



Comptroller General  
of the United States

United States Government Accountability Office  
Washington, DC 20548

December 17, 2007

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

Our report on the U.S. government's consolidated financial statements for fiscal years 2007 and 2006 is enclosed. In summary we found the following:

- Certain material weaknesses in financial reporting and other limitations on the scope of our work resulted in conditions that, for the 11th consecutive year, prevented us from expressing an opinion on the financial statements other than the Statement of Social Insurance, which are referred to as the federal government's accrual basis consolidated financial statements.<sup>1</sup> About \$895 billion, or 57 percent, of the federal government's reported total assets as of September 30, 2007, and approximately \$740 billion, or 25 percent, of the federal government's reported net cost for fiscal year 2007 relate to 4 of the 24 Chief Financial Officers (CFO) Act agencies' fiscal year 2007 financial statements that were disclaimed on or not audited and to certain unsupported assets and costs of a fifth CFO Act agency.<sup>2</sup>
- The 2007 Statement of Social Insurance is presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles; we disclaim an opinion on the 2006 Statement of Social Insurance.<sup>3</sup>
- The federal government did not maintain effective internal control over financial reporting (including safeguarding assets) and compliance with significant laws and regulations as of September 30, 2007.

<sup>1</sup> Most revenues reported in the accrual basis consolidated financial statements are recorded on a modified cash basis.

<sup>2</sup> The CFO Act agencies that received disclaimers of opinions on all of their fiscal year 2007 financial statements were the Department of Defense, Department of State, and the National Aeronautics and Space Administration. For the Department of Homeland Security for fiscal year 2007, only the Consolidated Balance Sheet and Statement of Custodial Activity were subjected to audit; the auditor was unable to express an opinion on these two financial statements. For the Department of Agriculture (USDA) for fiscal year 2007, the auditor was unable to obtain sufficient, appropriate evidence to support certain amounts reflected on USDA's consolidated balance sheet and statement of net cost, and therefore qualified its opinion on the department's financial statements.

<sup>3</sup> We disclaimed an opinion on the fiscal year 2006 consolidated financial statements, including the Statement of Social Insurance.

- Our work to test compliance with selected provisions of significant laws and regulations in fiscal year 2007 was limited by the material weaknesses and scope limitations discussed in our report.

While significant progress has been made in improving financial management since the U.S. government began preparing consolidated financial statements 11 years ago, three major impediments continue to prevent us from rendering an opinion on the accrual basis consolidated financial statements: (1) serious financial management problems at the Department of Defense, (2) the federal government's inability to adequately account for and reconcile intragovernmental activity and balances between federal agencies, and (3) the federal government's ineffective process for preparing the consolidated financial statements. Until the problems outlined in our audit report are adequately addressed, they will continue to have adverse implications for the federal government and American taxpayers.

Accounting and financial reporting standards have continued to evolve to provide greater transparency and accountability over the federal government's operations, financial condition, and fiscal outlook. Fiscal year 2007 marked the second year in which the Statement of Social Insurance has been presented as a basic financial statement.<sup>4</sup> As noted above, this year, we were able to render an unqualified opinion on the 2007 Statement of Social Insurance. This is a significant accomplishment for the federal government. This statement shows that projected scheduled benefits exceed earmarked revenues by approximately \$41 trillion<sup>5</sup> in present value terms for the next 75-year period.<sup>6</sup>

Considering this projected gap in social insurance, in addition to reported liabilities (e.g., debt held by the public and federal employee and veterans benefits payable) and other implicit commitments and contingencies that the federal government has pledged to support, the federal government's fiscal exposures totaled approximately \$53 trillion as of September 30, 2007, up more than \$2 trillion from September 30, 2006, and an increase of more than \$32 trillion from about \$20 trillion as of September 30, 2000.<sup>7</sup> This translates into a current burden of about \$175,000 per American or approximately \$455,000 per American household.

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<sup>4</sup> Social insurance programs included in the Statement of Social Insurance are Social Security, Medicare, Railroad Retirement, and Black Lung.

<sup>5</sup> On an open group basis (current and future participants). On a closed group basis, which excludes the benefit payments and contributions of individuals under the age of 15 (or not yet born), this amount is approximately \$45 trillion.

<sup>6</sup> Black Lung's long-range actuarial projections are through 2040 when the program is scheduled to terminate (i.e., a 33-year period).

<sup>7</sup> The federal government's fiscal exposures are derived from information reported throughout the financial statements and related footnotes.

Also, beginning in fiscal year 2006, the consolidated financial statements reported earmarked funds activity separately from non earmarked funds activity.<sup>8</sup> For fiscal year 2007, earmarked funds revenue and non earmarked funds revenue totaled about \$1,153 billion and \$1,667 billion, respectively. In addition, for fiscal year 2007, earmarked funds had reported net operating revenue of approximately \$194 billion, and non earmarked funds reported net operating cost of approximately \$469 billion.<sup>9</sup>

Further enhancements to accounting and financial reporting standards are needed to effectively convey the long-term financial condition of the U.S. government and annual changes therein. For example, the federal government's financial reporting should be expanded to disclose the reasons for significant changes during the year in scheduled social insurance benefits and funding. It should also include a Statement of Fiscal Sustainability<sup>10</sup>—providing a long-term look at the sustainability of social insurance programs in the context of all federal programs—and other sustainability information, including intergenerational equity.<sup>11, 12</sup> In addition, there is a need for a combined report on the performance and financial accountability of the federal government as a whole. This report would include, among other things, key outcome-based national indicators (e.g., economic, security, social, and environmental) which could be used to help assess the nation's and other governmental jurisdictions' position and progress.

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We appreciate the cooperation and assistance of the Department of the Treasury and Office of Management and Budget officials, as well as the federal agencies' CFOs and inspectors general, in carrying out our statutory responsibility to report on the U.S. government's consolidated financial statements. We look forward to continuing to work with these officials and the Congress to achieve the goals and objectives of financial management reform.

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<sup>8</sup> Earmarked funds (e.g., Social Security and Medicare trust funds) are financed by specifically identified revenues and other financing sources which remain available over time; are required by statute to be used for designated activities, benefits, or purposes; and must be accounted for separately from the federal government's general revenues. See the Federal Accounting Standards Advisory Board's (FASAB) Statement of Federal Financial Accounting Standards No. 27, *Identifying and Reporting Earmarked Funds* (Washington, D.C.: Dec. 28, 2004).

<sup>9</sup> The earmarked funds net operating revenue is the excess of revenues and of transfers from non earmarked funds over net costs. The non earmarked funds net operating cost is the excess of net costs and of transfers to earmarked funds over revenues.

<sup>10</sup> The Statement of Fiscal Sustainability would show the relationship between the present value of projected revenues and outlays for social insurance and for all other federal programs.

<sup>11</sup> Intergenerational equity assesses the extent to which different age groups may be required to assume financial burdens to sustain federal responsibilities.

<sup>12</sup> The Federal Accounting Standards Advisory Board is currently considering possible changes to social insurance reporting and has initiated a project on fiscal sustainability reporting.

Our audit report begins on page 159. Our guide<sup>13</sup> to the *Financial Report of the United States Government* will help those who seek to obtain a better understanding of the *Financial Report*. In addition, our guide<sup>14</sup> on *Understanding Similarities and Differences between Accrual and Cash Deficits* provides a useful perspective on the different purposes cash and accrual measures serve in providing a comprehensive picture of the federal government's fiscal condition today and over time. These guides are available on GAO's Web site at [www.gao.gov](http://www.gao.gov).

Our report was prepared under the direction of Jeffrey C. Steinhoff, Managing Director, and Gary T. Engel, Director, Financial Management and Assurance. If you have any questions, please contact me on (202) 512-5500 or them on (202) 512-2600.

A handwritten signature in black ink, appearing to read "D M Walker", with a long horizontal line extending to the right.

David M. Walker  
Comptroller General  
of the United States

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

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<sup>13</sup> GAO, *Understanding the Primary Components of the Annual Financial Report of the United States Government*, GAO-05-958SP (Washington, D.C.: September 2005).

<sup>14</sup> GAO, *Understanding Similarities and Differences between Accrual and Cash Deficits*, GAO-07-117SP (Washington, D.C.: December 2006). In January 2007, we issued an update to this guide for fiscal year 2006, GAO-07-341SP (Washington, D.C.: January 2007).