real Property Asset Management signed February 4, 2004, and the PMA Program initiative that was established in the 3rd quarter of fiscal year 2004. The goal of the initiative is to develop and implement the necessary tools (e.g. planning, inventory, performance measures) to improve management decision-making so that property inventories are maintained at the right size, cost, and condition to support agency mission and objectives.

In fiscal year 2005, the Federal Real Property Council, established under EO 13327, issued guidance to all Federal agencies on the required components to be addressed in each agency asset management plan and identified 23 data elements, including 4 performance measures, to be reported to a Governmentwide database. Agencies have completed or are in the process of drafting their asset management plans and are gathering complete and accurate asset level data inventory and performance measure data for reporting fiscal year 2005 data to the Governmentwide database in early fiscal year 2006. Through the PMA, the Administration is holding agencies accountable to use improved planning and data gathering to implement specific rightsizing activities that will reduce surplus assets, improve the condition of mission critical assets, and ensure that assets are managed at the right cost.

Executive Branch Management Scorecard

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

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

The Scorecard

NOTE: The fourth quarter scorecard presents the agencies' ratings as of September 30, 2005. These ratings were prior to the publication of the fiscal year 2005 audited financial statements. The status and progress ratings in the first quarter scorecard, as of December 31, 2005, will reflect auditors' findings from the fiscal year 2005 financial statement audit. For example, several agency audit opinions and internal controls declined during fiscal year 2005. OMB will review these changes and update the status and progress ratings reflecting the fiscal year 2005 results during the Quarter 1 PMA assessment process.

Executive Branch Management Scorecard

	Current Status as of September 30, 2005					Progress in Implementing the President's Management Agenda				
	Human Capital	Competi-tive Sourcing	Financial Perf.	E-Gov	Budget/ Perf. Integra-tion	Human Capital	Competi-tive Sourcing	Financial Perf.	E-Gov	Budget/ Perf. Integra-tion
AGRICULTURE	Y	Y	R	Y	Y	G	G	G	G	G
COMMERCE	Y↓	Y	G	Y	Y	G	G	G	G	G
DEFENSE	Y	R	R	R	Y	G	R	Y	R	G
EDUCATION	Y	G↑	G	Y	Y	G	G	G	G	G
ENERGY	G	Y↓	G	Y	G	G	Y	Y	G	G
EPA	Y	Y	G	Y↓	Y	Y	Y	G	Y	G
HHS	G	G	R	Y	Y	G	G	G	G	G
HOMELAND	Y	Y	R	R	Y	G	Y	Y	R	G
HUD	Y	Y	R	Y	Y	Y	G	G	G	G
INTERIOR	G↑	G	R	R↓	Y	G	G	G	R	G
JUSTICE	G↑	Y	R	R↓	Y	G	Y	Y	R	G
LABOR	G	G	G	G	G	G	G	G	G	G
STATE	G	Y	G	Y↓	G	G	G	G	G	G
DOT	G	G	R	G	G	G	G	G	G	G
TREASURY	Y	G	R	R	Y	G	G	Y	G	G
VA	Y	R	R	R	R	G	R	Y	G	G
USAID	Y	R	R	R↓	Y	G	G	G	Y	G
CORPS OF ENGINEERS	G	Y	R	R	R	G	G	Y	R	R
GSA	Y	G	G↑	Y	Y	G	Y	G	G	G
NASA	G	G	R	Y↓	G	Y	G	R	Y	Y
NSF	G	R	G	G	G	G	Y	G	G	G
OMB	Y	R	R	Y	R	G	G	G	G	Y
OPM	G	G	R	Y	Y	G	G	G	G	G
SBA	Y	G↑	R	G	G	G	G	G	G	G
SMITHSONIAN	Y↑	R	R	R	Y	G	R	G	G	G
SSA	G	Y	G	Y	G	G	G	G	G	G

Legend: R = Red Y = Yellow G = Green
↑↓ Arrows indicate change in status since evaluation on June 30, 2005.

Systems, Controls, & Legal Compliance

Systems

Improving agency investment decisions in financial system solutions is one of the President's top management priorities. As a first critical step in addressing this challenge, the Federal financial community developed a common set of core system requirements and a software certification process based on those requirements. As a result, most major agencies have purchased (and many have completed) the implementation of certified commercial-off-the-shelf financial management systems. This advance has helped ensure that purchased software solutions contain the necessary functionality to meet agency business needs. Nevertheless, agency auditors' Federal Financial Management Improvement Act (FFMIA) reviews have indicated that a majority of CFO Act agencies experience challenges with their financial management systems.

In fiscal year 2004, OMB launched the FMLOB initiative to decrease the overall cost of financial system solutions. Specifically, the FMLOB established a "Centers of Excellence" concept, that provided for cross-servicing of multiple financial systems, achieving cost and quality economies and providing a competitive alternative to stand alone solutions. The Centers of Excellence may be operated by public agencies, private firms, or public/private partnerships. Several agencies were selected in fiscal year 2005 to operate as Centers of Excellence, and several agencies are working toward migrating to this shared service environment.

FFMIA reporting shows that many agencies do not comply with one or more of three requirements. OMB and the Chief Financial Officers' Council are working together to disseminate best practices on financial system implementations. Through forums and other means, the Federal financial community is working to ensure that mistakes of the past are not repeated and that agencies initiating complex modernization efforts have a clear understanding of significant risks and appropriate mitigation strategies.

Controls

Internal Control

Federal managers have a fundamental responsibility to develop and maintain effective internal control. Effective internal control helps to ensure that programs are managed with integrity and resources are used efficiently and effectively. As the Federal financial management community strives to provide more timely and reliable financial information, managers are increasingly reliant upon a strong foundation of internal control. While progress is being made in reducing internal control weaknesses, agencies continue to face challenges in this area and GAO issued an adverse opinion on internal control at the Governmentwide level.

Recognizing the importance of effective internal control within federal agencies, OMB continues to emphasize the expectations for management accountability and responsibility in maintaining effective internal control. In December 2004, OMB revised Circular A-123, *Management's Responsibility for Internal Control* (A-123). The revisions to A-123 provide agencies with a framework for assessing and managing financial reporting risks more strategically and effectively.

Beginning in fiscal year 2006, the strengthened management requirements for assessing the effectiveness of internal control over financial reporting will be implemented. Appendix A of the A-123 requires management to undertake a more rigorous assessment process and for agency heads to provide a separate management assurance on the internal control over financial reporting. Over the next several months, agencies will complete risk assessments, identify key processes and controls and test these controls to determine their effectiveness. This effort will culminate in the agencies' first management assurance statement for internal control over financial reporting as of June 30, 2006. Key milestones from the plans will also be incorporated into the Improved Financial Performance initiative scorecard under the PMA to ensure agencies are accountable for meeting their goals.

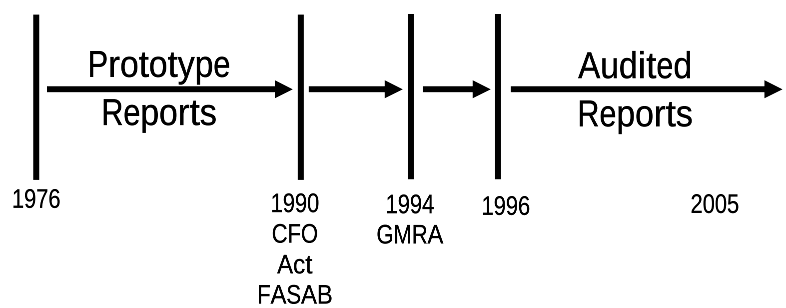
Legal Compliance

Federal agencies are required to comply with a wide range of laws and regulations, including appropriations, employment, health and safety, and others. Responsibility for compliance primarily rests with agency management. Compliance is addressed as part of agency financial statement audits. Agency auditors test for compliance with selected laws and regulations related to financial reporting. As a result of their testing, auditors found no instances of material noncompliance that affected the Governmentwide financial statements. Certain individual agency audit reports contain instances of noncompliance. None of these instances were material to the Governmentwide financial statements. However, GAO reported that its work on compliance with laws and regulations was limited in scope.

History of the Report & Additional Information

History of the Financial Reports of the United States Government

Treasury has prepared a prototype financial report for many years beginning in 1976. The earliest reports were accrual-based and included a balance sheet and statement of operations and were not audited, though Treasury hired private sector firms to conduct independent reviews of source data and collection procedures. The Government Management Reform Act of 1994 (GMRA) required audited financial statements from the 24 CFO Act Federal departments and agencies beginning for fiscal year 1996. GMRA also required the U.S. Government to submit consolidated financial statements audited by GAO beginning with fiscal year 1997's *Financial Report of the United States Government*. A Memorandum of Understanding between Treasury, OMB, and GAO created FASAB to develop formal Federal accounting standards and concepts for these audited financial statements. In 1999, the American Institute of Certified Public Accountants recognized FASAB as the promulgator of GAAP for the Federal Government. See the timeline below to get a sense of not only the *Financial Report's* history but also the significant dates and milestones that led to the issuance of financial reports for the Federal Government that have been subject to audit. Also visit http://www.treas.gov/offices/economic-policy/financial_report_hist.pdf for a more complete discussion of the history of the *Financial Report*.



Additional Information

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