



United States Government Accountability Office

Understanding the
Primary Components
of the

Annual Financial Report of the United States Government

Preface

The U.S. government is the largest, most diverse, most complex, and arguably the most important entity on earth today. Useful, timely, and reliable financial and performance information is needed to make sound decisions on the current results and future direction of vital federal programs and policies. The Department of the Treasury (Treasury), in coordination with the Office of Management and Budget, annually prepares the Financial Report of the United States Government, hereafter referred to as the Consolidated Financial Report (CFR). The CFR is a general-purpose report of accountability intended internally for members of Congress, federal executives and federal program managers, and externally primarily for citizens and citizen intermediaries who are interested in and have a reasonable understanding of federal government activities and are willing to study the information with reasonable diligence. Citizen intermediaries include members of the news media, analysts, and others who analyze and interpret, for the general public, the more complex and detailed information in the CFR.

The goal of the CFR, and the subject of this guide, is to make available to every American a comprehensive overview of the federal government's finances. As described in the CFR, significant issues regarding the reliability and presentation of the federal government's financial information still need to be addressed. For example, several long-standing material weaknesses and other scope limitations have prevented GAO from being able to express any opinion on the federal government's consolidated financial statements, except for the Statement of Social Insurance. GAO expressed an unqualified opinion on the fiscal year 2008 and 2007 Statements of Social Insurance. Also, additional transparency is needed in connection with intragovernmental debt and the large and growing intergenerational burden associated with the federal government's projected growth in costs and debt. At the same time, in its current form, the CFR offers certain valuable insights into the overall financial operations, condition, and financial outlook of the federal government.

GAO prepared this guide to the CFR to help those who seek to gain a baseline understanding of the significant information provided in the primary components that make up the CFR, especially the financial statements. This guide explains the purpose of each CFR component and provides illustrative financial information using actual fiscal year 2008 and 2007 data to focus readers on the kinds of significant information found in the various parts of the CFR. Because the illustrative financial information contained in this guide minimizes detail in order to highlight significant line items, it does not show or explain all of the items included in the federal government's actual CFR. This guide is not intended to help people who are interested in understanding the components of the financial statements of individual federal agencies as their form or content may vary from that of the CFR. Because this guide uses illustrative examples from the fiscal year 2008 CFR, significant financial transactions related to recent government actions to address the economic crisis that occurred in fiscal year 2009, such as the American Recovery and Reinvestment Act, are not included in this guide.

GAO is updating this guide, first issued in 2005, to reflect recent changes to the federal accounting standards and resulting changes to the CFR. Significant changes to the CFR are as follows:

- The Statement of Social Insurance is now a principal financial statement that is required to be audited. Prior to fiscal year 2006, all social insurance related information was included in the unaudited Stewardship Information section.
- Earmarked funds, representing about 45 percent of the total revenue for fiscal year 2008, are now reported on the Statement of Operations and Changes in Net Position, as well as the Balance Sheet. Earmarked funds are financed by specific revenue that remains available over time for designated purposes.
- Stewardship land and heritage assets information is now included on the Balance Sheet and in the Notes to the Financial Statements, and is no longer disclosed in the Stewardship Information section.

Treasury has also added another section to the CFR, “The Federal Government’s Financial Health: A Citizen’s Guide to the Financial Report of the United States Government” (Citizen Guide), which highlights key information found in the annual CFR for the general public.

The annual financial reports of the United States Government are available through Treasury’s website at <http://www.fms.treas.gov/fr/index.html>.

This guide was prepared under my direction, and I may be reached at (202) 512-8815 or engelg@gao.gov.



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Note: This guide can be found on-line through GAO's website at <http://www.gao.gov/products/GAO-09-946SP>. This guide supersedes GAO-05-958SP, "Understanding the Primary Components of the Annual Financial Report of the United States Government."

The Consolidated Financial Report

Similar to a corporation's annual report, the Consolidated Financial Report (CFR) is the federal government's general-purpose report of accountability to the American public on its finances. It is intended to

- provide an overall view of the annual financial results of operations and the financial position of the federal government, including long-term commitments and obligations;
- demonstrate accountability for the money the federal government raises through taxes and for spending money according to the laws and regulations that govern the federal government's budgets and financial operations;
- report on the federal government's operating performance, accounting systems, and internal control; and
- demonstrate the federal government's stewardship over its resources.

The consolidated financial statements (CFS) in the CFR, submitted by the Department of the Treasury in coordination with the Office of Management and Budget, present consolidated and summarized financial information from the various federal government agencies and departments. The federal government is responsible for

- preparing the annual CFS in conformity with U.S. generally accepted accounting principles;
- establishing, maintaining, and assessing internal control to provide reasonable assurance that the control objectives of the Federal Managers' Financial Integrity Act, 31 U.S.C. 3512 (c), (d) are met; and
- complying with applicable laws and regulations.

The Federal Accounting Standards Advisory Board (FASAB), after considering the financial and budgetary information needs of citizens, congressional oversight groups, executive agencies, and other users, promulgates the accounting and reporting standards essential for public accountability over federal dollars.

GAO conducts the audit of the CFS, along with the accompanying notes to the financial statements; the objective is to provide an opinion on the fairness of the consolidated financial statements taken as a whole.

The Consolidated Financial Report

The CFR is organized into seven major sections

| | | | | | | |
|-------------------|--------------------------------------|----------------------|-----------------------------------|--------------------------|-------------------------|---|
| A Citizen's Guide | Management's Discussion and Analysis | Financial Statements | Notes to the Financial Statements | Supplemental Information | Stewardship Information | Government Accountability Office Report |
|-------------------|--------------------------------------|----------------------|-----------------------------------|--------------------------|-------------------------|---|

- **A Citizen's Guide** highlights significant information found in the CFR.
- **Management's Discussion and Analysis** provides management's insights into the information presented in the federal government's financial statements.
- **Financial Statements** consolidate financial information from federal entities to provide an overall view of the federal government's financial operations and condition.
- **Notes to the Financial Statements** provide important disclosures and details related to information reported on the financial statements.
- **Supplemental Information** provides additional information to enhance the understanding of the federal government's operations and financial condition.
- **Stewardship Information** highlights substantial investments that have long-term benefits to the public including programs related to nonfederal physical property, human capital, and research and development.
- **Government Accountability Office Report** presents the results of GAO's audit of the financial statements and notes to the financial statements.

This guide discusses the significant content of each section in the CFR, with a primary emphasis on the federal government's financial statements.

A Citizen's Guide

The purpose of the Citizen's Guide is to provide a high-level overview of significant information found in the CFR. The fiscal year 2008 guide includes information on the following:

- Significant increases in the net operating cost and the unified budget deficit from fiscal year 2007 to fiscal year 2008. The net operating cost for the government's annual operations—the difference between revenue and net cost—increased from \$276 billion for fiscal year 2007 to just over \$1 trillion for fiscal year 2008. Total federal government revenue remained relatively constant compared to fiscal year 2007. However, the federal government's net cost increased by \$731 billion, or more than 25 percent, over fiscal year 2007. Approximately half of this increase was related to net cost increases at the Department of Veterans Affairs, primarily those related to increases in estimated actuarial liabilities for veterans' benefits. The unified budget deficit (primarily cash basis) for the year more than doubled, from \$163 billion in fiscal year 2007 to \$455 billion in fiscal year 2008, due in part to the weakening economy in fiscal year 2008.
- U.S. government actions to address the housing and credit market crisis and the economic recession. The Housing and Economic Recovery Act and the Emergency Economic Stabilization Act of 2008 were enacted in an effort to stabilize the financial sector and protect the economy. Actions taken in response to these legislative initiatives have the potential to significantly increase future borrowing by the government, and their impact will largely be reflected in the financial statements for fiscal year 2009 and beyond.
- The unsustainability of the federal government's existing fiscal policies. Under current policy, Medicare and Medicaid spending driven by escalating growth in health care costs and an aging population, along with scheduled higher Social Security spending due to an aging population, will significantly increase overall federal spending. Total government expenditures are projected to exceed federal revenues each year, resulting in permanent annual deficits that grow larger and larger. As the deficits grow, so does the need for more borrowing from the public. Projections under current policy show government debt levels reaching unprecedented and unsustainable levels.

Management's Discussion and Analysis

The Management's Discussion and Analysis (MD&A) section of the CFR provides important insights into the information presented in the federal government's financial statements. It presents management's perspective on the financial information and overall operations of the federal government in more detail than the Citizen's Guide.

The MD&A is intended to provide readers with a narrative overview and analysis of the federal government's performance, financial position, and financial operations. It is also intended to address the federal government's financial statements, systems and controls, compliance with laws and regulations, and actions taken or planned to address problems. For example, the fiscal year 2008 MD&A

- discusses the economic recession of the United States as a backdrop to the financial condition of the federal government for fiscal year 2008. It includes a summary of some key economic indicators, such as the ongoing slump in the residential homebuilding sector, record high energy prices, elevated food prices, increasing job losses, and the weakening or declining of corporate profits outside the energy sector.
- explains the volatility of the housing and credit markets during the last half of fiscal year 2008, which sparked unprecedented economic events. Major problems in the subprime credit market led the way for significant losses in mortgage backed securities and substantial cash shortfalls for the investment banks, government sponsored enterprises involved in the secondary housing financial market, and bank investors. This precarious environment has resulted in the transformation, acquisition, and even the demise of several leading and long-established major financial institutions. Also, the MD&A discusses the federal government's intended actions to provide stability in the housing and credit markets.
- discusses important fiscal issues and significant conditions that affect the country's future fiscal health. Emphasis is given to the estimated cost and exposures under current policy to pay benefits of key social insurance programs such as Social Security and Medicare. It provides historical data as well as forward looking projections of how the aging of the population and continually rising health care costs could lead to further erosion of the federal government's fiscal health.
- graphically depicts important information, such as the federal government's revenues and costs, or "what came in and what went out," over the past several years, and the federal government's increasing liabilities, or "what we owe," by major components.

Financial Statements

Some Important Financial Statement Concepts

Before considering the purpose and content of each of the federal government's consolidated financial statements, it is important to understand certain concepts about the nature of those financial statements, especially the (1) use of cash and accrual accounting and (2) treatment of transactions between federal entities.

Cash and Accrual Accounting

Except for the Statement of Social Insurance, the federal government generally uses both the accrual basis and cash basis of accounting to record and report financial information. Accrual accounting, also used in the private sector, is generally the basis used to prepare the Statement of Net Cost, Statement of Operations and Changes in Net Position, and the Balance Sheet. It is intended to provide a complete picture of the federal government's financial operations and financial position. In contrast, the federal government primarily uses the cash basis of accounting for its budget, which is the federal government's primary financial planning and control tool. The budget helps establish national spending priorities and helps ensure that the federal government spends taxpayers' money in accordance with applicable appropriations laws. Information on the most recent President's Budget can be found on the Office of Management and Budget's website at <http://www.whitehouse.gov/omb/budget>. Differences between the federal government's operating results and its budget results are shown in the statement called the Reconciliation of Net Operating Revenue (or Cost) and Unified Budget Surplus (or Deficit). Accordingly, understanding the basic concepts of the cash basis and accrual basis of accounting is important to understanding the information included in the federal government's financial statements.

Cash Basis of Accounting

Because it is similar to keeping a checkbook, the cash basis of accounting (used to account for and report budget results) is perhaps the easier of the two bases of accounting to understand. The cash basis focus is on cash receipts, cash disbursements, and the difference between the two amounts. With relatively few exceptions, receipts are recorded when cash is received, and outlays are recorded when cash is disbursed. The difference between cash receipts and cash outlays at the end of the fiscal year is reported as the annual budget surplus or budget deficit. For example, for fiscal year 2008 the federal government reported a unified budget deficit of about \$455 billion (explained in more detail later in this guide). This deficit was based on reported cash outlays of about \$2,979 billion compared with reported cash receipts of about \$2,524 billion. It is important to note that the federal government's cash receipts used in determining the unified budget deficit include surplus funds earmarked for the Social Security trust funds and certain other trust funds.

Accrual Basis of Accounting

The accrual basis of accounting recognizes revenue when it is earned and recognizes expenses in the period incurred, without regard to when cash is received or disbursed. The federal government, which receives most of its revenue from taxes, nevertheless, recognizes tax revenue when it is collected, under an accepted modified cash basis of accounting.

Expenses are recognized during the period in which they are incurred. Accrual accounting, for example, recognizes that while the employee is working, the employee earns not only a salary but also health, pension, and other benefits that will be paid in the future during the employee's retirement. Accordingly, each year, on the basis of actuarial calculations of benefits earned, the federal government records as an expense (operating cost) an estimated amount for these earned benefits and increases the related liability—Federal Employee and Veteran Benefits Payable—for the amount owed to its employees, both civilian and military. Thus, the accrual basis of accounting is intended to provide a complete financial picture, for the CFR reader, of the federal government's annual employee-related costs.

Also under accrual accounting, the federal government reports physical assets when they are acquired and records related expenses when the federal government benefits from their use or consumption or when they are sold. Physical assets consist of inventories of goods held for sale or for future consumption and long-lived or "fixed" assets such as land, buildings, and equipment. In the case of assets such as buildings and equipment, the annual cost attributed to their use is recorded as depreciation expense.

Treatment of Transactions between Federal Entities

In the normal course of federal government operations, federal agencies and departments frequently purchase and sell goods and services among themselves. These types of activities between federal agencies and departments are called intragovernmental transactions. They also include amounts the federal government borrows from the Social Security trust funds. Intragovernmental transactions are recorded in federal agencies' and departments' accounts and financial statements along with transactions conducted with nonfederal entities. These intragovernmental transactions are to be eliminated from the federal government's consolidated accounts and financial statements so that the totals for the affected accounts, when summarized for all federal government agencies and departments, are not overstated for the federal government as a whole.

Financial Statements

Composition of the Financial Statements

The federal government's consolidated financial statements include six statements (pages 31 and 32 of this guide provide discussion and a simplified overview of how the five accrual-basis financial statements are related). The first five financial statements below (accrual-basis financial statements) present 2 years of financial data so that readers can compare the federal government's financial information for the current and prior years. The sequence in which the financial statements appear below are the order in which they appear in the CFR.

| | | | | | |
|-----------------------|---|---|---|---------------|-------------------------------|
| Statement of Net Cost | Statement of Operations and Changes in Net Position | Reconciliation of Net Operating Revenue (or Cost) and Unified Budget Surplus (or Deficit) | Statement of Changes in Cash Balance from Unified Budget and Other Activities | Balance Sheet | Statement of Social Insurance |
|-----------------------|---|---|---|---------------|-------------------------------|

- **Statement of Net Cost** - The first statement shows the annual costs on the accrual basis of accounting, to operate the federal government in total, and by major department and agency.
- **Statement of Operations and Changes in Net Position** - The second statement shows the accrual-based results of the federal government's operations—the extent to which the federal government's tax revenue covers its net cost. It also shows how these annual results (called the net operating revenue or net operating cost) affect the federal government's net financial position as of a given date—the difference between its assets (what it owns) and its liabilities (what it owes).
- **Reconciliation of Net Operating Revenue (or Cost) and Unified Budget Surplus (or Deficit)** - The third statement shows the relationship between the accrual-based operating results and the cash-based budget results. It begins with the net operating result (revenue or cost) from the Statement of Operations and Changes in Net Position and shows the items that explain the difference between that amount and the federal government's annual cash-based budget surplus or deficit.
- **Statement of Changes in Cash Balance from Unified Budget and Other Activities** - The fourth statement shows the relationship between the cash-based budget surplus or deficit and the change in the balance of cash and other monetary assets. It begins with the cash-based budget surplus or deficit and shows the items that explain either how the federal government used a budget surplus or financed a budget deficit.
- **Balance Sheet** - The fifth statement shows the nature and amount of the federal government's assets (what it owns) and liabilities (what it owes) and the difference between the two, called the net position. This net position amount is the same as the net position amount reported in the Statement of Operations and Changes in Net Position.

Financial Statements

- **Statement of Social Insurance** - The sixth financial statement shows how much money in addition to earmarked revenue the federal government estimates it would need today, under current policy, to cover the projected long-term commitments of its major social insurance programs, such as Social Security and Medicare. Beginning in fiscal year 2006, the Statement of Social Insurance became a basic financial statement, with the key economic and demographic assumptions disclosed in the accompanying notes to the CFS, and with other social insurance related information presented in the Supplemental Information section of the CFR. Prior to fiscal year 2006, all social insurance related information was presented as Stewardship Information in the CFR.

The amount of revenue directed to earmarked funds, such as the Social Security trust funds, has increased dramatically over the past 2 decades and now constitutes a greater proportion of the federal budget. To improve the transparency of this important source of revenue, FASAB issued a standard for identifying and reporting earmarked funds. According to FASAB, an earmarked fund receives specifically identified revenue and other financing sources that (1) remain available over time, (2) are required by statute to be used for designated activities, benefits, or purposes, and (3) must be accounted for separately from the government's general revenues. Beginning in the fiscal year 2006 CFR, earmarked revenue is shown separately on the Statement of Operations and Changes in Net Position. In addition, the Balance Sheet shows separately the portion of net position attributable to earmarked funds. Additional financial information regarding the major earmarked funds is provided in the notes to the financial statements under the caption Earmarked Funds. This information is intended to assist users of financial statements in understanding the federal government's results of operations and related commitments.

Beginning in fiscal year 2009, the CFR will include additional information on fiduciary activities, such as the Federal Employees' Thrift Savings Fund. Fiduciary activities relate to the collection or receipt and the subsequent management, protection, accounting, investment, and disposition of cash or other assets in which nonfederal individuals or entities have an ownership interest that the federal government must uphold. Fiduciary assets are not assets of the federal government and therefore, will not be recognized on the Balance Sheet of the U.S. government.

The following sections discuss each of these six statements in additional detail and offer insights regarding potential uses and analytical data available from each.

Statement of Net Cost

The Statement of Net Cost is intended to show how much it cost to operate the federal government, by federal agency and department, and in total. It provides costs on an accrual basis of accounting, which recognizes expenses when they are incurred, regardless of when cash is disbursed. Thus, it provides, for the accounting period, cost information that can be related to the goods produced, services rendered, and the outcomes of the programs of the federal government's agencies and departments for the same period. Since the actuarial calculations for social insurance costs are not reported as liabilities on the Balance Sheet, the corresponding costs also are excluded from the cost of government operations. An important concept of the Statement of Net Cost is that the revenue earned by federal agencies and departments from their operations, such as admissions to national parks and fees paid for postal services and stamps, is subtracted from their cost of operations. The net cost is the amount to be financed from tax revenue and, as needed, borrowing.

Readers can use this statement to find such information as

- which agencies or departments accounted for most of the federal government's net cost,
- how much the federal government's net cost increased or decreased from the prior fiscal year, and
- which agency or department experienced the largest increase and which experienced the largest decrease in net cost from the previous year.

Over half of the federal government's fiscal year 2008 net costs came from three agencies or departments: the Department of Defense, the Department of Health and Human Services, and the Social Security Administration. Together, these three accounted for about \$2.1 trillion, or 58 percent of the approximately \$3.6 trillion of reported total net costs. The reported 2008 total net cost was substantially more than in 2007 by, \$731.2 billion or about 25 percent. The largest cost increase, by agency or department, was \$371 billion for the Department of Veterans Affairs, mostly related to increases in veterans-benefit actuarial liabilities for compensation benefits to veterans who are disabled by military service-related causes. The Department of Energy reported the largest cost decrease of \$31.6 billion, primarily due to changes in environmental cleanup and disposal liability estimates. It is important to note that agencies or departments that use actuarial projections in determining their costs and related liabilities may experience large fluctuations in annual costs due to program benefit changes and changes to actuarial assumptions.

Statement of Net Cost

Illustrative Net Cost Information

| (In billions of dollars) | Year ended Sept. 30 2008 | | | Year ended Sept. 30 2007 | | |
|--|-----------------------------|------------------------|------------------|-----------------------------|-------------------|----------------|
| | ● Gross Cost | ■ Earned Revenue | ▲ Net Cost | Gross Cost | Earned Revenue | Net Cost |
| Department of Defense | 767.6 | 26.8 | 740.8 | 689.6 | 25.1 | 664.5 |
| Department of Health and Human Services | 769.1 | 56.4 | 712.7 | 718.6 | 51.8 | 666.8 |
| Social Security Administration | 663.9 | .3 | 663.6 | 626.4 | .3 | 626.1 |
| Department of Veterans Affairs | 434.6 | 4.2 | 430.4 | 63.1 | 3.7 | 59.4 |
| Interest on Treasury securities held by the public | 241.6 | — | 241.6 | 238.9 | — | 238.9 |
| Department of Energy | 35.8 | 4.2 | 31.6 | 67.5 | 4.3 | 63.2 |
| All other entities | <u>979.0</u> | <u>159.0</u> | <u>820.0</u> | <u>753.2</u> | <u>162.6</u> | <u>590.6</u> |
| Total | <u>3,891.6</u> | <u>250.9</u> | <u>3,640.7</u> | <u>3,157.3</u> | <u>247.8</u> | <u>2,909.5</u> |

- **Gross Cost** is the accrual-based total cost of the federal government's operations for the year. The statement presents gross cost, earned revenue, and net cost by federal agency and department. Also, it includes the cost of interest on Treasury securities held by the public, which includes foreign investors.
- **Earned Revenue** comes from fees charged for goods and services. The fees charged for postal services such as stamps are a well-known example of earned revenue. Earned revenue shows how much the federal agencies and departments earn from their operations to cover their gross costs, as opposed to relying on taxes and borrowing to cover the costs.
- ▲ **Net Cost** is the portion of the gross cost left after subtracting earned revenue. The federal government funds the net cost of government from tax revenue and, as needed, by borrowing.

Statement of Operations and Changes in Net Position

Similar to corporations' income statements, the Statement of Operations and Changes in Net Position shows the annual financial results of federal operations (tax revenue less net cost) and how these results affect net position—the difference between its assets and liabilities.

The Statement of Operations and Changes in Net Position shows activity for earmarked and non earmarked funds. Earmarked funds are financed by specific revenue that remain available over time for designated purposes. For example, the Federal Old-Age and Survivors Insurance and Federal Disability Insurance programs, collectively referred to as “Social Security,” are financed through payroll and self-employment taxes. These programs provide a basic income supplement to retired workers; to survivors, in the event of death of a family's primary wage earner; and for protection against the loss of earnings due to a wage earner's disability. Other major earmarked funds include the Medicare trust funds, Military Retirement Fund, and Civil Service Retirement and Disability fund. The financial condition and operating results of each of these major funds can be found in the CFS' disclosure note, Earmarked Funds.

Non earmarked funds are financed by non earmarked receipts and proceeds of general borrowing. These funds finance the remaining federal government activities, and often are designated to supplement earmarked funds through appropriations and transfers, called intragovernmental transfers, on the Statement of Operations and Changes in Net Position. For example, Congress appropriated \$180 billion in fiscal year 2008 to finance the Federal Supplementary Medical Insurance Trust Fund (Medicare Parts B and D).

Treasury borrows cash surpluses from certain earmarked funds (e.g., the Social Security trust funds) to help finance federal government operations, and it issues to the funds Treasury securities for the amounts borrowed. As of September 30, 2008, the reported investments in Treasury securities held by earmarked funds totaled about \$4.2 trillion. Treasury pays interest on money borrowed from the earmarked funds. Both the related interest expense incurred by Treasury and the revenue earned by the earmarked funds, which totaled about \$201 billion for fiscal year 2008, are shown on this statement and referred to as “intragovernmental interest.” Such intragovernmental transactions are eliminated to avoid overstating the consolidated totals.

Statement of Operations and Changes in Net Position

An important concept for this statement is the relationship between the results of operations and the changes in net position on the Balance Sheet. The annual financial results of federal operations should be directly reflected in the values of assets and liabilities, which determine the net financial position. For example, a net operating cost of \$500 billion reduces the net position by \$500 billion. However, unexplained differences between the net operating cost and the changes in net position have been reported in the Statement of Operations and Changes in Net Position as “Unmatched transactions and balances” as shown in the Illustrative Information on Operations and Changes in Net Position on the next page.

Readers can use this statement to find such information as

- the annual net operating cost or revenue for earmarked funds, nonearmarked funds, and the consolidated totals,
- how much tax revenue the federal government generated for the earmarked funds and nonearmarked funds for the fiscal year,
- how much nonearmarked funds were used to supplement earmarked funds, and
- whether the financial status of the federal government—its net position—has improved or deteriorated from the prior year.

For example, the reported fiscal year 2008 consolidated net cost exceeded revenue by about \$1 trillion, with nonearmarked funds reporting net operating cost of \$1,093.5 billion and earmarked funds reporting a net operating surplus of \$84.4 billion. For earmarked funds and nonearmarked funds, total reported revenues generated were about \$1.2 trillion and \$1.7 trillion, respectively. Also, the net cost of activities financed by the earmarked funds and nonearmarked funds were about \$1.5 trillion and \$2.4 trillion, respectively. Nonearmarked funds provided additional appropriations and transfers of \$338 billion to earmarked funds.

Statement of Operations and Changes in Net Position

Illustrative Information on Operations and Changes in Net Position

| (In billions of dollars) | | | |
|---|-------------------------|----------------------|------------------------|
| Year ended Sept. 30, 2008 | | | |
| (Operations) | * Nonearmarked funds | ❖ Earmarked funds | Consolidated totals |
| Revenue: | | | |
| Individual income tax and tax withholdings | 1,210.0 | 868.4 | 2,078.4 |
| Corporate income and other taxes and miscellaneous revenues | 451.7 | 131.3 | 583.0 |
| ❖ Intragovernmental interest | <u>—</u> | <u>201.0</u> | <u>201.0</u> |
| Total Revenue | <u>1,661.7</u> | <u>1,200.7</u> | <u>2,862.4</u> |
| Eliminations | | | <u>(201.0)</u> |
| ▲ Consolidated Revenue | | | <u>2,661.4</u> |
| Net Cost: | | | |
| Net Cost | 2,186.4 | 1,454.3 | 3,640.7 |
| ❖ Intragovernmental interest | <u>201.0</u> | <u>—</u> | <u>201.0</u> |
| Total net cost | <u>2,387.4</u> | <u>1,454.3</u> | <u>3,841.7</u> |
| Eliminations | | | <u>(201.0)</u> |
| ▶ Consolidated net cost | | | <u>3,640.7</u> |
| ◆ Intragovernmental transfers | (338.0) | 338.0 | — |
| ● Unmatched transactions and balances | <u>(29.8)</u> | <u>—</u> | <u>(29.8)</u> |
| * Net Operating (Cost) Revenue | <u>(1,093.5)</u> | <u>84.4</u> | <u>(1,009.1)</u> |
| (Changes in Net Position) | | | |
| □ Net Position, Beginning of Period | (9,826.0) | 620.2 | (9,205.8) |
| Adjustments to beginning balances | 11.4 | — | 11.4 |
| Net Operating (Cost) Revenue | <u>(1,093.5)</u> | <u>84.4</u> | <u>(1,009.1)</u> |
| □ Net Position, End of Period | <u>(10,908.1)</u> | <u>704.6</u> | <u>(10,203.5)</u> |

Statement of Operations and Changes in Net Position

- * **Nonearmarked Funds** are financed by nonearmarked receipts and proceeds of general borrowing. These funds finance federal government activities that are not financed by earmarked funds.
- ❖ **Earmarked Funds** are financed by specific revenue that remains available over time for designated purposes. Major earmarked funds relate to Social Security and Medicare programs, and military and civil service retirements and disability benefits.
- ❖ **Intragovernmental Interest** is the interest earned by earmarked funds and the interest paid by nonearmarked funds for money borrowed by the nonearmarked funds from the earmarked funds.
- ▲ **Consolidated Revenue** primarily comes from federal income tax collections, which includes taxes earmarked for Social Security and Medicare.
- ▶ **Consolidated Net Cost** is the net cost from the Statement of Net Cost.
- ◆ **Intragovernmental Transfers** supplement earmarked-fund activities, generally through appropriations from the Treasury General Fund.
- **Unmatched Transactions and Balances** are the unexplained differences between the Net Operating Cost and the Changes in Net Position.
- * **Consolidated Net Operating (Cost) Revenue** is the financial results of operations—the difference between the revenue and the net cost of government operations for the fiscal year (plus or minus) the net amount of any unmatched transactions and balances.
- **Net Position** is the difference between the assets and liabilities reported on the Balance Sheet.

Reconciliation of Net Operating Revenue (or Cost) and Unified Budget Surplus (or Deficit)

This statement is intended to demonstrate the federal government's accountability to the budget by reconciling its net operating cost to its unified budget results. The term "unified budget" refers to the budget compilation that includes the full range of federal activities, both "on-budget" and "off-budget" amounts. By law, Social Security and the Postal Service's activities are the only two material activities considered off-budget. On-budget programs and costs are those not excluded from the budget by law. The approximately \$454.8 billion fiscal year 2008 unified budget deficit shown on the statement consists of about \$638.1 billion on-budget deficit and approximately \$183.3 billion off-budget surplus. The off-budget surplus for fiscal year 2008 consisted of \$185.7 billion in surplus revenue from the Social Security trust funds offset by a \$2.4 billion deficit in the Postal Service.

Readers can use this statement to find such information as

- major differences between the net operating cost and unified budget deficit,
- how much of the federal government's operating cost was attributable to the depreciation of its assets, and
- how much the federal government spent on capitalized fixed assets.

A major difference between the two bases of accounting for fiscal year 2008 is that changes in accrued expenses related to employee and veteran benefits, which totaled about \$549.8 billion, are included in the net operating cost but not in the budget. In this statement, accrued benefit expenses are shown as an increase in liabilities for employee and veteran benefits. Also, the federal government reported about \$54.8 billion for depreciation expense for fiscal year 2008, which is included in the net operating cost but not in the budget. In addition, the amount identified on this statement for the purchase of capitalized fixed assets for fiscal year 2008 totaled about \$106.4 billion, consisting of approximately \$71.6 billion for the Department of Defense and about \$34.8 billion for all other federal agencies.

Reconciliation of Net Operating Revenue (or Cost) and Unified Budget Surplus (or Deficit)

Illustrative Reconciliation of Net Operating Cost and Unified Budget Deficit

| (In billions of dollars) | Years ended Sept. 30 | |
|--|----------------------|----------------|
| | 2008 | 2007 |
| ● Net Operating Cost (Results of Operations) | (1,009.1) | (275.5) |
| ■ Components of Net Operating Cost Not Part of the Budget Deficit | | |
| Increase in liabilities for employee and veteran benefits | 549.8 | 90.1 |
| Increase in environmental and disposal liabilities | 0.8 | 36.8 |
| Depreciation expense | 54.8 | 45.3 |
| Other | 70.4 | 25.0 |
| ▲ Components of the Budget Deficit Not Part of the Net Operating Cost | | |
| Cash outlays for capitalized fixed assets | (106.4) | (58.8) |
| Other | <u>(15.1)</u> | <u>(25.7)</u> |
| * The Unified Budget Deficit | <u>(454.8)</u> | <u>(162.8)</u> |

- **The Net Operating Cost** comes from the Statement of Operations and Changes in Net Position. It primarily represents the difference between the federal government's tax revenue and expenses.
- **Components of Net Operating Cost Not Part of the Budget Deficit** are mostly current-year expenses under accrual accounting that do not involve current-year cash outlays. Increases in liabilities such as employee and veteran benefits and depreciation expense are recognized as current-year operating expenses under accrual accounting, but are not in the unified budget total.
- ▲ **Components of the Budget Deficit Not Part of Net Operating Cost** consist mostly of current-year cash outlays for transactions that do not involve current-year expenses, such as outlays to purchase buildings and equipment that the federal government capitalizes (records on its Balance Sheet as assets) and depreciates (expenses) as they are used in operations. The outlays to purchase these assets increase the unified budget deficit but not the current net operating cost.
- * **The Unified Budget Deficit** represents the difference between cash receipts (primarily from taxes) and cash outlays for the year for all programs, on- and off-budget.

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

Since the federal government operates its budget principally on a cash basis, the primary purpose of the Statement 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 (debt held by the public) and changes in the balance of cash and other monetary assets. It explains why a unified budget surplus or deficit normally would not result in an equal change in the balance of cash and other monetary assets.

Readers can use this statement to identify

- increases in federal borrowing as a result of the federal government's spending more than it collected in taxes,
- decreases in federal borrowing as a result of a budget surplus,
- changes in the balance of cash and other monetary assets, and
- how much cash the federal government spent to pay interest on debt held by the public.

For example, for fiscal year 2008, the federal government reported that it increased its net borrowings from the public by about \$762.7 billion to help finance the approximately \$454.8 billion fiscal year 2008 unified budget deficit. It did this by borrowing about \$5,615.8 billion from the public and paying off debts of approximately \$4,853.1 billion. The federal government also reported that it used about \$213.3 billion of its cash to pay interest on debt held by the public.

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

Illustrative Information on Changes in Cash Balance from Unified Budget and Other Activities

| (In billions of dollars) | Years ended Sept. 30 | |
|--|----------------------|----------------|
| | 2008 | 2007 |
| Unified Budget Deficit | (454.8) | (162.8) |
| Adjustments for Noncash Outlays Included in the Budget | | |
| ■ Interest accrued by Treasury on debt held by the public | 209.0 | 189.4 |
| Subsidy expense | <u>(3.0)</u> | <u>(9.3)</u> |
| Subtotal | 206.0 | 180.1 |
| Items Affecting the Cash Balance Not Included in the Budget | | |
| Net transactions from financing activity | | |
| ▲ Borrowings from the public | 5,615.8 | 4,547.3 |
| ▲ Repayment of debt held by the public | (4,853.1) | (4,340.4) |
| Other | <u>—</u> | <u>(0.4)</u> |
| Subtotal | 762.7 | 206.5 |
| Net transactions from monetary and other activity | | |
| ■ Interest paid by Treasury on debt held by the public | (213.3) | (186.1) |
| Other | <u>(4.1)</u> | <u>(7.6)</u> |
| Subtotal | <u>(217.4)</u> | <u>(193.7)</u> |
| Increase in Cash and Other Monetary Assets | 296.5 | 30.1 |
| Cash and Other Monetary Assets Balance, Beginning of Period | <u>128.0</u> | <u>97.9</u> |
| Cash and Other Monetary Assets Balance, End of Period | <u>424.5</u> | <u>128.0</u> |

- An exception to the primarily cash-based budget is the reporting of accrued interest on debt held by the public. To calculate the change in the balance of cash and other monetary assets, interest for the unified budget results is adjusted to include only the cash outlays. Specifically, the amount reported for **interest accrued by Treasury on debt held by the public** is added to the unified budget results and the amount reported for **interest paid by Treasury on debt held by the public** is subtracted from the unified budget results.
- ▲ The major financing activities include **borrowings from the public** and **repayment of debt held by the public**. Net borrowings provide operating cash needed to finance the budget deficit.

Balance Sheet

The Balance Sheet shows an end-of-year view of the federal government’s overall financial position, its assets (what it owns), its liabilities (what it owes), and the difference between the two (its net position). It is important to note that the Balance Sheet does not include the value of the sovereign powers of the federal government to tax, regulate commerce, and set monetary policy. In addition, the federal government’s responsibilities are much broader than the liabilities reported on the Balance Sheet, including the potential commitments related to and the impact of social insurance programs, such as Social Security and Medicare, over the long term. These resources and responsibilities are described in the Statement of Social Insurance, Notes to the Financial Statements, and the Supplemental Information section of the CFR.

Readers can use this statement to find such information as

- the makeup of the federal government’s assets and liabilities,
- which liabilities increased the most, and
- whether the federal government has a positive net position—more assets than liabilities—or a negative net position—more liabilities than assets.

For example, the two largest liabilities as of the end of fiscal year 2008 are (1) about \$5.8 trillion of debt held by the public, from whom the federal government borrowed money to pay for past deficits, and (2) about \$5.3 trillion of pension and benefits owed to civilian employees and military personnel. These two items also account for the largest increases in liabilities for fiscal year 2008: federal debt held by the public and accrued interest increased by about \$758.5 billion, and federal employee and veteran benefits payable increased by approximately \$549.8 billion. As of the end of fiscal year 2008, the federal government’s negative net position was about \$10.2 trillion.

Other Considerations

Certain federal trust funds, such as the Social Security trust funds, have been running cash surpluses, which are loaned to the Treasury and reduce the current need for the federal government to borrow from the public to finance current operations of the rest of the government. The transactions related to the use of such surpluses are eliminated from the federal government’s Balance Sheet because, in effect, they represent loans from one part of the government to another. Importantly, these intragovernmental debt holdings, which are not shown on the Balance Sheet, constitute future obligations of the Treasury because the Treasury must provide cash to redeem these securities in order for the trust funds to pay benefits or other obligations as they come due.

Balance Sheet

Illustrative Balance Sheet Information

| (In billions of dollars) | As of Sept. 30 | |
|---|-------------------|--------------------|
| | 2008 | 2007 (Restated) |
| ■ Assets | | |
| Cash and other monetary assets | 424.5 | 128.0 |
| Loans receivable, net | 263.4 | 231.9 |
| Inventories and related property, net | 289.6 | 277.1 |
| Property, plant, and equipment, net | 737.7 | 691.1 |
| Other assets | 259.5 | 253.0 |
| Total assets | <u>1,974.7</u> | <u>1,581.1</u> |
| * Stewardship Land and Heritage Assets | | |
| ▲ Liabilities | | |
| Federal debt securities held by the public and accrued interest | 5,836.2 | 5,077.7 |
| Federal employee and veteran benefits payable | 5,318.9 | 4,769.1 |
| Environmental and disposal liabilities | 342.8 | 342.0 |
| Other liabilities | 680.3 | 598.1 |
| Total liabilities | 12,178.2 | 10,786.9 |
| ● Commitments and Contingencies | | |
| ◆ Net Position | | |
| Earmarked funds | 704.6 | 620.2 |
| Nonearmarked funds | <u>(10,908.1)</u> | <u>(9,826.0)</u> |
| Total net position | <u>(10,203.5)</u> | <u>(9,205.8)</u> |
| Total liabilities and net position | <u>1,974.7</u> | <u>1,581.1</u> |

■ **Assets** are the operational resources the federal government has available as of the end of the fiscal year. The largest category—property, plant, and equipment, net—includes land and buildings and the federal government’s military equipment, such as ships, aircraft, and tanks, after subtracting accumulated depreciation.

* **Stewardship Land and Heritage Assets**, which include national parks and natural resources, are reported in nonfinancial units in the notes to the financial statements.

▲ **Liabilities** are the financial responsibilities of the federal government as of the end of the fiscal year. In addition to federal debt securities, liabilities include federal employee and veteran benefits payable—the amount the federal government estimates that it owes or will owe its military and civilian employees and veterans under its life and health insurance and pension plans.

● Not all **Commitments and Contingencies** of the federal government require recognition as liabilities on the Balance Sheet. Commitments that require the future use of resources, such as long-term leases, as well as loss contingencies that are assessed to be at least reasonably possible, are disclosed in the notes to the financial statements.

◆ **Net Position** is the difference between the federal government’s assets and liabilities.

Statement of Social Insurance

The Statement of Social Insurance shows how much more money would be needed, in today's dollars, for the federal government's social insurance programs to continue operating over the long term, as they are structured today. The estimates presented in these statements are based on actuarial projections of persons who are or will be participants in these programs. These estimates exclude related trust fund balances, primarily the special U.S. Treasury securities held by such trust funds. These securities are guaranteed for principal and interest by the full faith and credit of the U.S. government and, as of September 30, 2008, totaled about \$2.7 trillion, of which the Social Security trust funds held about \$2.4 trillion. Additional information regarding Social Security and Medicare programs are included in the annual reports of the Trustees of the Social Security and Medicare trust funds; the summary and full annual reports can be found on Social Security's website at <http://www.socialsecurity.gov/OACT/TR/index.html>.

Readers can use this statement to find such information as

- the total amount of projected additional resources needed today, under current policy, in addition to future earmarked revenue for the federal government to fund the major social insurance programs over the projected period, and
- how much the projected resource needs have changed from prior years.

For example, in 2008, Social Security's projected expenditures of about \$43 trillion exceeded projected revenue of about \$36 trillion by approximately \$7 trillion.

Estimated amounts shown as needed over an infinite period, while not shown on the Statement of Social Insurance, are presented in the Supplemental Information section of the CFR. The present value of the resources needed for programs noted above totaled about \$102 trillion based on an infinite time period.

Statement of Social Insurance

Illustrative Social Insurance Information

| Present Value of Long-Range (75 Years) Actuarial Projections | As of January 1 | | | | |
|---|------------------|------------------|-----------------|-----------------|------------------|
| (In billions of dollars) | 2008 | 2007 | 2006 | **Unaudited** | |
| | | | | 2005 | 2004 |
| ● Federal Old-Age, Survivors and Disability Insurance (Social Security) | | | | | |
| Revenue (Contributions and Earmarked Taxes) | 36,357 | 34,113 | 32,107 | 29,450 | 27,699 |
| Expenditures for Scheduled Future Benefits | <u>(42,911)</u> | <u>(40,876)</u> | <u>(38,557)</u> | <u>(35,154)</u> | <u>(32, 928)</u> |
| Present Value of Future Expenditures in Excess of Future Revenue | (6,555) | (6,763) | (6,449) | (5,704) | (5,229) |
| ■ Federal Hospital Insurance (Medicare Part A) | | | | | |
| Revenue (Contributions and Earmarked Taxes) | 11,883 | 11,023 | 10,644 | 9,435 | 8,976 |
| Expenditures for Scheduled Future Benefits | <u>(24,619)</u> | <u>(23,315)</u> | <u>(21,934)</u> | <u>(18,264)</u> | <u>(17,468)</u> |
| Present Value of Future Expenditures in Excess of Future Revenue | (12,736) | (12,292) | (11,290) | (8,829) | (8,492) |
| ▲ Federal Supplementary Medical Insurance (Medicare Part B) | | | | | |
| Revenue (Premiums) | 5,478 | 4,789 | 4,481 | 4,187 | 3,889 |
| Expenditures for Scheduled Future Benefits | <u>(21, 197)</u> | <u>(18, 221)</u> | <u>(17,613)</u> | <u>(16,571)</u> | <u>(15,329)</u> |
| Present Value of Future Expenditures in Excess of Future Revenue | (15,719) | (13,432) | (13,131) | (12,384) | (11, 440) |
| ▲ Federal Supplementary Medical Insurance (Medicare Part D) | | | | | |
| Revenue (Premiums and State Transfers) | 2,107 | 2,405 | 2,366 | 2,547 | 2,651 |
| Expenditures for Scheduled Future Benefits | <u>(9,964)</u> | <u>(10,766)</u> | <u>(10,250)</u> | <u>(11,233)</u> | <u>(10,770)</u> |
| Present Value of Future Expenditures in Excess of Future Revenue | <u>(7,857)</u> | <u>(8,361)</u> | <u>(7,884)</u> | <u>(8,686)</u> | <u>(8,119)</u> |
| Other - Present Value of Future Expenditures in Excess of Future Revenue | <u>(104)</u> | <u>(100)</u> | <u>(97)</u> | <u>(86)</u> | <u>(83)</u> |
| Total | <u>(42,970)</u> | <u>(40,948)</u> | <u>(38,851)</u> | <u>(35,689)</u> | <u>(33,363)</u> |

- **Social Security provides Federal Old-Age and Survivors Insurance and Disability Insurance.** Both programs are financed by taxes on employees and employers, including the self-employed, and are administered by the Social Security Administration.
- **Federal Hospital Insurance (Medicare Part A)** covers inpatient hospital and related care. It is financed primarily by a payroll tax on employers and employees, including the self-employed, and a portion of the income taxes paid on Social Security benefits. Federal Hospital Insurance is administered by the Department of Health and Human Services.
- ▲ **Federal Supplementary Medical Insurance**, which also is administered by the Department of Health and Human Services, consists of two parts, called Medicare Part B and Medicare Part D. Medicare Part B covers hospital outpatient services, physicians' services, and other assorted products and services. Part D covers the federal government's prescription drug program. Both parts are financed primarily by transfers from the general fund of the Treasury and premiums from participants.

Notes to the Financial Statements

The notes to the financial statements are an important source of information about the financial operations and condition of the federal government. As stated on the bottom of each of the statements, notes are considered an integral part of the financial statements. Moreover, most of the consolidated financial statements contain references to one or more notes.

The 25 notes to the federal government's fiscal year 2008 consolidated financial statements provided 73 pages of important and required disclosures. The notes addressed the following topics:

| | | |
|--|---|--|
| 1. Significant Accounting Policies | 10. Accounts Payable | 19. Contingencies |
| 2. Cash and Other Monetary Assets | 11. Federal Debt Securities Held by the Public | 20. Commitments |
| 3. Accounts and Taxes Receivable | 12. Federal Employee and Veteran Benefits Payable | 21. Earmarked Funds |
| 4. Loans Receivable and Loan Guarantee Liabilities | 13. Environmental and Disposal Liabilities | 22. Indian Trust Funds |
| 5. Inventories and Related Property | 14. Benefits Due and Payable | 23. Social Insurance |
| 6. Property, Plant and Equipment | 15. Insurance Program Liabilities | 24. Stewardship Land and Heritage Assets |
| 7. Securities and Investments | 16. Other Liabilities | 25. Subsequent Events |
| 8. Financial and Housing Market Stabilization | 17. Collections and Refunds of Federal Revenue | |
| 9. Other Assets | 18. Prior Period Adjustments | |

The first note to the federal government's consolidated financial statements summarizes the significant accounting policies used in accounting for and reporting on the federal government's consolidated financial information. Other notes provide important disclosures and details about the items on the statements. For example, the Federal Employee and Veteran Benefits Payable note provides details about the composition of benefits payable to federal civilian employees and military

Notes to the Financial Statements

personnel and disabled veterans, which exceeded \$5.3 trillion as of September 30, 2008. Because this estimated amount is based on actuarial calculations, the note also identifies the significant long-term assumptions used in determining these liabilities and related expenses. In addition, the note discloses that the Department of Veterans Affairs (VA) provides medical care to veterans on an “as available” basis, subject to the limits of the annual appropriations. VA does not report an accrued long-term actuarial liability for this medical care, but recognizes the medical care expenses in the period the services are provided. For the time period 2004 through 2008, the note states that the average medical cost per year was \$30 billion. Further, the note discloses that VA provides pension benefits to certain veterans and their dependents based on annual eligibility reviews. Although VA does not recognize a long-term actuarial liability for these pension benefits, VA discloses the projected amounts of future payments for pension benefits, \$97.3 billion as of September 30, 2008, and \$81.4 billion as of September 30, 2007. Readers can use this information to learn which benefit programs are primarily responsible for changes in the federal government’s liability to its civilian employees, military personnel, and veterans, and thus, to better understand factors likely to drive future federal disbursements.

The table below is the summary table from the fiscal year 2008 note for Federal Employee and Veteran Benefits Payable, which shows how much the federal government estimates it owes civilian and military employees in various categories of benefits. The full note also provides additional tables depicting the details of the changes in the pension and post-retirement health benefits categories from fiscal year 2007 to fiscal year 2008 for both civilian and military employees, and discusses the various categories.

Illustrative Note Information

| Federal Employee and Veteran Benefits Payable as of September 30 | | | | | | |
|---|-----------------|----------------|-----------------|----------------|----------------|----------------|
| | Civilian | | Military | | Total | |
| (In billions of dollars) | 2008 | 2007 | 2008 | 2007 | 2008 | 2007 |
| Pension and accrued benefits | 1,454.8 | 1,386.3 | 1,154.1 | 1,028.8 | 2,608.9 | 2,415.1 |
| Post-retirement health and accrued benefits | 341.8 | 311.6 | 820.6 | 835.9 | 1,162.4 | 1,147.5 |
| Veteran compensation and burial benefits | N/A | N/A | 1,466.7 | 1,127.7 | 1,466.7 | 1,127.7 |
| Liabilities for other benefits | <u>54.5</u> | <u>52.3</u> | <u>26.4</u> | <u>26.5</u> | <u>80.9</u> | <u>78.8</u> |
| Total | <u>1,851.1</u> | <u>1,750.2</u> | <u>3,467.8</u> | <u>3,018.9</u> | <u>5,318.9</u> | <u>4,769.1</u> |

Supplemental Information

The Supplemental Information section is intended to provide additional information to enhance the understanding of the federal government's operations or financial condition. The supplemental information is not required to be audited.

Readers can use this section to understand

- how Medicare and Social Security Trust Funds are financed, and the sustainability of Social Security and the Hospital Insurance Fund (Medicare Part A) under current law. For example, Medicare Part A is used to pay for inpatient hospital stays, skilled nursing care, hospice, and certain home health services. This trust fund is financed primarily through payroll taxes and in 2008 was projected to remain solvent until 2019. Similarly, the combined Social Security Trust Funds are financed primarily through payroll taxes and in 2008 were projected to remain solvent until 2041. Actuarial projections of the solvency of these trust funds are updated annually.
- the sensitivity of changes in the assumptions used to determine estimated cashflow projections for these trust funds. For example, the Social Security Trust Funds used assumptions such as the changes in the average annual reduction in death rates, fertility rates, and net immigration to determine the present values of estimated future expenditures in excess of future revenue.
- the current year's net results for Medicare and Social Security Trust Funds, which is computed as revenue received from payroll and benefit taxes and insurance premiums less expenditures for health care and income security benefits.
- the estimated cost of maintenance needed to bring property owned by the federal government to an acceptable condition, called deferred maintenance (e.g., for fiscal year 2008, the estimated cost of deferred maintenance on such property ranged from about \$110 billion to approximately \$117 billion).
- the amount of federal taxes paid by individuals grouped by income level (e.g., individuals with adjusted gross incomes of \$200,000 or more paid about 53 percent of the individual federal income taxes collected for tax year 2006).

Supplemental Information

The following table is taken from the Supplemental Information section of the CFR. It is intended to provide additional information about individual taxable income and taxes paid. Although the data are from the 2006 tax year, the information nonetheless helps readers understand how the federal tax burden is distributed based on adjusted gross income.

Illustrative Supplemental Information

| Individual Income Tax Liability for Tax Year 2006 | | | | | | |
|--|----------------------------------|--------------------------|--------------------------|-------------------------------|--------------------------------------|--|
| Adjusted gross income (AGI) | Number of taxable returns | AGI | Total income tax | Average AGI per return | Average income tax per return | Income tax as a percentage of AGI |
| | (in thousands) | (in millions of dollars) | (in millions of dollars) | (in whole dollars) | (in whole dollars) | |
| Under \$15,000 | 37,614 | 188,624 | 3,141 | 5,015 | 84 | 1.7% |
| \$15,000 to under \$30,000 | 29,649 | 655,386 | 22,562 | 22,105 | 761 | 3.4% |
| \$30,000 to under \$50,000 | 24,907 | 973,569 | 59,846 | 39,088 | 2,403 | 6.1% |
| \$50,000 to under \$100,000 | 30,053 | 2,123,894 | 185,019 | 70,672 | 6,156 | 8.7% |
| \$100,000 to under \$200,000 | 12,110 | 1,610,028 | 210,538 | 132,956 | 17,386 | 13.1% |
| \$200,000 or more | <u>4,088</u> | <u>2,431,160</u> | <u>545,226</u> | 594,740 | 133,380 | 22.4% |
| Total | <u>138,421</u> | <u>7,982,661</u> | <u>1,026,332</u> | — | — | — |

Stewardship Information

The Stewardship Information section of the CFR describes how much the federal government spent for programs that provide long-term benefits to the public, or stewardship investments. These programs include grants for construction and major renovation of state and local government property, such as bridges and roads, and grants for education and training. The Stewardship Information section also describes the expenses the federal government has incurred in its basic and applied research and in development programs. The Stewardship Information section is not required to be audited.

Readers can use this section to find such information as

- how much the federal government spent on nonfederal physical property such as state and local bridges and roads, and whether such spending has increased or decreased,
- how much the federal government spent on educating and training the public and whether such spending has increased or decreased, and
- how much the federal government spent on research and development, and whether such spending has increased or decreased.

The next illustrative table on stewardship investments, reports annual expenditures from fiscal year 2004 through fiscal year 2008. It includes items that the government considers investments in the future of the nation, such as public education and training—reported under investments in human capital, and various categories of research and development. The amounts reported for fiscal years 2004–2007 are restated due to agencies' continued reviewing, correcting, and updating these data.

Stewardship Information

Illustrative Stewardship Information

| Stewardship Investments for the Years Ended September 30 | | | | | |
|---|------------------------|-------------------------------------|-------------------------------------|-------------------------------------|-------------------------------------|
| | Fiscal year | Restated fiscal year | Restated fiscal year | Restated fiscal year | Restated fiscal year |
| (In billions of dollars) | 2008 | 2007 | 2006 | 2005 | 2004 |
| Investments in nonfederal physical property | 57.8 | 56.2 | 54.4 | 51.9 | 54.8 |
| Investments in human capital | 77.2 | 76.1 | 107.4 | 88.2 | 76.6 |
| Research and development | | | | | |
| Investments in basic research | 27.6 | 26.5 | 25.2 | 25.1 | 23.4 |
| Investments in applied research | 21.4 | 22.2 | 21.7 | 21.2 | 20.0 |
| Investments in development | <u>79.2</u> | <u>66.3</u> | <u>52.1</u> | <u>42.1</u> | <u>37.9</u> |
| Total investments | <u>263.2</u> | <u>247.3</u> | <u>260.8</u> | <u>228.5</u> | <u>212.7</u> |

Government Accountability Office Report

GAO's report tells readers whether or not, or to what extent, the information provided in the CFS is reliable. GAO conducts its audit of the CFS in accordance with U.S. generally accepted government auditing standards, and obtains and evaluates evidence, with the objective of providing a formal written conclusion on whether the consolidated financial statements taken as a whole are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles. The Citizen's Guide, MD&A, Supplemental, and Stewardship Information sections in the CFR are not required to be audited.

The auditor may express an **unqualified opinion**, a **qualified opinion**, or an **adverse opinion**, or **disclaim an opinion** on the fairness of the financial statements taken as a whole. In an **unqualified opinion**, the auditor states that the information in the financial statements and accompanying notes is presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles. A **qualified opinion** discloses exceptions to an unqualified opinion, such as inadequate disclosures or selected nonconformities with U.S. generally accepted accounting principles. However, in a qualified opinion, the exceptions are not considered material enough to affect the fairness of the statements taken as a whole. Exceptions considered too serious or pervasive to justify a qualified opinion result in an **adverse opinion**, which states that the financial statements taken as a whole are not presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles. The circumstances related to such exceptions are also disclosed in the auditor's report. A **disclaimer of opinion** may result when the auditor is unable to obtain sufficient information upon which to base an opinion. The circumstances related to a disclaimer are described in the auditor's report.

GAO expressed an unqualified opinion on the 2008 and 2007 Statements of Social Insurance. GAO disclaimed an opinion on the fiscal year 2008 and 2007 Consolidated Financial Statements other than the Statements of Social Insurance because of the effects of persistent material weaknesses in the federal government's internal control and certain accounting and reporting practices that limited the scope of work that could be performed; a major factor in this limitation is the Department of Defense's continued inability to undergo an audit of its financial statements.

Government Accountability Office Report

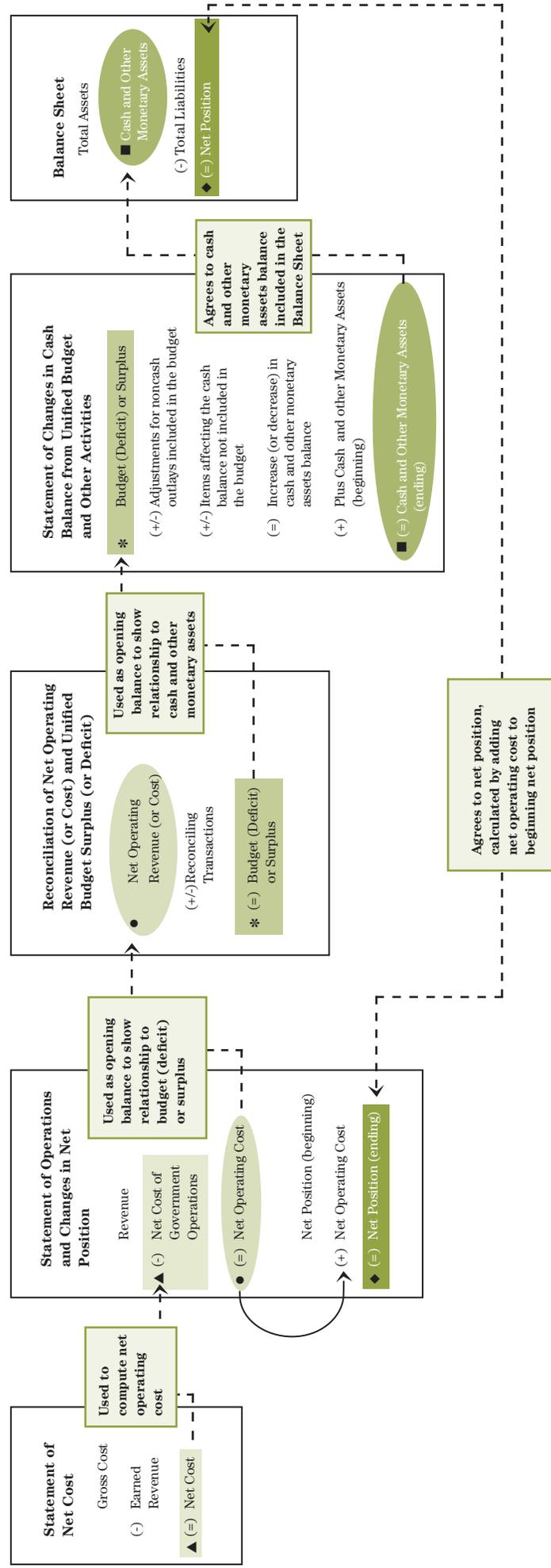
GAO's report also includes an opinion on whether the federal government had effective internal control over financial reporting and over compliance with laws and regulations. It also reports on any identified significant matters of noncompliance with selected provisions of applicable laws and regulations. For fiscal year 2008, GAO reported that the federal government did not maintain effective internal control over financial reporting (including safeguarding assets) and compliance with significant laws and regulations. GAO's work to test compliance with selected provisions of significant laws and regulations in fiscal year 2008 was limited by material weaknesses and scope limitations. GAO's audit report 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 agencies.

How the Federal Government's Accrual-Basis Consolidated Financial Statements Relate to One Another

The federal government's consolidated financial statements consist of (1) five interrelated statements, referred to as the accrual-basis consolidated financial statements, and (2) the Statement of Social Insurance, which does not relate to the other consolidated financial statements. The chart on the next page provides an overview of the five accrual-basis consolidated financial statements and how selected components of those statements are related.

- ▲ 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.
- 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).
- ◆ 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.
- * 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 cash and other monetary assets are connected to the unified budget results.
- The federal government's ending cash and other monetary assets balance from the Statement of Changes in Cash Balance from Unified Budget and Other Activities is the same as the "cash and other monetary assets" line on the Balance Sheet.

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