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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

A MESSAGE FROM THE SECRETARY OF THE TREASURY

It is my privilege to issue to the Congress and the American people the 2007 *Financial Report of the U.S. Government.* The budget and financial results presented in this report demonstrate the remarkable strength of the U.S. economy that translated into record-breaking revenues of $2.6 trillion flowing into the Treasury in 2007. A combination of solid economic growth and improved corporate tax yields have contributed to revenue growth of nearly 50 percent since 2003. This increase in revenues and our sustained economic expansion resulted in a continued decline in the federal budget deficit. In addition to reporting the government's 2007 operating costs and financial condition, this report discusses the nation's long-term fiscal outlook.

The report highlights a huge challenge—a coming wave of spending for our two major entitlement programs, Social Security and Medicare. The costs for these two programs will grow substantially faster than the economy over the next several decades as the "baby-boom" generation retires and health care costs continue to rise.

We must now look ahead to the future claims on spending for Social Security and Medicare and squarely face the challenge of fundamental reform to ensure the sustainability of these programs. We must also strive to make all our disclosures in this area as transparent as possible, provide all points of view with relevant data, and expand our reporting to include the reasons these critical forecasts are increasing year over year.

Through the type of comprehensive reporting contained in this report, we hope to inform and support the decision-making so critical to the nation's fiscal future.

Henry M. Paulson, Jr.

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The Nation by the Numbers: A Citizen's Guide

A Summary of the FY 2007 Financial Report of the U.S. Government

"We might hope to see the finances of the Union as clear and intelligible as a merchant's books, so that every member of Congress and every man of any mind in the Union should be able to comprehend them, to investigate abuses, and consequently to control them."
President Thomas Jefferson to Treasury Secretary Albert Gallatin, 1802

Financial Condition of the U.S. Government: An Overview

The *Fiscal Year 2007 Financial Report of the United States Government (Report)* provides the President, Congress, and the American people a comprehensive view of how the Federal Government is managing taxpayer dollars. This *Citizen's Guide* is a summary of that Report, which attempts to make sense of the trillions of dollars that the Government receives from taxpayers and spends through thousands of Government programs and services, such as national defense, Social Security, Medicare, and education each year, dwarfing even the largest companies worldwide. It discusses the Government's financial position and condition, its revenues and costs, assets and liabilities, and other responsibilities and commitments, as well as important financial issues that affect the Nation and its citizens both now and in the future. Table 1 summarizes several key indicators of the Government's financial health.

Table 1: The Nation By the Numbers - An Overview

billions of dollars	2005	2006	2007
Gross Costs	**$(3,174.6)**	**$ (3,127.7)**	**$ (3,157.3)**
Total Taxes and Other Revenues	**$ 2,185.5**	**$ 2,440.8**	**$ 2,627.3**
Net Operating Cost [1]	**$ (760.2)**	**$ (449.5)**	**$ (275.5)**
Assets	**$ 1,447.9**	**$ 1,496.5**	**$ 1,581.1**
Less: Liabilities, comprised of:			
Federal Debt held by the Public	$ (4,624.2)	$ (4,867.5)	$ (5,077.7)
Federal Employee & Veteran Benefits	$ (4,491.8)	$ (4,679.0)	$ (4,769.1)
Other Liabilities	$ (798.8)	$ (866.4)	$ (940.1)
Total Liabilities	**$(9,914.8)**	**$ (10,412.9)**	**$ (10,786.9)**
Net Position (Assets Net of Liabilities)	**$(8,466.9)**	**$ (8,916.4)**	**$ (9,205.8)**
Social Insurance Exposures (not included on the balance sheet): [2]			
Closed Group (current participants) [3]	$ (40,038)	$ (44,147)	$ (45,062)
Open Group (current + future participants) [4]	$ (35,689)	$ (38,851)	$ (40,948)
Budget Results			
Unified Budget Deficit	**$ (318.6)**	**$ (247.7)**	**$ (162.8)**

1 Total Net Operating Cost includes Earned Revenues (offset against Gross Costs) and 'Unmatched Transactions and Balances' not shown in this table.

2 present value of 75-year actuarial projections of benefit payments under current law for Social Security, Medicare, and other social insurance programs in excess of their scheduled contributions and earmarked taxes. Not considered liabilities on the balance sheet.

3 includes current participants (i.e., receiving and/or are eligible to receive benefits) ages 15 and over at the start of the period.

4 includes all current and future projected participants (i.e., individuals receiving and/or eligible to receive benefits ages 15 and over at the start of the period, PLUS participants estimated to receive and/or be eligible for benefits over the 75-yr horizon).

Each year, the Administration issues two reports that detail financial results for the Government:

- the ***President's Budget (Budget)***, the Government's primary financial planning and control tool, describes how the Government spent and plans to spend its money. The unified budget deficit, from Table 1 on the previous page shows that the Government spent $163 billion more than it received in fiscal year 2007 on a cash basis.
- the ***Financial Report of the United States Government*** (Report) includes the accrual-based cost of operations, the sources used to finance those costs, how much the Government owns and owes, and the outlook for its social insurance programs. Table 1 shows that the Government's *costs* exceeded its *revenues* by $275.5 billion for fiscal year 2007.

Table 2: The Nation By the Numbers Budget Deficit vs. Net Operating Cost

Dollars in billions	2006	2007
Unified Budget Deficit	**$247.7**	**$162.8**
Unfunded Postemployment Programs	$187.2	$90.1
Increase in Environmental Liabilities	$45.4	$36.8
Capitalized Fixed Assets, Net	($20.8)	($13.5)
Other	($10.2)	($0.6)
Net Operating Cost	**$449.5**	**$275.5**

The Budget's emphasis is on initiatives and how resources *will be used*, focusing on the Government's spending surplus or deficit. The Report focuses on the Government's net operating cost - how resources *have been used* to fund programs and services. How does the Government's largely *cash-based* spending deficit differ from the largely *accrual-based* net operating cost?

- The Budget shows *receipts*, or cash paid to the Government (e.g., income tax payments and national park fees received); while the Report presents *revenue*, or amounts that the Government has earned, some of which has not yet been received[1].
- The Budget reports cash outlays when the Government makes payments to individuals, businesses or other parties. The financial statements reflect costs in the period in which resources are consumed or liabilities increased.
- From Table 2, almost the entire difference between these two reports can be explained by a single item. The Budget does not include $90.1 billion in postemployment benefits earned by, but not yet due to be paid to, employees in fiscal year 2007.
- Similarly, the Budget does not include an estimated $36.8 billion of additional clean-up costs that the Government will eventually have to pay to fund environmental efforts (e.g., EPA Superfund).
- Conversely, the Budget does include more than $13 billion in net spending for Capitalized Fixed Assets. For Budget purposes, the entire purchase price for major assets, such as buildings or aircraft carriers must be shown as a cost in the year of outlay. However, due to their estimated longevity, agencies capitalize and depreciate (i.e., spread) the cost of these assets over their 'useful lives' in the financial statements.

Together, the Budget and the Report present a complementary perspective on the Nation's financial health and provide a valuable management tool for the country's leaders. The following pages will provide some insight into how the Government managed taxpayer dollars in 2007 and the prospects for the future.

[1] Under GAAP, most U.S. Government revenues are recognized on a 'modified cash' basis, or when they become measurable.

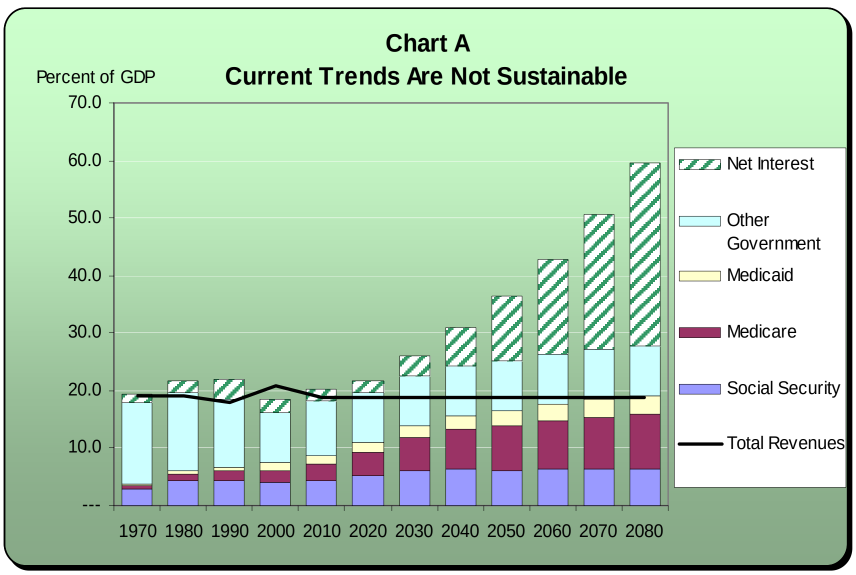
The Government's Financial Position and Condition

Financial position refers to the Government's financial health as of a distinct point in time (September 30 of each year), based on past events. The Government's financial statements provide a number of 'vital signs' of its health, including the assets that the Government owns, the liabilities owed, and the cost of running the Government's many operations and services. How and why the Government's financial position changed during the year, as discussed in the 'Financial Highlights' section of this Report, are also important indicators. As of the end of 2007, the Government's net position (assets net of liabilities) was a net liability of $9.2 trillion.

By comparison, the Government's financial or fiscal condition not only considers the Government's current and past performance, but also its capacity to meet future demands and responsibilities. For example, the growing responsibilities associated with future social insurance benefits (e.g., Social Security, Medicare) is a well-documented issue that impacts every citizen in the Nation, due in great part to the aging of the 'baby boom' generation and rising health care costs. The ***Statement of Social Insurance*** (SOSI) compares the resources that the Government expects to receive for these programs from dedicated sources (e.g., earmarked taxes, premiums) to what it expects to have to pay out in benefits over the next 75 years in current dollar terms.

> ***What Does This Mean to Me?***
> **Gross Domestic Product (GDP)**. GDP is one of the ways to measure the size of an economy. The GDP is the total market value of all final goods and services produced within a country during a period of time (usually a calendar year).

Chart A forecasts the Government's historical major spending programs and revenues over the next 75 years as a percent of Gross Domestic Product (GDP). The projection that revenue as a percent of GDP will remain relatively constant in future years is based on historical data and trends that are not expected to change. Since World War II Federal revenues as a share of GDP have been roughly constant at around 18 percent of GDP. Whenever taxes have risen above this range, policy actions have tended to pull them back.



Simply said, holding revenues constant, required Medicare, Medicaid, and Social Security spending and the related deficit financing costs will far exceed the Government's ability to pay. Projections show that by 2070, total Government expenditures are projected to be 50 percent of GDP. Such levels of expenditures have only been witnessed once before, during World War II, when Government expenditures reached a record high of 44 percent of GDP. And by 2080, expenditures are projected to approach 60 percent of GDP. This would cause dramatic increases in deficit spending, and consequently, as explained later, Federal debt needed to finance them.

The spending for social insurance programs, in particular, is projected to grow at an alarming rate under current law. The precise amounts of the Government's future social insurance responsibilities are far from certain, as they are based on complex calculations and many assumptions, e.g., age, life expectancy, and the cost of health care. However, the magnitude of the problem and the need for a solution are evident and could have a significant impact on the economy in the future unless action is taken in the near future.

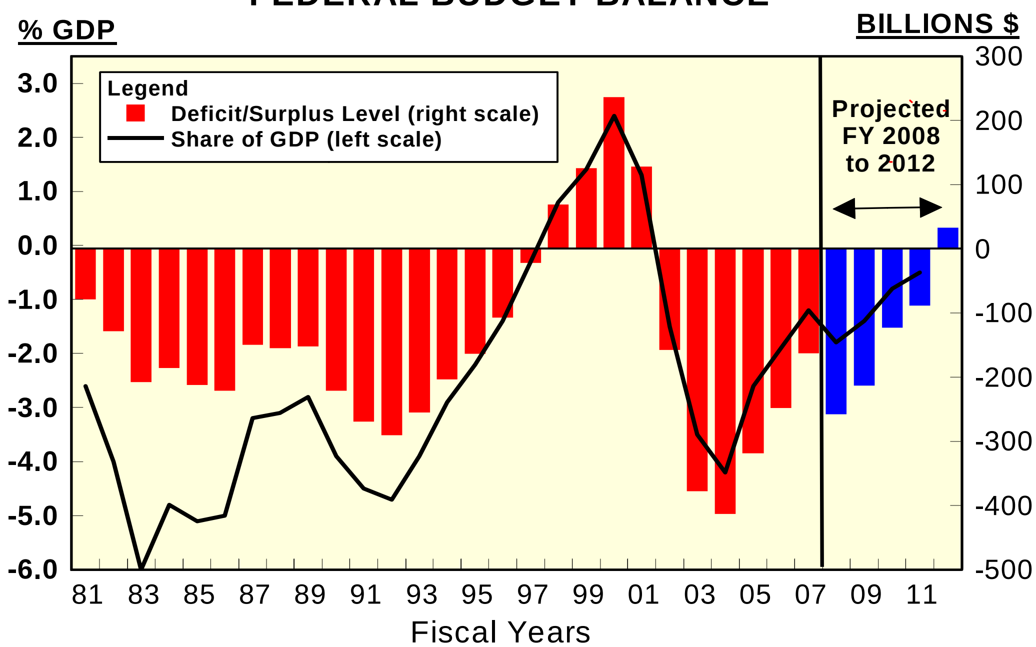
The Economy

The fiscal year 2007 unified budget deficit decreased $85 billion to $162.8 billion, the third consecutive annual decrease. The decrease was due almost entirely to a substantial increase in revenue. Net cost across agencies nearly broke even as the three largest increases (at the Departments of Health and Human Services and Defense, and the Social Security Administration) almost entirely offset the four largest decreases (at the Departments of Agriculture, Education, Homeland Security, and Veterans Affairs).

U.S. economic growth edged up in fiscal 2007, but growth was partly restrained by continued weakening in the residential homebuilding sector and growing financial market uncertainty. Employment gains tapered off through the year, although the unemployment rate remained low. Inflation rose in the first half of the year, due in part to swings in oil and gasoline prices, as well as noticeable increases in food prices, but declined in the second half.

Image 1

FEDERAL BUDGET BALANCE



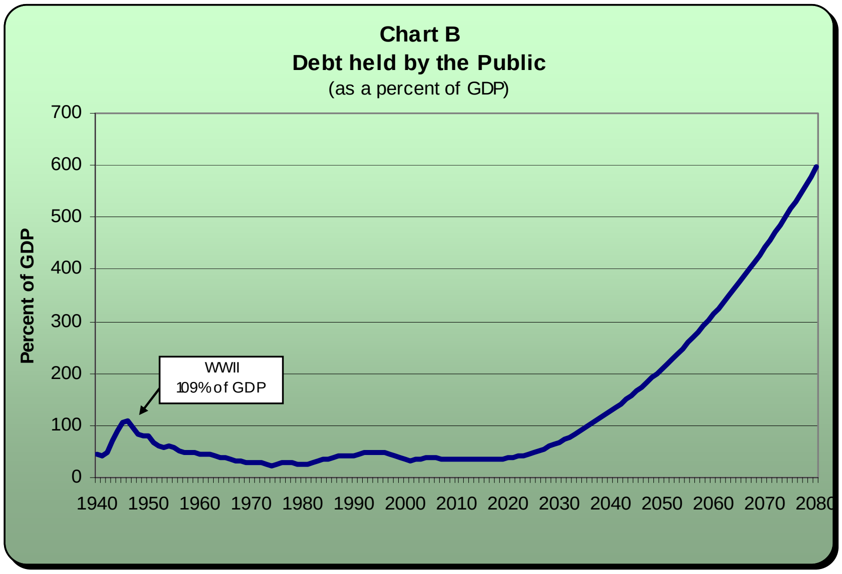
Source of Projections: FY 2008 Mid-Session Review

The Financial and Housing Markets

Financial market turbulence this past summer reflected concern over growing mortgage defaults and a realization that some mortgage-backed securities contained substantially more risk than originally assumed. This caused some investors to move to less risky investments (e.g., Treasury debt). The uncertainty created by those difficulties prompted market participants to reappraise values of assets in a broader array of markets for equities, sovereign debt, and corporate debt. A widening of spreads reflected this repricing of risk: for example, the spread between the Baa corporate bond yield and the comparable U.S. Treasury yield widened to a two year high in mid-September 2007.

The Government's Debt

The Government must borrow from the public at home and abroad to fund its deficits. The projected increases in interest expenditures as a percent of GDP in Chart A above and in total public debt in Chart B indicate that the anticipated social insurance spending shortfall could have a dramatic and extended impact on the Government's financial health. As shown in Chart B, under current policy, the confluence of these trends would cause the Government's debt levels to more than triple by 2040 (well above even the WWII peak of 109 percent), to double again by 2060, and approach six times GDP levels by 2080. At some point before the debt reaches such unprecedented levels, the world's financial markets would likely cease lending to the United States. Although the precise point at which this would occur is unknown, it is clear that these projected debt levels cannot be sustained indefinitely. As indicated earlier, such dramatic projections are based on a wide array of assumptions about the future. Nonetheless, it is clear that action will be required in the future to bridge this emerging fiscal imbalance.



However, debt held by the public accounts for only approximately half of the Government's gross debt. The other half is primarily held in the form of special nonmarketable securities by various parts of the Government. This intragovernmental debt does not appear on the balance sheet because, under current accounting principles, claims of one part of the Government against another are eliminated when consolidated governmentwide financial statements are prepared so that the statements do not appear to be inflated. Accounting principles prevent such 'left hand owing the right hand' amounts from distorting results.

Gross Federal debt, excluding some adjustments, is subject to the statutory debt limit. Prior to 1917, the Congress approved each debt issuance. In 1917, to facilitate planning in World War I, Congress established a dollar ceiling for Federal borrowing, which has been periodically increased over the years (most recently from $9.0 trillion to $9.8 trillion in 2007). At the end of fiscal year 2007, the amount of debt subject to the limit was $8.9 trillion, $893.7 billion under the limit.

Financial Highlights

The Government's financial position and condition have traditionally been expressed through the Budget, focusing on the impact of surpluses and deficits. While this primarily cash-based discussion of the Government's net outlays (deficit) or net receipts (surplus) tells an important part of the story, the rest is told by the changes in its assets and liabilities. The Government Accountability Office (GAO) is responsible for conducting the audit of the Government's financial statements. For FY 2007, GAO has again issued an audit opinion 'disclaimer', as it has in each of the past eleven years, on the consolidated financial statements for the fiscal years ended September 30, 2007 and 2006. This means that the auditors did not have sufficient information to determine whether the financial results were reliable. Material weaknesses in internal control and other scope limitations resulted in conditions that prevented GAO from forming and expressing an opinion. However, FY 2007 marks the first year that the Government earned an unqualified audit opinion on a Report component - - the Statement of Social Insurance (SOSI).

The following highlights the Federal Government's financial results for FY 2007 and shows how the various statements relate to each other.

Image 2
Navigating the Government's Financial Statements

I

Statements of Net Cost

(in billions)	2007	2006
Gross Cost	$ (3,157.3)	$ (3,127.7)
(-) Earned Revenue	247.8	226.4
(=) Net Cost [1]	**$ (2,909.5)**	**$ (2,901.3)**

How does Net Operating Cost affect Net Position?

II

Statements of Operations and Changes in Net Position

(in billions)	2007	2006
Net Position (beginning)	**$ (8,916.4)**	**$ (8,466.9)**
(+) Revenue	2,627.3	2,440.8
(-) Net Cost [1]	(2,909.5)	(2,901.3)
Net Operating Cost [2]	**(275.5)**	**(449.5)**
(=) Net Position (end) [3]	**$ (9,205.8)**	**$ (8,916.4)**

How does cost differ from the budget deficit?

IV

Statements of Changes in Cash Balance from Unified Budget Deficit & Other Activities

(in billions)	2007	2006
Unified Budget Deficit [4]	**$ (162.8)**	**$ (247.7)**
Increase (Decrease) in operating cash balance, Net	26.1	15.7
(+) Operating Cash (begin)	**43.6**	**27.9**
(=) Operating Cash (end) [5]	**$ 69.7**	**$ 43.6**

How does the deficit relate to cash?

III

Reconciliation of Net Operating Cost & Unified Budget Deficit

(in billions)	2007	2006
Net Operating Cost 2	**$ (275.5)**	**$ (449.5)**
Increase (Decrease) in Postemployment Liabilities, Environmental Liabilities, Other, Net:	112.7	201.8
Unified Budget Deficit [4]	**$ (162.8)**	**$ (247.7)**

V

Balance Sheet

(in billions)	2007	2006
Assets:		
Cash [5]	$ 128.0	$ 97.9
Property	691.1	688.5
Other	762.0	710.1
Total Assets	**1581.1**	**1496.5**
Liabilities:		
Debt held by the Public	5077.7	4867.5
Postemployment Benefits	4769.1	4679.0
Other	940.1	866.4
(-) Total Liabilities	**(10,786.9)**	**(10,412.9)**
Net Position [3]	**$ (9,205.8)**	**$ (8,916.4)**

What does the Govt own and owe?

Net Position also shown in II

What about Social Security and Medicare?

VI

Statement of Social Insurance (SOSI)*

Expenditures for future Scheduled Benefits, Net of Contributions and Earmarked Taxes

	2007	2006
Social Security	$ (6,763)	$ (6,449)
Medicare	$ (34,085)	$ (32,305)

*Note - The SOSI presents actuarial estimates of the present value of future expenditures, in excess of contributions over a 75-yr period. SOSI amounts are future sustainability estimates over an extended period. These amounts are for future benefit payments not yet due and therefore are NOT reflected in the balance sheet or other principal statements.

1 The Statements of Net Cost presents the Government's net operating expense, which, when combined with tax and other revenue in the Statement of Operations and Changes in Net Position, yields the Government's Net Operating Cost and shows how the Government's Net Position changed during the year.

2 . Net Operating Cost is the Government's net cost, less any 'unearned' revenue (e.g., taxes, fees). The 'Reconciliation Statement' shows the primary differences between the Government's accrual-based Net Operating Cost and cash-based unified budget deficit. Net Operating Cost includes t$6.7 billion adjustment for unreconciled transactions.

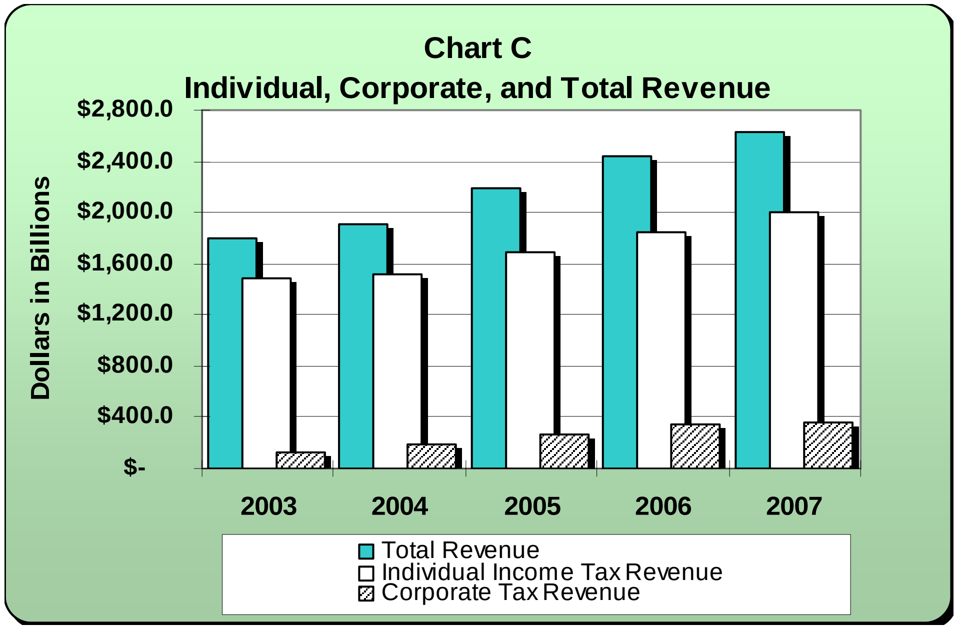
3 The Net Position from the Statement of Operations and Changes in Net Position agrees to the Net Position on the Balance Sheet, which is based on the difference between the Government's reported assets and liabilities.

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 spending deficit is related to its Net Operating Cost.

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.

Revenue: "What Came In"

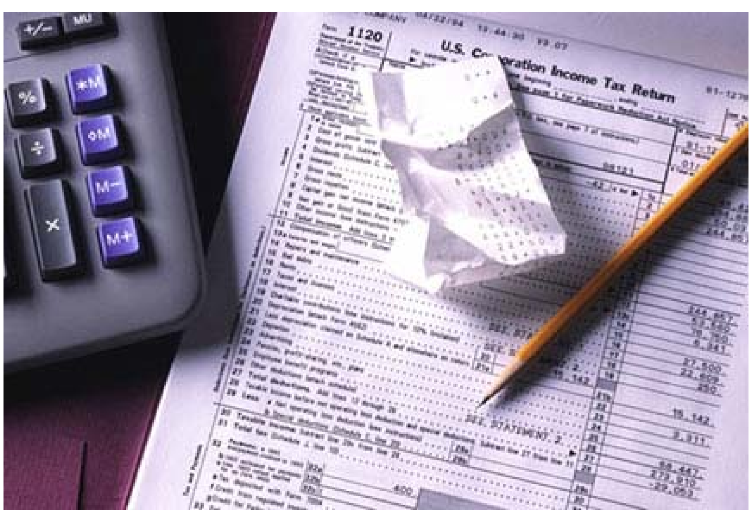
The Government's ***Statement of Operations and Changes in Net Position***, much like a corporation's income statement, shows the Government's 'bottom line' (i.e., its net revenues and costs). The Government's revenue is mostly comprised of individual and corporate income taxes. In 2007, revenues grew to $2.6 trillion, establishing a new record.



Facts and Figures:

- 2007 marked the fourth consecutive fiscal year of substantial revenue growth. A combination of solid economic growth and improved corporate tax yields have contributed to revenue collections that exceed 2003 levels by 46 percent.

- In 2007, the Government collected $2.6 trillion. Cash collections have increased by an average of $200 billion per year since 2003, contributing to a reduction of both the unified budget deficit and net operating cost.

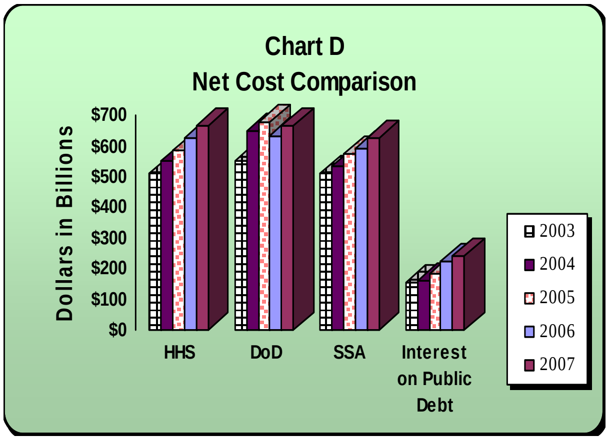


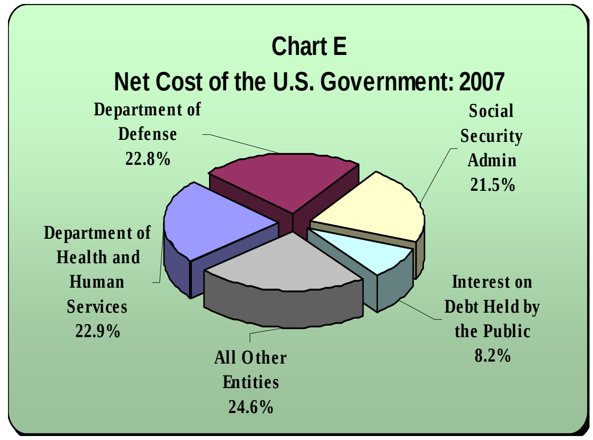
IRS
Department of the Treasury
Internal Revenue Service

IRS e-file

Cost: "What Went Out"

The Government nets its costs against both earned revenues from Government programs (e.g., Medicare premiums, national park entry fees) and taxes and other revenue. Taxes account for the vast majority of total revenues. The government's 'bottom line' is its net operating cost. The Government must finance any costs as they are paid that cannot be covered by revenues with Federal debt, subject to the statutory debt limit.





Facts and Figures:

- Gross costs, which increased slightly to $3.2 trillion in 2007, have increased by an average of 5.7 percent over the past five years, including a slight decline in 2006.
- The Departments of Health and Human Services, and Defense, as well as the Social Security Administration and interest on public debt, accounted for approximately three-fourths of the Government's total net costs in FY 2007.
- Much of the annual fluctuation in actuarial costs stems from the methodology and assumptions used by the Department of Veterans Affairs to calculate post-employment benefit liabilities.

Assets: "What We Own"

The Government's total assets, most of which are property, plant, and equipment, increased $84.6 billion to $1.6 trillion in 2007.

Facts and Figures:

- Net property, plant, and equipment has been the Government's largest asset over the past seven fiscal years, comprising more than 40 percent of total assets in FY 2007.
- In addition to the $1.6 trillion in total assets, the Government owns certain other assets such as stewardship land (e.g., national parks and forests) and heritage assets (e.g., national memorials, historic structures).

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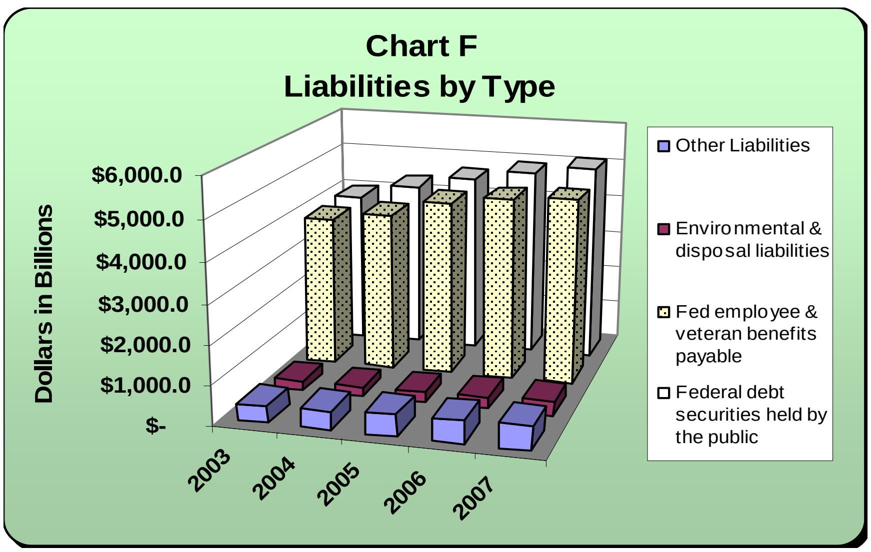
Liabilities: "What We Owe"

Total Liabilities increased $374.0 billion to nearly $10.8 trillion in fiscal year 2007. Most of this total is comprised of Federal debt held by (owed to) the public and accrued interest, and Federal employee and veteran benefits payable.



Facts and Figures:

- Debt held by the public and accrued interest, which increased $210.2 billion to $5.1 trillion in 2007, accounted for nearly 50 percent of the Government's total liabilities.
- After nearly doubling as a share of GDP over a 15-year period throughout the mid-1990s to about 50 percent in 1993, smaller deficits and a period of surpluses in the late 1990s led to a decline in the public debt as a percentage of GDP to 36.9 percent in 2007.
- Federal employee and veteran benefits payable make up another 44 percent of total liabilities. These liabilities have increased dramatically in recent years, from $2.6 trillion at fiscal year-end 1999, to $4.8 trillion in 2007.
- As of the end of 2007, the Government's liabilities exceeded its assets (net position) by $9.2 trillion.

<u>What Does This Mean to Me</u>?

Federal Debt held by the Public

Based on current estimates, every citizen's share of the Federal debt is over $17 thousand.

Nearly half of the U.S. public debt is held by foreign countries, so a substantial portion of government interest payments go abroad.

Looking Ahead

Fiscal responsibility requires the sound stewardship of taxpayer money. 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 agencies and programs are managed professionally and efficiently to achieve the results expected by the Congress and the American people.

The PMA's broad goal is to make the Government more results-oriented with a focus on achievement, efficiency, and accountability. It emphasizes improving Government operations by setting clear goals and action plans, and then following through on those plans. Agencies continue to manage to achieve better results. PMA standards for success are used to measure agencies' progress and achievement in meeting overall goals. Agency ratings and other related information are discussed in the Report and are available at: www.whitehouse.gov/results/agenda/standards.pdf

Find Out More

You will find details and more in-depth information on the issues discussed here in the full Financial Report of the U.S. Government. As the information in this Report potentially impacts every U.S. citizen, all are encouraged to explore the facts contained herein and to ask questions about how the Government manages taxpayer money.

This Report and other information about the Nation's finances are available on the Internet at:
http://www.fms.treas.gov/fr/index.html
http://www.whitehouse.gov/omb/financial/index.html
www.gao.gov

MANAGEMENT'S DISCUSSION AND ANALYSIS

Introduction

The *2007 Financial Report of the United States Government (Report)* provides the President, Congress, and the American people a comprehensive view of the Federal Government's finances, i.e., its financial position and condition, its revenues and costs, assets and liabilities, and other obligations and commitments. The Report also discusses important financial issues and significant conditions that may affect future operations. Due to its broad impact on practically every United States citizen, particular emphasis is given in this year's Report to the Government's capacity to sustain the funding and pay the earned benefits of key social insurance programs, such as Social Security and Medicare. This Report presents historical data as well as forward-looking projections of how retirement of the 'baby boom' generation and continually rising health-care costs could potentially lead to the erosion the Government's financial health.

Pursuant to 31 U.S.C. § 331(e)(1), the Department of the Treasury must submit the Report, which is subject to audit by the Government Accountability Office (GAO), to Congress no later than six months after the September 30 fiscal year-end. To encourage more timely and relevant reporting, the Office of Management and Budget (OMB) accelerated both the individual agency and governmentwide reporting deadlines to 45 days and 75 days after year-end, respectively.

FY 2007 CFO Act Agency Audit Results

Unqualified			Qualified	Disclaimer
Energy	Justice	GSA		
Commerce	Labor	NSF		
Education	Treasury	NRC		Defense
HHS	VA	OPM	USDA	DHS [1]
HUD	USAID	SBA		State
Interior	EPA	SSA		NASA
	Transportation			

[1] Balance Sheet and Custodial Statement Audit Only

The Financial Report of the U.S. Government is prepared from the audited financial statements of specifically designated Federal agencies, including the Cabinet Departments and many smaller, independent agencies (see organizational chart on the next page). For FY 2007, GAO has again issued an audit opinion 'disclaimer', as it has in each of the past eleven years, on the consolidated financial statements for the fiscal years ended September 30, 2007 and 2006. This means that sufficient information was not available for the auditors to determine whether the financial results were reliable. However, in FY 2007, 19 of 24 of the most prominent agencies earned unqualified opinions on the financial statement audits. FY 2007 also marks the first year that the Government earned an unqualified audit opinion on a Report component - - the Statement of Social Insurance (SOSI), indicating the auditor's opinion that the SOSI fairly presents the financial condition of the programs covered in that statement.

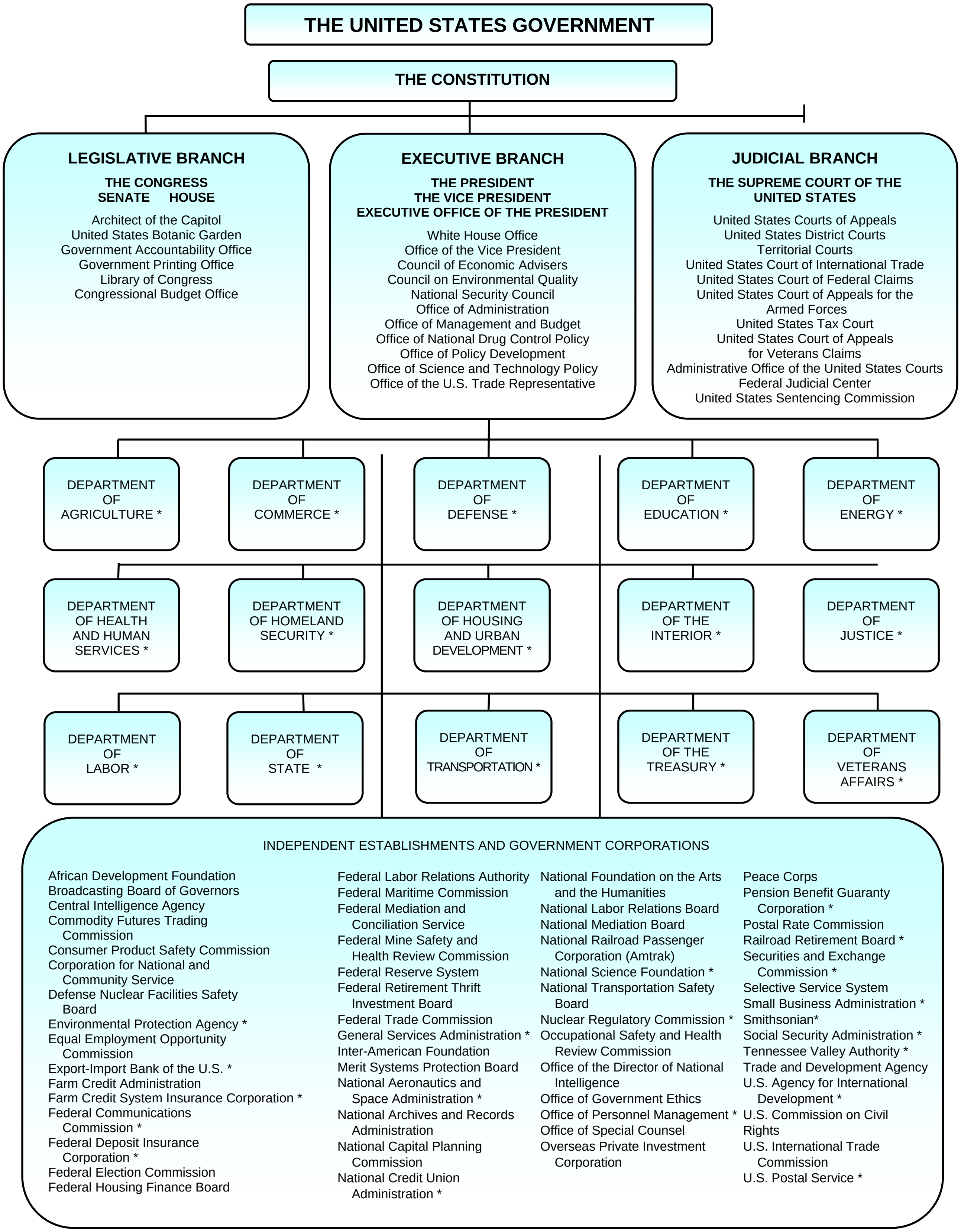
The fiscal year 2007 *Financial Report* consists of:

- Management's Discussion and Analysis (MD&A), which provides management's perspectives on and analysis of information presented in the Report, such as financial and performance trends;
- The principal financial statements and the related footnotes to the financial statements;
- Supplemental and Stewardship Information; and
- GAO's Audit Report.

Mission & Organization

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

The following chart provides an abbreviated overview of how the U.S. Government is organized.



The Government's Financial Condition

> ***What Does This Mean to Me?***
> **Gross Domestic Product (GDP)**. GDP is one of the ways to measure the size of an economy. The GDP is the total market value of all final goods and services produced within a country during a period of time (usually a calendar year).

A complete assessment of the Government's financial or fiscal condition requires analysis of historical results, projections of future revenues and expenditures, and an assessment of the long-term fiscal sustainability of programs and services. As discussed later in this Report, the Government's financial statements show its financial position at the end of the fiscal year, explain how and why the financial position changed during the year, and provide insight into how the Government's financial condition may change in the future. In particular, the Statement of Social Insurance (SOSI) compares the actuarial present value of the Government's anticipated future benefits expenditures to its expected collections (e.g., taxes and premiums) for Social Security, Medicare and other social insurance programs over a 75-year period. Expected expenditures, as well as future revenues for other major programs, including defense, Medicaid and education, while not presented in the SOSI, will also affect the Government's future fiscal condition.

The natural starting point for assessing the Government's long-term financial condition is its current financial position, both in absolute terms and in relation to the economy as a whole. Gross Domestic Product (GDP) measures the size of the Nation's economy in terms of the total value of all final goods and services that are produced in a year. It serves as a useful indicator of the economy's capacity to sustain the Government's many programs. For example, in fiscal year 2007:

- Offsetting cash-based Government expenditures of $2.7 trillion and receipts of $2.6 trillion (approximately 20 percent and 19 percent of GDP, respectively) yields the fiscal year 2007 unified budget deficit of $162.8 billion.
- The Government borrows from the public to finance the gap between expenditures and revenues (spending deficit). The accumulated value, including interest, of public debt was 37 percent of GDP at the end of fiscal year 2007.
- The social insurance programs and Medicaid have become a large share of Government expenditures. Forty years ago, Medicare, Medicaid and Social Security accounted for 16 percent of total Government expenditures. Today, they comprise 40 percent of all expenditures.

The following pages contain a more detailed discussion of the budget, the economy, and the debt, as well as a long-term view of the Government's ability to meet its social insurance obligations.

Budget Deficit vs. Net Cost

Table 3: Budget Deficit vs. Net Operating Cost

Dollars in Billions	2006	2007
Unified Budget Deficit	**$247.7**	**$162.8**
Unfunded Postemployment Programs	$187.2	$90.1
Increase in Environmental Liabilities	$45.4	$36.8
Capitalized Fixed Assets, Net	($20.8)	($13.5)
Other	($10.2)	($0.6)
Net Operating Cost	**$449.5**	**$275.5**

Each year, the Administration issues two reports that detail financial results for the Government. The ***President's Budget*** (Budget), the Government's primary financial planning and control tool, describes how the Government spent and plans to spend its money. By comparison, the accrual-based ***Financial Report of the United States Government*** (Report) includes the cost of operations, the sources used to finance those costs, how much the Government owns and owes, and the outlook for its social insurance programs.

The fiscal year 2007 unified budget deficit decreased $85 billion to $162.8 billion, the third consecutive annual decrease. The decrease was due almost entirely to a $186.5 billion increase in revenue. Net cost across agencies nearly broke even as the three largest increases ($103 billion at the Departments of Health and Human Services and Defense, and the Social Security Administration) almost entirely offset the four largest decreases ($109 billion at Departments of Agriculture, Education, Homeland Security, and Veterans Affairs). The Government's 2007 total Net Operating Cost was $275.5 billion, down $174.0 billion from 2006. The significant differences between these two measures are summarized in Table 1 and discussed further in the Financial Analysis section of this document.

The Economy in Fiscal 2007

Table 4: Economic Indicators

National Economic Indicators	FY 2006	FY 2007
Real GDP growth	2.4%	2.8%
Residential construction growth	-8.5%	-16.3%
Average monthly payroll job increase (thousands)	199	135
Unemployment rate (percent, end of period)	4.6%	4.7%
Consumer price index (CPI)	2.1%	2.8%
CPI, excluding food and energy	2.9%	2.1%
Treasury constant-maturity 10-year rate, (end of period)	4.7%	4.5%
Moody's Baa bond rate (end of period)	6.4%	6.6%

As noted in Table 4, U.S. economic growth edged up in fiscal year 2007, although quarterly figures were volatile and on average growth remained below the economy's potential. Growth was partly restrained by continued weakening in the residential homebuilding sector and a dramatic increase in financial turbulence as risk spreads widened sharply. Employment gains tapered off through the year, although the unemployment rate remained at low levels. Inflation was affected by swings in oil and gasoline prices, rising in the first half of the year and declining in the second half, and also by noticeable increases in food prices. Partly as a result of lower headline inflation in the second half, real wage growth picked up. Corporate profits remained relatively healthy. Federal tax receipts grew solidly in FY2007 and spending growth was modest, and, as a result, the Federal unified budget deficit fell to $163 billion, about 1.2 percent of GDP.

After rising at an annual average rate of 2.4 percent during fiscal year 2006, real GDP growth edged up to 2.8 percent over the four quarters of fiscal 2007. Growth was stronger in the second half of fiscal 2007, averaging over 4 percent. Residential fixed investment declined at double-digit rates in each of the fiscal year's four quarters, reflecting sharply weaker housing demand. Nonresidential fixed investment started the year on a decline but picked up in the second half.

The following discusses key points about economic performance in fiscal 2007.

- Consumer spending growth averaged a 2.9 percent annual rate during fiscal 2007. Spending was faster during the first half of fiscal 2007 but slowed in the second half. Still, the annual rate was faster than the 2.7 percent rise over the four quarters of fiscal 2006.
- Exports contributed more strongly to overall economic growth in fiscal 2007, growing by 10.2 percent, after rising 8.4 percent in fiscal 2006.
- Labor markets continue to be relatively robust (although growth in jobs slowed throughout the year). Nonfarm payroll employment expanded at an average rate of 135,000 jobs per month in fiscal 2007, down from the 199,000 average in fiscal 2006. Since the employment trough of August 2003, the economy has created more than 8 million new jobs.
- The unemployment rate declined to a 2007 low of 4.4 percent in March, but has since increased to 4.7 percent as of September.
- Overall inflation, as measured by the consumer price index (CPI) advanced 2.1 percent in fiscal 2006, then rose by 2.8 percent in fiscal 2007.
- Financial market turbulence over the summer reflected a repricing of risk in the sub-prime mortgage market. The uncertainty created by those difficulties prompted market participants to reappraise values of assets in a broader array of markets for equities, sovereign debt, and corporate debt.
    - A widening of spreads reflected this repricing of risk: for example, the spread between the Baa corporate bond yield and the comparable U.S. Treasury yield widened to a two year high in mid-September 2007.

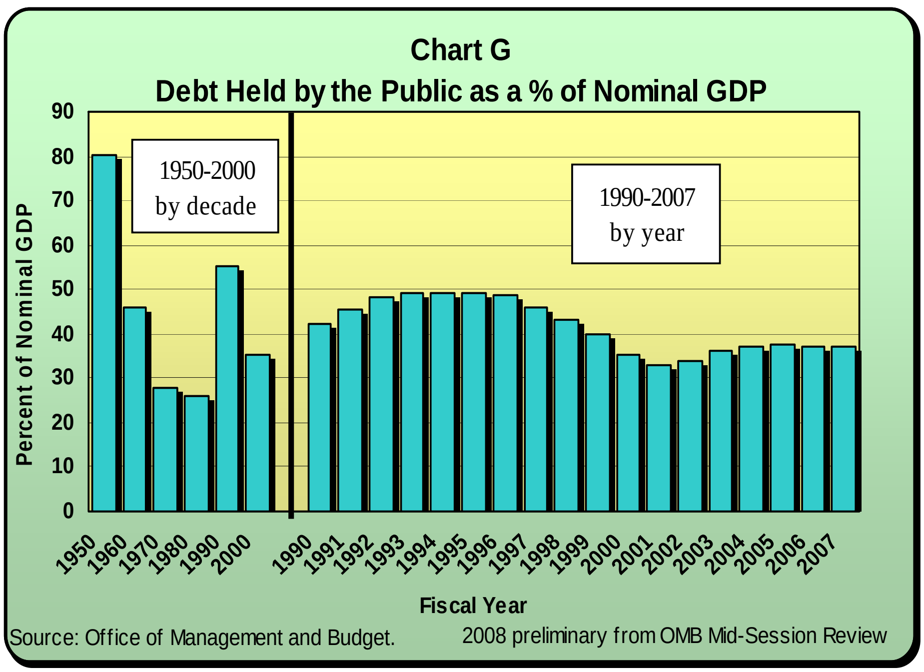
Federal Debt

As indicated earlier, the budget surplus or deficit is the difference between total Federal spending and receipts (e.g., taxes) in a given year. The Government borrows from the public (increases Federal debt levels) to finance deficits (spending in excess of receipts). During a budget surplus (receipts exceed spending), the Government typically uses those excess funds to reduce the debt borrowed from the public. Over time, the debt held by the public generally represents the total of all cash-based deficits minus all cash-based surpluses.

At the end of fiscal year 2007, the Government had incurred $9.0 trillion in debt, comprised of: debt held by (or owed to) the public (i.e., public debt) and intragovernmental debt (i.e., debt the Government owes to itself). Public debt (a balance sheet liability) includes all Treasury securities (e.g., bills, notes, and bonds) held by individuals, corporations, Federal Reserve banks, foreign governments, and other entities outside the Government. Intra-governmental debt is primarily held in the form of special nonmarketable securities by various parts of the Government. Laws establishing Government trust funds generally require excess trust fund receipts to be invested in these special securities. Intra-governmental debt is not shown on the balance sheet because claims of one part of the Government against another are eliminated for consolidation purposes (see Financial Statement Note # 10).

Gross Federal debt (with some adjustments) is subject to a statutory ceiling (i.e., the debt limit). Prior to 1917, the Congress approved each debt issuance. In 1917, to facilitate planning in World War I, Congress established a dollar ceiling for Federal borrowing, which has been periodically increased over the years (most recently from $9.0 trillion to $9.8 trillion in 2007). At the end of fiscal year 2007, the amount of debt subject to the limit was $8.9 trillion, $893.7 billion under the limit.

Public Debt as a Percentage of GDP

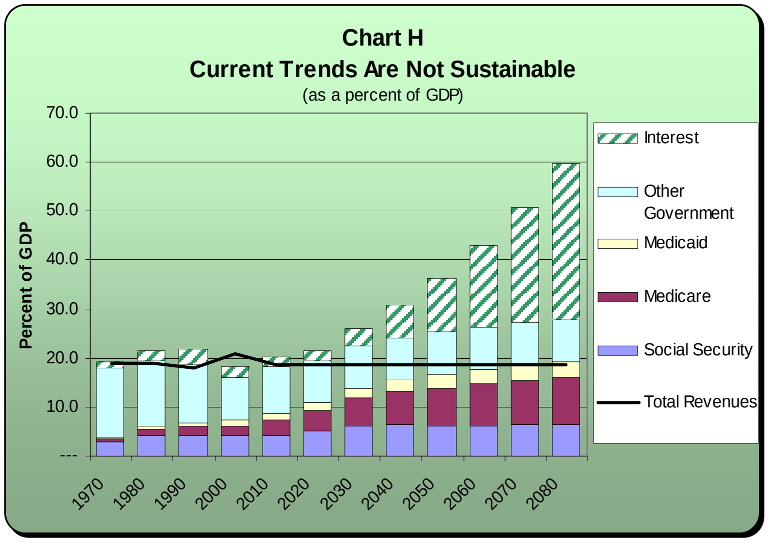


The Federal debt held by the public (public debt) as a share of GDP (Chart G) compares a country's debt level to the size of its economy over time. In the late 1970s, increasing budget deficits spurred an increase in public debt, which essentially doubled as a share of GDP over a 15-year period, reaching about 50 percent in 1993. The budget controls instituted by the Congress and the President, together with economic growth, contributed to declining deficits and emerging surpluses at the end of the 1990s. This improved fiscal performance led to a decline in the public debt, (from 43 percent of GDP to about 33 percent from 1998 through 2001). In fiscal years 2002 through 2004, the debt-to-GDP ratio started to rise slightly, due to many factors, including increased spending for homeland security and defense commitments, a decline in receipts owing to the recession and lower stock market value, tax cuts, and the expiration of the budget controls from the late 1990s. The public debt-GDP ratio has increased each year since 2001, peaking at 37.4 percent in 2004, and then gradually declining to 36.9 percent in 2007, still far below the roughly 50 percent ratio of the mid-1990s.

The Long-Term Fiscal Outlook

The Government's long-term financial condition will depend largely on two factors: the aging of the population, and the growth rate of future health care costs. Consider the following:

- The 78 million baby boomers (those born between 1946 and 1964) comprise one quarter of the Nation's population. Beginning in 2008, the first of the 'boomers' became eligible for early retirement benefits under Social Security. In just three years, they will start to become eligible for Medicare.
- Over the next 25 years, the share of the population aged 65 and older is forecast to *increase* from 12 percent to 20 percent (effectively increasing anticipated expenditures), while the share of the Nation's population that is working and paying taxes (anticipated revenue), will *decrease* from 60 percent to approximately 55 percent.
- Over the last three decades, Medicare spending has grown at more than twice the overall rate of economic growth and the Medicare Trustees assume that in the future Medicare expenditures will continue to outpace overall economic growth in the future.
- Social Security, Medicare, and Medicaid combined expenditures are projected to grow from 40 percent of total Government expenditures to more than 50 percent by 2030.
- Under current conditions, Government revenues will ultimately be sufficient to cover only 31 percent of anticipated expenditures.
- Chart H shows the Government's historical and projected long-term expenditures for Social Security and Medicare, as well as Medicaid, Interest on the Debt Held by the Public, and other purposes, and compares them to total projected revenue as a constant percent of GDP[2]



The projection that revenue as a percent of GDP will remain relatively constant in future years is based on historical data and trends that are not expected to change. Since World War II, Federal revenues as a share of GDP have been roughly constant at around 18 percent of GDP. Whenever taxes have risen above this range, policy actions have tended to pull them back.

Projections show that by 2070, total Government expenditures are projected to be 50 percent of GDP. Such levels of expenditures have only been witnessed once before, during World War II, when Government expenditures reached a record high of 44 percent of GDP. And by 2080, expenditures are projected to approach 60 percent of GDP. This would cause dramatic increases in deficit spending, and consequently, as explained later, Federal debt needed to finance them.

Much uncertainty surrounds the future of these programs and their impact on Government finances. Despite this uncertainty, projections such as these are critical to assessing whether future Government revenue will be sufficient to meet future expenses. At a glance, it is clear that the potential exists for these programs, particularly social insurance programs, to have a significant adverse impact on the Nation's future financial condition.

Social Insurance Trust Funds

Social Security:
- Old-Age and Survivors Insurance (OASI) pays retirement and survivors benefits,
- Disability Insurance (DI) pays disability benefits.

Medicare:
- Part A: Hospital Insurance (HI), which pays for inpatient hospital and related care.
- Part B: Supplementary Medical Insurance (SMI), which pays for physician and outpatient services
- Part D, SMI prescription drug benefit program.

[2] In this chart, expenditures for Social Security and Medicare are consistent with the SOSI, expenditures for Medicaid reflect Medicare cost growth rates and Social Security demographic projections, and expenditures for all other programs and tax revenue are assumed to grow at the same rate of growth as GDP. Supplemental appropriations are assumed to be phased out over the next ten years.

Social Insurance

For major 'social insurance' programs (e.g., Social Security, Medicare Parts A, B, and D), the Statement of Social Insurance (SOSI) reports: (1) the actuarial present value of all future contributions, tax, and other income, (excluding interest), received from or on behalf of current and future participants; (2) the estimated future scheduled expenditures paid to or on behalf of current and future participants; and (3) the estimated future excess of future expenditures over future contributions and tax income (excluding interest) . Amounts reported in the SOSI and in the supplemental information in this report are based on each program's official actuarial trust fund calculations.

The social insurance trust funds account for all related program income and expenses. Social Security and Medicare taxes, premiums, and other income are credited to the funds; fund disbursements may only be made for benefit payments and program administrative costs. Any excess revenues (surpluses) are invested in special non-marketable U.S. Government securities at a market rate of interest. The trust funds represent the accumulated value, including interest, of all prior program surpluses, and provide automatic funding authority to pay benefits.

As shown in Chart I, over the next two decades, Medicare and Social Security expenditures are projected to increase from their current 7 percent of GDP to about 13 percent. By 2080, they are projected to equal nearly 18 percent of GDP, only slightly less than the historical average of revenue from all sources (18.3 percent). Simply said, holding revenues constant, current spending will far exceed the Government's ability to pay.

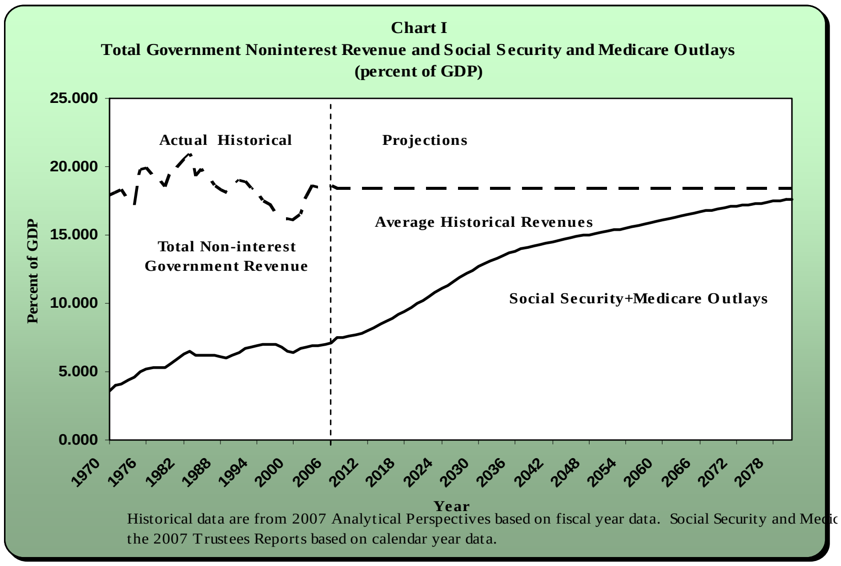


Chart I
Total Government Noninterest Revenue and Social Security and Medicare Outlays
(percent of GDP)

Historical data are from 2007 Analytical Perspectives based on fiscal year data. Social Security and Medic
the 2007 Trustees Reports based on calendar year data.

Unsustainable Debt

As noted earlier, the Government must borrow from the public to finance any gaps between expenditures and revenues. Increased borrowing leads to higher debt service (net interest) which in turn can make it more difficult to balance expenditures and revenues in the future. Chart J shows that by 2030, public debt is projected to rise to 68 percent of GDP, surpassing the non-wartime peak of 49 percent in 1993. By 2040, public debt is projected to be 128 percent of GDP, well above the World War II peak of 109 percent, and by 2080, debt is projected to approach 600 percent of GDP.

At some point before the debt reaches such unprecedented levels, the world's financial markets would likely cease lending to the United States. Although the precise point at which this would occur is unknown, these projected debt levels cannot be sustained indefinitely. Many economists believe that persistent debt / GDP levels over 100% are unhealthy. The U.S. is projected to surpass that mark within the next 30 years, with the debt/GDP ratio at that point on a continually and dramatically rising trajectory (more than 10 percentage points per decade through 2080). Avoiding the catastrophic consequences of this fiscal path will require action to bring program expenditures in line with available resources. How soon those actions are taken will greatly influence their ultimate impact on the Nation.

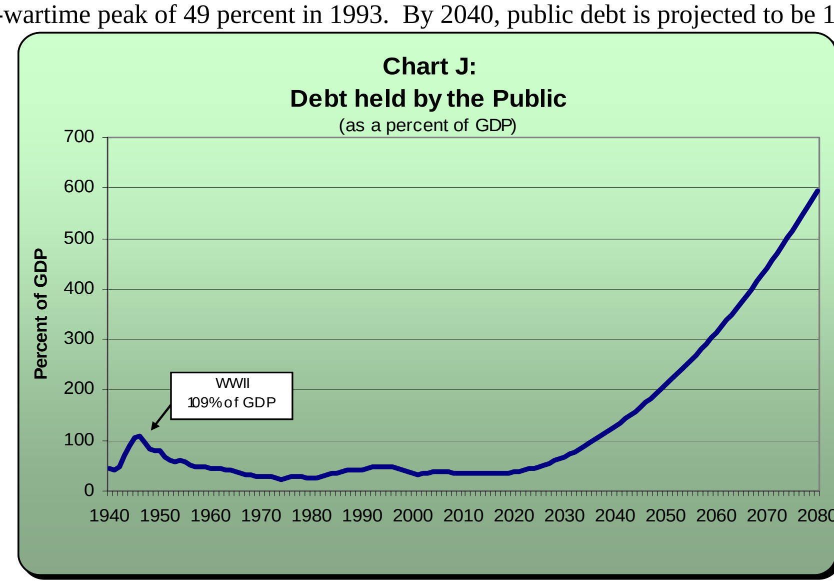


Chart J:
Debt held by the Public
(as a percent of GDP)

Financial Position and Results of Operations

This *Report* provides the results of the Government's financial operations, including its financial condition, revenues and costs, assets and liabilities, and other obligations and commitments. This information, when combined with the President's Budget, collectively provides a valuable tool for managing current operations and planning future initiatives.

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*, whose main purpose is to provide a prospective discussion of future initiatives and the resources needed to support them; and this *Financial Report*, which provides the President, Congress, and the American people a broad, comprehensive overview of the cost on an accrual basis of the Government's operations, the sources used to finance them, its balance sheet, and the outlook for its social insurance programs.

President's Budget	Financial Report of the U.S. Government
Prepared on a '*cash basis*' • Initiative-based: focus on current and future initiatives planned and how resources *will be used* to fund them. • Receipts ('cash in'), e.g federal income tax received, National Park fees collected , • Outlays ('cash out'), e.g., defense spending, benefit checks sent.	Prepared on an '*accrual basis*' • Retrospective – prior and present resources used to implement initiatives. • Revenue: recognized when earned, but not necessarily received. • Costs: recognized when owed, but not necessarily paid.

Treasury prepares the financial statements in this Report on an 'accrual basis' of accounting (i.e., recognizing revenues when earned, some of which has not yet been received; and costs when incurred, not paid) as prescribed by U. S. generally accepted accounting principles (GAAP) for Federal entities.[3]

These standards are tailored to the Government's unique characteristics and circumstances. For example, agencies prepare a uniquely structured 'Statement of Net Cost,' which is intended to present net Government resources used in its operations, instead of an 'Income Statement,' which private sector companies typically use to focus on profits earned. Also unique to Government is the preparation of separate statements, to reconcile differences and articulate the relationship between budget and accrual accounting results (e.g., Statement of Reconciliation of Net Operating Revenue (or Cost) and Unified Budget Deficit).

Reporting Entity

These financial statements conceptually cover the three branches of the Government (legislative, executive, judicial). Legislative and judicial branch reporting focuses primarily on budgetary activity. Only executive branch entities are required, by law, to prepare audited financial statements. Some legislative branch entities do, however, voluntarily submit financial reports.

A number of Government entities and organizations are excluded due to the nature of their operations, including the Federal Reserve System (an independent entity that serves both public and private purposes); the Federal Retirement Thrift Investment Board; fiduciary funds owned by Federal employees; and government-sponsored but privately-owned enterprises, including the Federal Home Loan Banks, the Federal National Mortgage Association, and the Federal Home Loan Mortgage Corporation. A list of the significant agencies and entities contributing to this report is included in the Appendices.

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). These statements are in addition to the financial reports used to monitor and control budgetary resources that are prepared from the same books and records.

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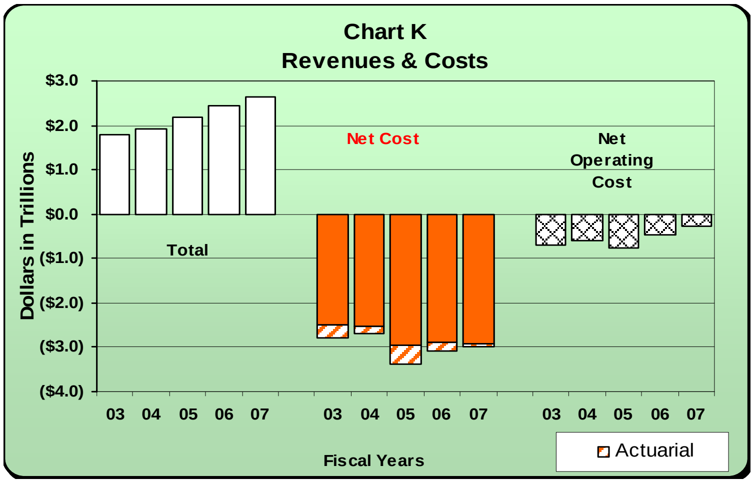
[3] Under GAAP, most U.S. Government revenues are recognized on a 'modified cash' basis, or when they become measurable.

Determining the Government's Net Position: "Where We Are"

The Government's financial position and condition have traditionally been expressed through the Budget, focusing on the impact of surpluses and deficits. However, this primarily cash-based discussion of the Government's net outlays (deficit) or net receipts (surplus) tells only part of the story. The Government's net position is driven simultaneously by the Government's revenues and expenses, as well as the changes in its assets and liabilities.

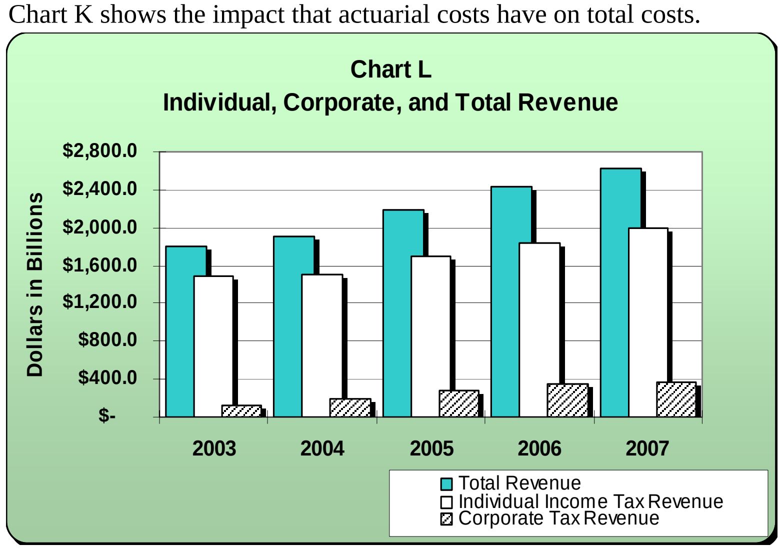
Revenues and Costs: "What Came In & What Went Out"



The Government's ***Statement of Operations and Changes in Net Position***, much like a corporation's income statement, shows the Government's 'bottom line'. Chart K shows that the Government has incurred a total net operating cost (i.e., costs have exceeded its revenues) over the past several years. The Government's revenues last exceeded its costs in fiscal years 1999 and 2000 in concert with the budget surplus.

The Government nets its costs against both earned revenues from Government programs (e.g., Social Security withholdings, national park entry fees) and taxes, which account for the vast majority of total revenues. In addition, the Government distinguishes revenues that are earmarked for specific purposes (e.g., Medicare premiums) from those for general purpose spending. The Government's 'bottom line' is its net operating cost, or total costs in excess of revenues. The Government must issue debt to finance any costs as they are paid that cannot be covered by revenues, subject to the statutory debt limit.

The ***Reconciliation of Net Operating Cost and Unified Budget Deficit Statement*** shows how the Government's net operating cost relates to the more widely-known budget deficit. Most of this difference is attributable to accruals of actuarial costs for the estimated present value of the Federal Government's future postemployment benefit payments.. Chart K shows that the Government's total net cost includes an 'actuarial' element (e.g., the estimated annual change in long-term postemployment benefit liabilities). These actuarial costs, in recent years, have accounted for the vast majority of the difference between the primarily cash-based budget and the primarily accrual-based financial reports. Chart K shows the impact that actuarial costs have on total costs. Changes in assumptions used to project actuarial costs, such as interest rates and the Department of Veterans Affairs (VA's) annual estimates of veterans' compensation and burial benefits, can cause those projections, and consequently total costs, to fluctuate year to year.



Revenue: "What Came In"

The ***Statement of Net Costs*** reports 'earned' revenue generated by Federal programs. In fiscal year 2007, more than 20 percent of these revenues were attributable to Medicare premiums paid by program participants. The ***Statement of Operations and Changes in Net Position*** shows the Government's taxes and other revenues (i.e., revenues other than 'earned'). A combination of solid economic growth and improved corporate tax yields have contributed to revenue growth of nearly 50 percent since 2003. Personal income and corporate profits before tax rose 6.2 percent and 6.7 percent, respectively in 2007 [4], and have increased by an average of 5.3 percent and 14.2 percent per year, respectively, since fiscal year 2001, including revenue decreases in 2001and 2002. These trends, in part, contributed to an increase in taxes and other revenues to a new record high (see Table 5).

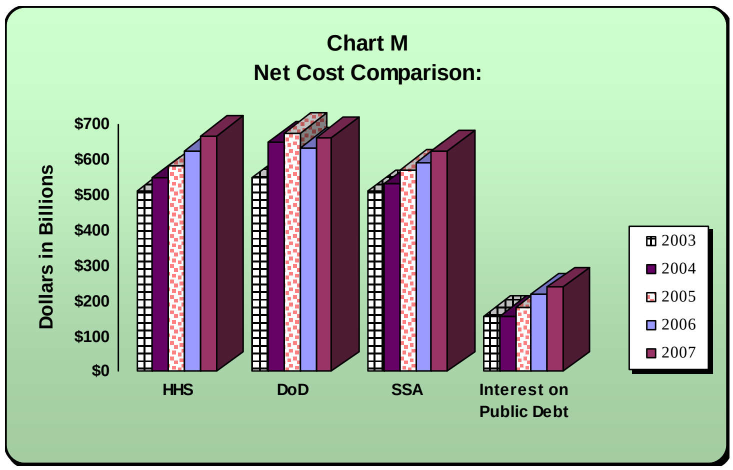
Table 5: Revenues

Dollars in Billions	2006	2007	Increase (Decrease) $	Increase (Decrease) %
Taxes & Other Revenue	**$2,440.8**	**$2,627.3**	**$ 186.5**	**7.6%**
Individual Tax Revenue	$1,846.1	$1,999.8	$ 153.7	8.3%
Corporate Tax Revenue	$350.0	$367.2	$ 17.2	4.9%
Other Revenue	$244.7	$260.3	$ 15.6	6.4%

Chart L and Table 5 show that individual and corporate income tax revenues account for the majority (nearly 90 percent) of total revenues. In 2007, the Government collected $2.6 trillion. Cash collections have increased by an average of $200 billion per year since 2003, contributing to a reduction of both the budget deficit and net operating cost.

Cost: "What Went Out"

The ***Statement of Net Cost*** also shows how much it costs to operate the Federal Government, recognizing expenses when they happen, regardless of when payment is made (accrual basis). It shows the derivation of the Government's net cost of operations or the difference between costs of goods produced and services rendered by the Government during the fiscal year. This amount, in turn, is offset against the Government's taxes and other revenue in the ***Statement of Operations and Changes in Net Position*** to calculate the 'bottom line' or net operating cost.



In fiscal year 2007, the Government's 'bottom line' net operating cost totaled $275.5 billion, a nearly 40 percent reduction from 2006, when total costs exceeded revenues by $449.5 billion. Table 6 shows that, along with interest on debt held by the public, the source of two-thirds of the Government's costs in FY 2007 comes from three Federal entities: the Departments of Health and Human Services (HHS), Defense (DoD), and the Social Security Administration (SSA). Chart M shows that HHS and DoD have incurred the largest agency shares of the Government's total net cost of operations in recent years, mostly attributable to the continued global war on terror and changes in actuarial liabilities related to Military

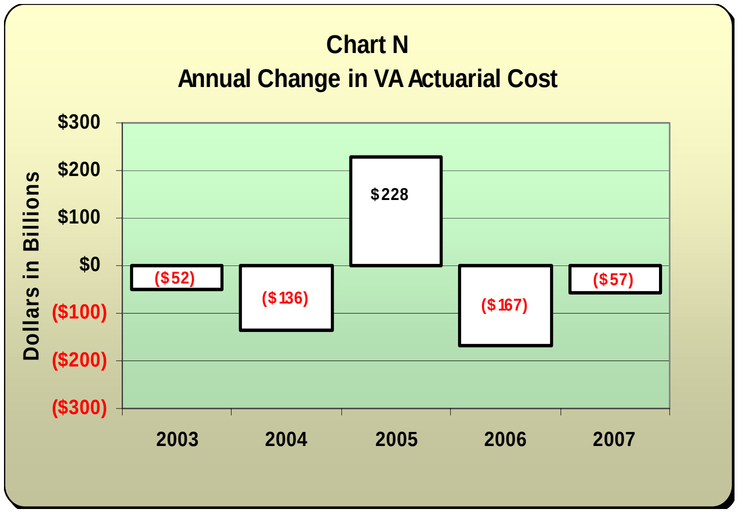
Table 6: Gross and Net Cost

Dollars in Billions	2006	2007	Increase (Decrease) $	Increase (Decrease) %
Gross Cost				
HHS	$ (678.8)	$ (718.6)	$ (39.8)	5.9%
DoD	$ (658.0)	$ (689.6)	$ (31.6)	4.8%
SSA	$ (593.1)	$ (626.4)	$ (33.3)	5.6%
Interest on Federal Debt	$ (221.5)	$ (238.9)	$ (17.4)	7.9%
Other Federal Agencies	$ (976.3)	$ (883.8)	$ 92.5	-9.5%
Total Gross Cost	**($3,127.7)**	**($3,157.3)**	**$ (29.6)**	**0.9%**
Less: Earned Revenue	$226.4	$247.8	$ 21.4	9.5%
Net Cost	**($2,901.3)**	**($2,909.5)**	**$ (8.2)**	**0.3%**
Less: Taxes & Other Revenue	$ 2,440.8	$ 2,627.3	$ 186.5	7.6%
Net Operating Cost [1]	**($449.5)**	**($275.5)**	**$ 174.0**	**-38.7%**

[1] Net Operating Cost includes adjustment for Unreconciled Transactions

[4] Personal income and corporate profit statistics sources: National Income and Products Account Tables, Bureau of Economic Analysis, Department of Commerce.

Retirement Fund and Health Benefits. HHS and SSA combine to make up nearly half of the 2007 total net cost of operations, the bulk of which are attributable to these agencies' administration of the Government's major social insurance programs, e.g., Social Security and Medicare. The ***Statement of Social Insurance*** (SOSI) and the related information in this report discuss the current costs and future sustainability of these programs in greater detail. Among cabinet agencies, the Department of Housing and Urban Development (HUD) experienced the greatest percentage increase in its net cost (+ 26.4 percent), while VA experienced the greatest cost decrease (- 47.8 percent). Both changes resulted from each agency's need to estimate future costs and liabilities based on complex assumptions and cost models. HUD's cost increase, in large part, stems from the annual reestimation of long-term credit program costs, which can be impacted by both performance and economic factors[5]. Similarly, VA considers several variables (e.g., number of eligible recipients, discount rates, and life expectancy) in estimating its actuarial liability for future veterans' compensation benefits. Because a small change in key assumptions produces the large actuarial cost fluctuations shown in chart N, reported annual VA actuarial costs are not useful in predicting future annual costs. The change in VA's actuarial costs from year to year accounts for the majority of the change in the Government's total actuarial cost in most years (nearly 60 percent in 2007). In turn, in 2007, the net decrease in total actuarial costs accounted for nearly 60 percent of the $174.0 billion decrease in total net operating cost.



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

Net Position at the end of the year can also be derived by netting the Government's assets against its liabilities, as presented in the ***Balance Sheet***. It is important to note that the balance sheet does not include the financial value of the Government's sovereign powers to tax, regulate commerce, and set monetary policy. It also excludes its control over nonoperational resources, including national and natural resources, for which the Government is a steward. As noted earlier, the Government distinguishes between resources and spending that are earmarked for specific purposes versus those intended for general purposes. In 2007, earmarked funds accounted for less than 6 percent of the Government's total Net Position. In addition, as was the case with the ***Statement of Operations and Changes in Net Position***, the ***Balance Sheet*** does include a separate presentation of the portion of net position earmarked for specific funds and programs (e.g., Social Security, Medicare, Unemployment, National Flood Insurance, and Land and Water Conservation). Moreover, the Government's exposures are broader than the liabilities presented on the balance sheet, including such items as the Government's future social insurance exposures (e.g., Social Security and Medicare), as well as other commitments and contingencies. These exposures are discussed in this section as well as in the supplemental disclosures of this Report.

Table 7: Assets and Liabilities

Net Position Dollars in Billions	2006	2007	Increase (Decrease) $	Increase (Decrease) %
Assets	**$ 1,496.5**	**$ 1,581.1**	$ 84.6	5.7%
Less: Liabilities, comprised of:				
Debt to the Public	$ 4,867.5	$ 5,077.7	$ 210.2	4.3%
Federal Employee & Veterans Benefits	$ 4,679.0	$ 4,769.1	$ 90.1	1.9%
Other Liabilities	$ 866.4	$ 940.1	$ 73.7	8.5%
Total Liabilities	**$ 10,412.9**	**$ 10,786.9**	$ 374.0	3.6%
Net Position (Assets Net of Liabilities)	**$ (8,916.4)**	**$ (9,205.8)**	**$ (289.4)**	**3.2%**

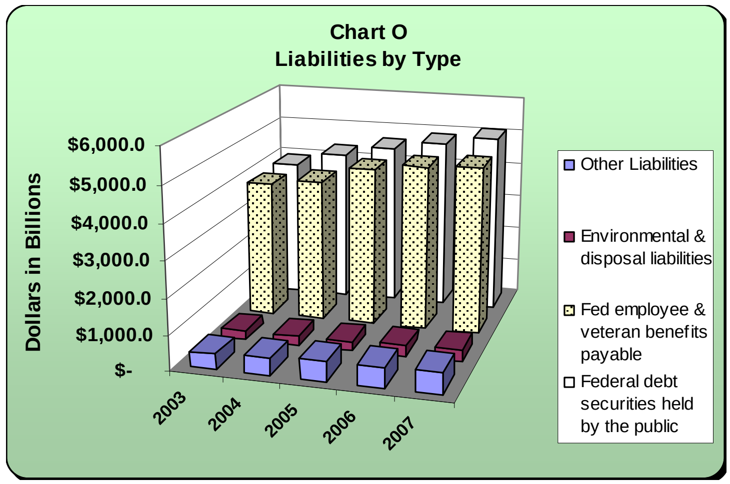
[5] FY 2007 Department of Housing and Urban Development Performance and Accountability Report, p. 72.

Assets – "What We Own"

During 2007, nearly all Government asset balances increased. Net property, plant, and equipment ($691.1billion in FY 2007) has been the Government's largest asset over the past several fiscal years, accounting for more than 40 percent of $1,581.1 billion in total assets in 2007. In addition, the Government owns certain other assets such as stewardship land (e.g., national parks and forests) and heritage assets (e.g., national memorials, historic structures).

Liabilities – "What We Owe"

Chart O and Table 7 show the major components of liabilities, or what the Government owes, as of September 30, for fiscal years 2003 through 2007. The largest liability in recent years has been Federal debt held by the public and accrued interest, the balance of which increased to $5,077.7 billion in 2007. The increase in tax revenues enabled the Government to borrow a smaller amount of cash from the public this year. Over the past seven fiscal years, Federal debt securities held by the public and accrued interest have moved in tandem with the budget results.



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

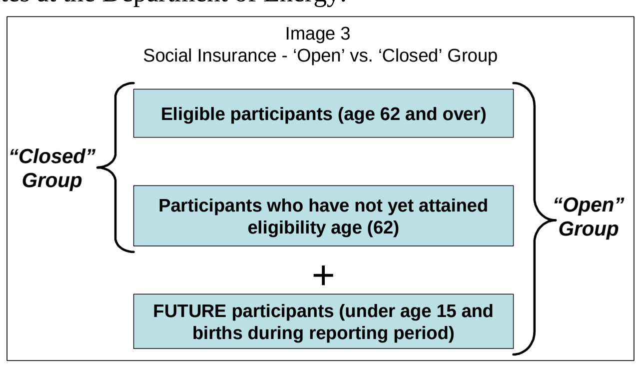
The Government's net borrowings from the public increased by $206.3 billion in fiscal year 2007 and by a combined $740 billion in the past three years to help finance just over 100% of the budget deficit during that time. Typically, budget surpluses have resulted in borrowing reductions, and budget deficits have yielded borrowing increases. However, the Government's debt operations are much more complex than this would imply. Each year, trillions of dollars of debt matures and new debt takes its place. In 2007, new borrowings were $4.5 trillion and maturing debts repaid were $4.3 trillion.

Federal employee postemployment and veteran benefits payable have increased dramatically in recent years, more than 80 percent since fiscal year 1999, to $4,769.1 billion as of fiscal year-end, 2007 (representing nearly half of the Government's total reported liabilities in recent years), with civilian benefits payable accounting for more than a third of total employee and veteran benefits. The Office of Personnel Management (OPM) administers the largest civilian pension plan, covering about 90 percent of all Federal civilian employees, including nearly 2 million current employees and 2.4 million annuitants[6]. The military pension plan covers nearly 3 million current employees (including active service, reserve and national guard, and civilians) and approximately 2 million annuitants[7].

Environmental and disposal liabilities increased $36.8 billion to $342.0 billion in 2007, mainly due to the increases in environmental management baseline estimates at the Department of Energy.

The Government's Exposures: What Lies Ahead

The SOSI provides additional perspective on the Government's long term estimated exposures and costs. However, it should be noted that the Government's financial statements do not reflect future costs implied by any current policy, such as national defense, the global war on terrorism, and disaster recovery. For the 'social insurance' programs (e.g., Social Security, Medicare Parts A, B, and D), ***the Statement of Social Insurance (SOSI)***



[6] OPM FY 2007 Performance and Accountability Report, p. 1.
[7] DoD FY 2007 Agency Financial Report, p. 5

shows the estimated future scheduled benefit expenses net of contributions and tax income (excluding interest), based on each program's actuarial trust fund report.

Table 8 shows estimated net social insurance and other exposures for both the 'open-group' and 'closed-group' population, which differ based on the population measured. As shown in Image 3, the 'closed group' pertains to individuals age 14 and over on January 1 of the valuation year and/or those who have met or will meet other eligibility requirements during the projection period (typically 75 years). In short, it represents an estimate of the responsibility, under current law, of future taxpayers to pay benefits to current participants. By comparison, the 'open group' is comprised of workers who will enter covered employment during the period, as well as those already in covered employment at the beginning of that period. That is, it represents the 'closed group' *plus* all *future* projected participants who will make contributions to postemployment benefit plans and/or will be eligible for benefits over the 75-year projection period). Since the open group's contributions will significantly exceed benefits earned during the projection period, it can be expected that the net social insurance benefits for the open group ($40,948 billion in 2007) would be less than that for the closed group ($45,062 billion).

Table 8: Long-Term Exposures Compared to Net Position

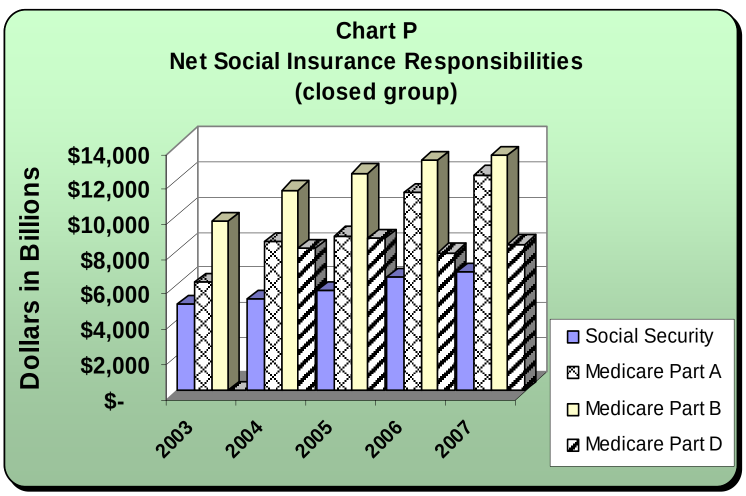
Billions of Dollars	2006	2007	Increase (Decrease) $	%
Closed Group (Net):				
Social Security	$ (14,976)	$ (16,265)	$ (1,289)	8.6%
Medicare:			$ -	
Part A	$ (12,153)	$ (12,044)	$ 109	-0.9%
Part B	$ (10,630)	$ (10,347)	$ 283	-2.7%
Part D	$ (6,257)	$ (6,273)	$ (16)	0.3%
Subtotal - Medicare	$ (29,040)	$ (28,664)	$ 376	-1.3%
Other	$ (131)	$ (133)	$ (2)	1.8%
Total Social Insurance Exposures, Net (Closed Group)	**$ (44,145)**	**$ (45,062)**	**$ (917)**	**2.1%**
Total Social Exposures, Net (Open Group)	$ (38,851)	$ (40,948)	$ (2,097)	5.4%
Net Position				
Assets	$ 1,497	$ 1,581	$ 85	5.7%
Liabilities	$ 10,413	$ 10,787	$ 374	3.6%
Net Position	**$ (8,916)**	**$ (9,206)**	**$ (289)**	**3.2%**

Although not included in Table 8, nor shown on the balance sheet, the Government incurs other exposures, such as contingencies for unadjudicated claims and commitments for long-term leases. Details of these exposures may be found in Notes 18 and 19 to the financial statements.

This forward-looking information combined with other financial statements and information provides both a short- and long-term view of significant financial issues facing the Government. As indicated above, however, it should be noted that significant differences exist between balance sheet liabilities and the exposures from the SOSI, which limit their comparability:

- The ***Balance Sheet*** presents a 'snapshot' at a point in time of an entity's *current* financial condition, with an emphasis on how current and prior actions and events have impacted its assets and liabilities.
- The ***SOSI*** presents the calculated net present value of *future* estimated revenues and expenditures over an extended period. They represent an assessment of the extent to which the social insurance programs are out of balance under current financing arrangements relative to scheduled benefit obligations. Since they are not liabilities, and therefore do not impact either an entity's current assets or liabilities, they are not included on the balance sheet according to Federal accounting standards.

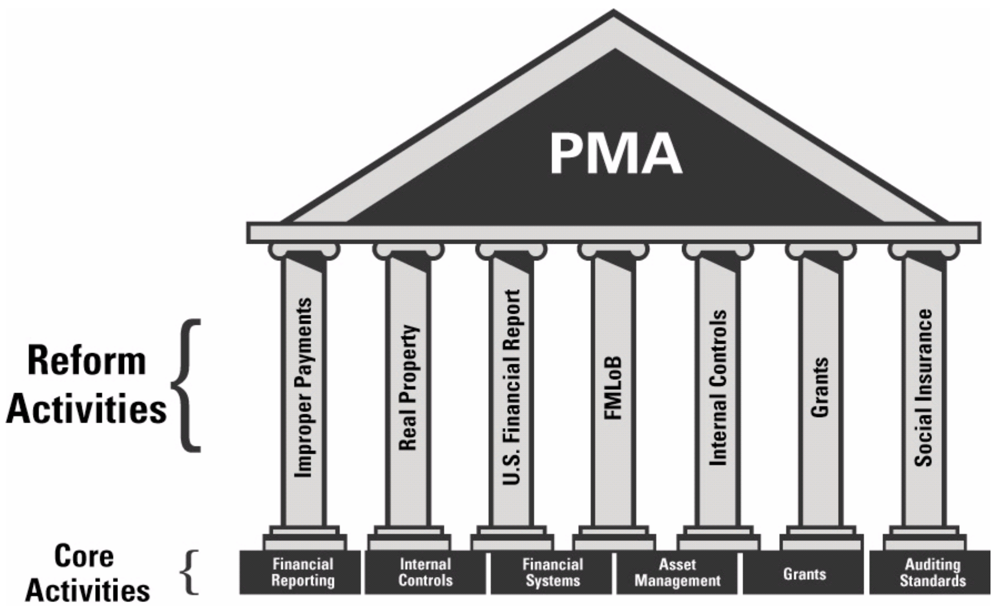
While comparability of liabilities to 'other exposures' is limited, their significance can be analyzed in other contexts. For example, Table 8 also compares the Government's current net position ($9,205.8 billion net liability) to its estimated future social insurance exposures. While these exposures are currently not considered Government liabilities, they do have the potential to become liabilities in the future. As discussed earlier, the foreseeable future suggests an unsustainable fiscal path. Difficult choices will be necessary in order to address their large and growing long-term fiscal gap. Delay is costly and choices will be more difficult.



The President's Management Agenda: How We Define and Measure Financial Management Success

Launched in August 2001, the President's Management Agenda (PMA) provides Federal agencies with a concise set of clear and measurable financial management performance goals that allow Federal managers, Congress, and the public to gauge whether taxpayer funds are being properly accounted for and wisely spent. These performance measures include, among others, the achievement of clean audit opinions, the elimination of material weaknesses in internal control, timely financial reporting, the disposal of excess real property, the elimination of improper payments, and the reduction in government costs through the strategic use of financial data. What follows is an overview of fiscal year 2007 results for three of the seven Government-wide PMA initiatives: 1) Improving Financial Performance, 2) Eliminating Improper Payments, and 3) Real Property Asset Management.[8]

These initiatives are managed by the Office of Management and Budget's (OMB's) Office of Federal Financial Management (OFFM). OFFM has also developed a "Framework for Improving Financial Performance" to provide direction and clarity on how these financial management improvement goals will be met. The Framework (as depicted in the below diagram) is intended to provide the public with a simple tool for identifying: 1) the ultimate objective (or "apex") of the Government's financial management improvement efforts (i.e., the financial management goals of the ***PMA***); 2) the priority projects currently underway in the Federal financial community to help support and facilitate PMA goals (i.e., current Government-wide financial management ***reform activities***); and 3) the day-to-day financial management activities or ***core activities*** that help ensure a strong foundation is in place for achieving the PMA's success.



The Framework is also described in OFFM's 2007 Federal Financial Management Report that was submitted to the Congress on January 31, 2007. The most recent reports are available at http://www.whitehouse.gov/omb/financial/reports. Also visit http://www.Results.gov and http://www.ExpectMore.gov for additional information on the PMA initiatives, including individual agencies' performance under these initiatives, and agencies' performance under their individual programs.[9]

8 The other four initiatives are: 1) Implementing Strategic Human Capital, 2) Gaining Efficiencies through Strategic Sourcing, 3) Expanding Electronic Government, and 4) Budget and Performance Integration.

9 Since programs are not administered at the Government-wide level, the FASAB requirement to report performance goals and measures for the Federal Government as a whole does not apply and, therefore, is not reported upon here. Program administration and the subsequent reporting of the outcomes and results of those programs are handled at the agency level.

Fiscal Year 2007 Results

Improving Financial Performance

For the third year in a row, **all** major Federal agencies successfully met the 45-day financial audit deadline as required by the rigorous reporting guidelines set by the Office of Management and Budget (OMB). Since 2001, agencies are required to complete the financial report 45-days after the end of the fiscal year, compared to the previous five month (150 days) window for completion. The accelerated deadline results in more immediate availability of financial information to agency decision-makers and requires agencies to employ rigorous disciplines throughout the year to ensure readiness for year-end reporting.

In addition to timely reporting, the results from fiscal year 2007 show that the Federal Government is improving the validity of its financial information. Of the 24 major Federal agencies, 19 received clean opinions, one more than the 18 clean opinions reported last year at this time. Although five agencies—DHS, DoD, DOT, EPA, and NASA—restated their fiscal year 2006 financial statements, their audit opinions for fiscal year 2007 either remained the same or improved. Table 9 below includes the audit results for fiscal year 2007.

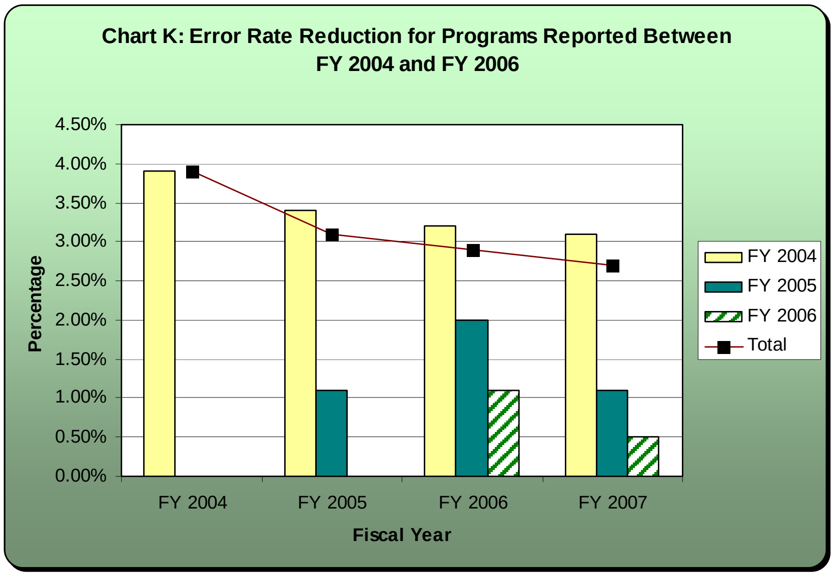
Table 9: Summary of FY 2007 Financial Statement Results by Agencies

CFO Act Agencies:	*FY 2007 Audit Opinion*
Department of Agriculture (USDA)	Qualified
Department of Commerce (DOC)	Unqualified
Department of Defense (DOD)	Disclaimer
Department of Education (Education)	Unqualified
Department of Energy (DOE)	Unqualified
Department of Health and Human Services (HHS)	Unqualified
Department of Homeland Security (DHS)	Disclaimer
Department of Housing and Urban Development (HUD)	Unqualified
Department of the Interior (DOI)	Unqualified
Department of Labor (DOL)	Unqualified
Department of Justice (DOJ)	Unqualified
Department of State (State)	Disclaimer
Department of Transportation (DOT)	Unqualified
Department of the Treasury (Treasury)	Unqualified
Department of Veterans Affairs (VA)	Unqualified
Agency for International Development (USAID)	Unqualified
Environmental Protection Agency (EPA)	Unqualified
General Services Administration (GSA)	Unqualified
National Aeronautics and Space Administration (NASA)	Disclaimer
National Science Foundation (NSF)	Unqualified
Nuclear Regulatory Commission (NRC)	Unqualified
Office of Personnel Management (OPM)	Unqualified
Small Business Administration (SBA)	Unqualified
Social Security Administration (SSA)	Unqualified

In addition to these results, the total number of material weaknesses Government-wide declined from 41 to 39. This is the fourth year in a row that material weaknesses have declined, with a more than 35% decrease in weaknesses since 2001. In fiscal year 2007, five additional agencies received a clean opinion with no material weaknesses, including the Departments of Justice, the Interior, Energy, the Small Business Administration and the U.S. Agency for International Development. This brings the total number of agencies realizing this important accomplishment to 13, up from just seven in 2001. The decrease in weaknesses this year is more notable in light of recent changes to government audit guidelines that lower materiality thresholds and have the effect of characterizing more audit findings as "material weaknesses."[10] In other words, while auditing standards are getting tougher, Federal agencies are more than keeping pace by continuing to decrease the number of material findings.

Eliminating Improper Payments

Fiscal Year 2007 was also an important year for the initiative of identifying, measuring, and eliminating improper payments (e.g., the right amount, to the right recipient). Full transparency of annual improper payment totals allows the public to understand the extent of payment errors and assess the Government's efforts to eliminate them. With this year's financial reports, Federal agencies are now reporting improper payment measurements for nearly 86% of all high-risk outlays (up from 81% in fiscal year 2006), with error rates reported on 13 new programs, including the Medicaid Fee-for-Service and School Lunch programs.



The results from the past three years of reporting on improper payments demonstrate that once an agency has measured and reported program errors, it is able to implement corrective actions to reduce those errors in subsequent years. As illustrated in Chart K,[11] Error Rate Reduction for Programs Reported Between FY 2004 and FY 2006, the error rate for the first programs measured, in fiscal year 2004, was 3.9% (or $45.1 billion in improper payments). For these programs, the error rate has declined to 3.1% (or a $7.9 billion reduction in improper payments). Similar to the progress achieved in programs that first reported in fiscal year 2004, programs that first reported in fiscal years 2005 and 2006 have seen improper payments cut in half, representing a $2.3 billion reduction.

With 13 additional programs reporting in fiscal year 2007, the preliminary Government-wide error rate increased to 3.5% or $54.9 billion. The cause of the majority of the errors in these 13 new programs is insufficient documentation, meaning that all of the supporting documentation necessary to verify the accuracy of the claim was not provided. If all the supporting documentation had been received, the agencies could have better determined whether the payment was appropriate or made in error. As has been the case in other programs, it is anticipated that the errors in these 13 programs will decrease significantly after correcting the root cause of the insufficient documentation errors.

Asset Management

Under the PMA Real Property Asset Management initiative, agencies continue to make significant progress implementing the necessary tools to manage the size, condition, and costs of their asset portfolios and comply with Executive Order 13327, Federal Real Property Asset Management. In fiscal year 2007, Executive agencies reported more than 1.2 million assets, including land, buildings, and structures, to the Government-wide real property inventory, which provides a more complete picture of the Government's asset inventory; where the assets are located; and how and whether the assets are being used effectively to help serve agencies' missions and objectives. Having a more complete inventory picture and performance information means that agencies, and the Government as a whole, can make smarter asset management decisions. Agencies are moving forward with improving asset condition, increasing asset utilization, and disposing of unneeded assets.

10 Statement of Auditing Standards 112, *Communicating Internal Control Related Matters Identified in an Audit*

11 The table does not include programs reporting for the first time in FY 2007.

The Administration continues holding agencies accountable for their asset management goals through the PMA process. Since fiscal year 2004, agencies have shown significant improvement in their asset management processes and their ability to gather and use inventory and performance data to drive the decision-making process toward rightsizing the Government's real property assets. To this end, Executive agencies have disposed of more than $4.5 billion in real property assets and are well on the way to meeting the Administration's goal of disposing $9 billion in assets by the close of fiscal year 2009.

Systems, Controls, & Legal Compliance

Systems

As Federal agencies have continued to demonstrate success in obtaining and keeping unqualified opinion on their audited financial statements, the Federal Government continues to face challenges in implementing financial systems that meet Federal requirements. In fiscal year 2007, however, there was some progress in agencies implementing and maintaining these complex systems. The number of agencies in compliance with the Federal Financial Management Improvement Act (FFMIA) increased to 13 from 8 compared to last year.

The cause for the recent progress is mainly attributable to the Financial Management Line of Business (FMLoB) initiative. It is intended to help agencies implement financial systems that are complaint with Federal requirements and to improve the cost, quality, and performance in the Government's financial management systems by leveraging shared solutions and implementing Government-wide reforms that improve efficiency of financial operations. OMB expects this initiative to help agencies meet Federal standards and achieve efficiencies, while delivering cost savings to the tax payers.

Multiple FMLoB initiative are underway that will collectively make these improved results possible, including standardizing common business processes across the Government, creating opportunities for agencies to move financial systems to shared service providers, and increasing transparency by establishing performance measures to evaluate the results of these efforts. Through the FMLoB and other information-sharing initiatives, 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

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 through three objectives: effective and efficient operations, reliable financial reporting, and compliance with applicable laws and regulations. The safeguarding of assets is a subcomponent of each objective.

Law/Policy	What it Does
Federal Managers' Finanical Integrity Act of 1982	requires the head of each executive agency to annually prepare a statement reporting the effectiveness of the agency's internal control and whether its systems comply with the federal financial system requirements.
Federal Financial Management Improvement Act of 1996	ensuring that Federal financial management systems provide accurate, reliable, and timely financial management information to the government's managers.
OMB Circular A-123	provides instruction to agencies in implementing the **FMFIA**
OMB Circular A-127	provides instruction for complying with the federal financial system requirements.

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

In fiscal year 2007, agencies continued to implement the requirements of FMFIA and the A-123 and have made much progress. The 24 major CFO Act agencies completed the second year of the more rigorous assessment of the internal control over financial reporting as required by the A-123 Appendix A. Furthermore, pursuant to the A-123 Appendix C, federal agencies are now reporting improper payment measurements for nearly 86% of all high-risk outlays and reported error rates for 13 new programs (see Eliminating Improper Payments section for more details).

During fiscal year 2008, OMB will facilitate a forum on the better integration and leverage of internal control reviews being performed throughout departments and agencies through the exploration of alternate frameworks and implementation strategies. Due to the myriad of legislative and regulatory requirements, internal control reviews, to satisfy those legislative and regulatory requirements, have been layered upon each other rather than being integrated. This forum is intended to facilitate discussions of alternatives and best practices between the financial, acquisition, and information technology communities.

While many agencies are making progress on identifying and resolving deficiencies found in internal control, continued diligence and commitment is needed. However, effective internal control is not only a challenge at the agency level, but it is also a challenge at the Government-wide level. Consequently, GAO has issued an adverse opinion on the effectiveness of the internal control for the Government as a whole, in its report.

Legal Compliance

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

Additional Information

The Report's appendices contain the names and web sites of the significant Government entities included in the *Financial Report's* financial statements. Details about the information contained in this report can be found in these entities' Performance and Accountability Reports. Related Government publications, include, but are not limited to:

- 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.

The FY 2007 Financial Report, as well as those from previous years, may be accessed online at:

http://www.fms.treas.gov/fr/index.html
http://www.whitehouse.gov/omb/financial/index.html
www.gao.gov

GAO
Accountability * Integrity * Reliability

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.[1] 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.[2]

- 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.[3]

- 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.

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[1] Most revenues reported in the accrual basis consolidated financial statements are recorded on a modified cash basis.
[2] 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.
[3] 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.[4] 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[5] in present value terms for the next 75-year period.[6]

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.[7] This translates into a current burden of about $175,000 per American or approximately $455,000 per American household.

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[4] Social insurance programs included in the Statement of Social Insurance are Social Security, Medicare, Railroad Retirement, and Black Lung.

[5] 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.

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

[7] 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 nonearmarked funds activity.[8] For fiscal year 2007, earmarked funds revenue and nonearmarked 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 nonearmarked funds reported net operating cost of approximately $469 billion.[9]

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[10]—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.[11, 12] 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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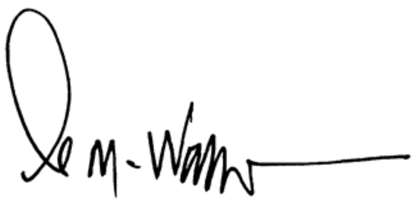
[8] Earmarked funds (e.g., Social Security and Medicare trust funds) are financed by specifically identified revenues and other financing sources which remain available over time; are required by statute to be used for designated activities, benefits, or purposes; and must be accounted for separately 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).
[9] The earmarked funds net operating revenue is the excess of revenues and of transfers from nonearmarked funds over net costs. The nonearmarked funds net operating cost is the excess of net costs and of transfers to earmarked funds over revenues.
[10] 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.
[11] Intergenerational equity assesses the extent to which different age groups may be required to assume financial burdens to sustain federal responsibilities.
[12] 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[13] 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[14] 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.

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.



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

(198465)

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

[14] 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).

Financial Statements of the United States Government for the Years Ended September 30, 2007, and September 30, 2006

Statements of Net Cost

These statements present the net cost from October 1 through September 30, fiscal years 2007 and 2006 Government operations, which include the operations related to earmarked funds, funds financed by specifically identified revenues, often supplemented by other financing sources, which remain available over time. For the purposes of this document, "Government" refers to the United States Government. It categorizes costs by Chief Financial Officer Act entities and other significant entities. Costs and earned revenues are generally presented by department on an accrual basis, while the budget presents costs and revenues by obligations and outlays generally on a cash basis. In the Statements of Net Cost, the costs and earned revenues are divided between the corresponding departments and entities mentioned above, providing greater accountability by showing the relationship of the agencies' net cost to the Governmentwide net cost. The focus of the budget of the United States is by agency. Budgets are prepared, defended, and monitored by agency. In reporting by agency, we are assisting the external users in assessing the budget integrity, operating performance, stewardship, and systems and control of the Federal Government.

These statements contain the following three components:

- Gross cost—This is the full cost of all the departments and entities. These costs are assigned on a cause-and-effect basis, or reasonably allocated to the corresponding departments and entities.
- Earned revenue—This is revenue the Government earned by providing goods and services to the public at a price.
- Net cost—This is computed by subtracting earned revenue from gross cost.

Net cost for Governmentwide reporting purposes includes the General Services Administration (GSA) and the Office of Personnel Management (OPM) agency allocations, and is net of intragovernmental eliminations. For this reason, individual agency net cost amounts will not agree with the agency's financial statements. Because of their specific functions, most of the costs originally associated with GSA and OPM have been allocated to and reflected in the costs of their user agencies. The remaining costs for GSA and OPM on the Statements of Net Cost are the administrative operating costs, the expenses from prior and past costs from health and pension plan amendments, and the actuarial gains and losses for these agencies. Health and pension benefits that are not reported in the individual agency statements have been allocated out of OPM to the agencies. The interest on securities issued by the Department of the Treasury (Treasury) held by the public is part of Treasury's responsibilities, but because of its importance, and the dollar amounts, it is reported separately in these statements.

Statements of Operations and Changes in Net Position

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

Revenue

Individual income tax and tax withholdings include Federal Insurance Contributions Act (FICA)/Self-Employment Contributions Act (SECA) taxes and other taxes including payroll taxes collected from other agencies. These taxes are characterized as “unearned” revenue.

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

Miscellaneous earned revenues consist of earned revenues received from the public with virtually no associated cost. Therefore, unlike other earned revenues, miscellaneous earned revenues are not subtracted from gross cost to derive net cost. It also includes rents and royalties on the Outer Continental Shelf Lands resulting from the leasing and development of mineral resources on public lands.

Earmarked revenues are from specifically identified “earmarked” activities during the year. Earmarked revenues are required by statute to be used for designated activities, benefits or purposes and must be accounted for separately from the rest of the Government’s non-earmarked revenues. Refer to Note 20—Earmarked Funds for detailed information.

Intragovernmental interest represents interest earned from the investment of surplus earmarked revenues, which finance the deficit spending of non-earmarked operations. These investments are recorded as Intragovernmental debt holdings and included in Note 10, in the table titled Intragovernmental Debt Holdings: Federal Debt Securities Held as Investments by Government Accounts. These interest payments, and the associated investments, are eliminated in the consolidation process.

Net Cost of Government Operations

The net cost of Government operations (which is gross cost less earned revenue) flows through from the Statements of Net Cost. The net cost associated with earmarked activities is separately reported.

Intragovernmental Transfers

Intragovernmental transfers reflect amounts required by statute to be transferred from the General Fund of the Treasury to earmarked funds, as well as contributions to earmarked funds made by Federal agencies on behalf of their employees, beneficiaries, or others.

Other-Unmatched Transactions and Balances

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

Net Position, Beginning of Period

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

Prior period adjustments are revisions to adjust the beginning net position and balances presented on the prior year financial statements. Refer to Note 1B—Basis of Accounting and Revenue Recognition, and Note 17—Prior Period Adjustments for detailed information.

Net Position, End of Period

The net position, end-of-period, amount reflects the net position as of the end of the fiscal year. The net position for earmarked funds is shown separately.

Reconciliations of Net Operating Cost and Unified Budget Deficit

The purpose of the reconciliation is to report how the proprietary net operating cost and the unified budget deficit relate to each other. The premise of the reconciliation is that the accrual and budgetary accounting bases share transaction data.

These statements report the reconciliation of the results of operations (net operating cost) on the Statements of Operations and Changes in Net Position to the unified budget deficit in the President's budget.

Receipts and outlays in the President's budget are measured primarily on a cash basis and differ from the basis of accounting measures used in the *Financial Report*. These statements begin with the net results of operations (net operating cost), where operating revenues are reported on a modified cash basis of accounting and the net cost of Government operations on an accrual basis of accounting and reports activities where the bases of accounting for the components of net operating cost and the unified budget deficit differed.

Components of Net Operating Cost Not Part of the Budget Deficit

This information includes the operating components, such as the changes of benefits payable for veterans, military and civilian employees, and the environmental liabilities and depreciation expense not included in the budget results.

Components of the Budget Deficit Not Part of Net Operating Cost

This information includes the budget components, such as capitalized fixed assets, changes in accounts and taxes receivable, and increases in other assets not included in the operating results. These items are typically part of the balance sheets only, and are not part of the operating results. All Other Reconciling Items represent the net difference that is needed to balance this statement to the unified budget deficit.

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

The primary purpose of these statements is to report how the annual unified budget deficit relates to the change in the Government's operating cash balance and debt held by the public. It explains why the unified budget deficit normally would not result in an equivalent change in the Government's operating cash balance.

These statements reconcile the unified budget deficit to the change in operating cash during the fiscal year and explain how the budget deficits (fiscal years 2007 and 2006) were financed. A budget deficit is the result of outlays (expenditures) exceeding receipts (revenue) during a particular fiscal year.

In depicting how the unified budget deficits were financed, these statements show that in fiscal years 2007 and 2006, the greatest amounts were net new borrowings from the public. Other transactions also required cash disbursements and are not part of the repayments of the debt. These other transactions, such as the payment of interest on debt held by the public, required cash payments and contributed to the use of cash. These statements show the differences between accrual and cash budgetary basis, mainly because of timing differences in the financial statements.

Balance Sheets

The balance sheets show the Government's assets and liabilities. When combined with stewardship information, this information presents a more comprehensive understanding of the Government's financial position. All of the line items on the balance sheets are described in the Notes to the Financial Statements. The net position for earmarked funds is shown separately.

Assets

Assets included on the balance sheets are resources of the Government that remain available to meet future needs. The most significant assets that are reported on the balance sheets are property, plant, and equipment; inventories; and loans receivable. There are, however, other significant resources available to the Government that extend beyond the assets presented in these financial statements. Those resources include stewardship assets, including natural resources, and the Government's sovereign powers to tax, regulate commerce, set monetary policy and the power to print additional currency.

Liabilities and Net Position

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

As with reported assets, the Government's responsibilities, policy commitments, and contingencies are much broader than these reported balance sheet liabilities. They include the social insurance programs in the Statements of Social Insurance and are disclosed in the Supplemental Information—Social Insurance section and a wide range of other programs under which the Government provides benefits and services to the people of this Nation, as well as certain future loss contingencies.

The magnitude and complexity of social insurance programs, coupled with the extreme sensitivity of projections relating to the many assumptions of the programs, produce a wide range of possible results. Note 22—Social Insurance describes the social insurance programs, reports long-range estimates that can be used to assess the financial condition of the programs, and explains some of the factors that impact the various programs. Using this information, readers can apply their own judgment as to the condition and sustainability of the individual programs.

Each of the social insurance programs has an associated trust fund to account for its activity. The collection of earmarked taxes and other earmarked revenue is credited to the corresponding trust fund that will use these funds to meet a particular Government purpose. If the collections from taxes and other sources exceed the payments to the beneficiaries, the excess revenue is invested in Treasury securities or "loaned" to the Treasury's General Fund; therefore, the trust fund balances do not represent cash. An explanation of the trust funds for social insurance and many of the other large trust funds is included in Note 20—Earmarked Funds. That note also contains information about trust fund receipts, disbursements, and assets.

The Government has entered into contractual commitments requiring the future use of financial resources and has unresolved contingencies where existing conditions, situations, or circumstances create uncertainty about future losses. Commitments as well as contingencies that do not meet the criteria for recognition as liabilities on the balance sheets, but for which there is at least a reasonable possibility that losses have been incurred, are disclosed in Note 18—Contingencies and Note 19—Commitments.

Because of its sovereign power to tax and borrow, and the country's wide economic base, the Government has unique access to financial resources through generating tax revenues and issuing Federal debt securities. This provides the Government with the ability to meet present obligations and those that are anticipated from future operations and are not reflected in net position.

Statements of Social Insurance

The Statements of Social Insurance provide estimates of the status of the most significant Social Insurance programs; Social Security, Medicare, Railroad Retirement, and Black Lung social insurance programs, which are administered by the Social Security Administration (SSA), the Department of Health and Human Services (HHS), the Railroad Retirement Board (RRB), and the Department of Labor (DOL), respectively. The estimates are actuarial present values[1] of the projections and are based on the economic and demographic assumptions representing the trustees' best estimates as set forth in the relevant Social Security and Medicare trustees' reports and in the relevant agency performance and accountability reports for the Railroad Retirement Board and the Department of Labor (Black Lung).

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

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United States Government
Statements of Net Cost
for the Years Ended September 30, 2007, and September 30, 2006

(In billions of dollars)	Gross Cost 2007	Earned Revenue 2007	Net Cost 2007	Gross Cost 2006	Earned Revenue 2006	Net Cost 2006
Department of Health & Human Services	718.6	51.8	666.8	678.8	51.4	627.4
Department of Defense	689.6	25.1	664.5	658.0	24.1	633.9
Social Security Administration	626.4	0.3	626.1	593.1	0.3	592.8
Interest on Treasury Securities held by the public	238.9	-	238.9	221.5	-	221.5
Department of Agriculture	98.6	12.1	86.5	109.0	11.4	97.6
Department of the Treasury	86.9	6.3	80.6	85.5	4.1	81.4
Department of Transportation	66.2	0.5	65.7	66.6	0.6	66.0
Department of Energy	67.5	4.3	63.2	70.9	5.1	65.8
Department of Education	66.3	4.5	61.8	97.3	4.7	92.6
Department of Veterans Affairs	63.1	3.7	59.4	117.3	3.5	113.8
Department of Housing and Urban Development	54.0	0.9	53.1	43.0	1.0	42.0
Department of Labor	50.1	-	50.1	48.2	-	48.2
Department of Homeland Security	51.1	7.1	44.0	63.4	6.8	56.6
Department of Justice	28.8	1.0	27.8	28.6	1.0	27.6
Office of Personnel Management	36.2	15.5	20.7	34.8	15.1	19.7
Department of the Interior	18.6	2.0	16.6	20.0	2.9	17.1
National Aeronautics and Space Administration	16.3	0.1	16.2	19.2	-	19.2
Department of State	18.4	3.4	15.0	16.0	2.2	13.8
Environmental Protection Agency	10.0	0.4	9.6	9.9	0.3	9.6
Agency for International Development	9.7	0.3	9.4	10.5	0.1	10.4
Department of Commerce	9.6	1.9	7.7	9.9	1.7	8.2
Federal Communications Commission	7.9	0.4	7.5	7.9	0.3	7.6
National Science Foundation	5.7	-	5.7	5.7	-	5.7
Railroad Retirement Board	15.7	10.3	5.4	12.1	5.0	7.1
Small Business Administration	1.3	0.4	0.9	1.7	0.3	1.4
Federal Deposit Insurance Corporation	1.7	0.9	0.8	1.8	0.1	1.7
Tennessee Valley Authority	10.9	10.4	0.5	9.5	10.0	(0.5)
U.S. Nuclear Regulatory Commission	1.0	0.6	0.4	1.0	0.6	0.4
National Credit Union Administration	0.3	0.1	0.2	0.2	0.1	0.1
General Services Administration	0.6	0.5	0.1	0.9	0.5	0.4
Export-Import Bank of the United States	0.5	0.9	(0.4)	-	1.3	(1.3)
Pension Benefit Guaranty Corporation	1.5	6.1	(4.6)	(0.5)	3.8	(4.3)
U.S. Postal Service	60.1	73.7	(13.6)	58.9	71.6	(12.7)
All other entities	25.2	2.3	22.9	27.0	(3.5)	30.5
Total	3,157.3	247.8	2,909.5	3,127.7	226.4	2,901.3

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

United States Government
Statements of Operations and Changes in Net Position
for the Years Ended September 30, 2007, and September 30, 2006

(In billions of dollars)	Non-Earmarked Funds 2007	Earmarked Funds 2007	Consolidated 2007	Non-Earmarked Funds 2006	Earmarked Funds 2006	Consolidated 2006
Revenue:						
Individual income tax and tax withholdings	1,152.6	847.2	1,999.8	1,045.7	800.4	1,846.1
Corporation income taxes	367.2		367.2	350.0	-	350.0
Unemployment taxes		39.3	39.3	-	41.4	41.4
Excise taxes	15.3	52.2	67.5	24.5	49.6	74.1
Estate and gift taxes	26.0		26.0	27.4	-	27.4
Customs duties	18.2		18.2	24.7	-	24.7
Other taxes and receipts	57.9	21.7	79.6	42.8	17.2	60.0
Miscellaneous earned revenues	29.7		29.7	17.1	-	17.1
Intragovernmental interest		192.7	192.7	-	185.3	185.3
Total revenue	1,666.9	1,153.1	2,820.0	1,532.2	1,093.9	2,626.1
Eliminations			(192.7)			(185.3)
Consolidated revenue			2,627.3			2,440.8
Net Cost:						
Net cost	1,622.6	1,286.9	2,909.5	1,635.6	1,265.7	2,901.3
Intragovernmental interest	192.7		192.7	185.3	-	185.3
Total net cost	1,815.3	1,286.9	3,102.2	1,820.9	1,265.7	3,086.6
Eliminations			(192.7)			(185.3)
Consolidated net cost			2,909.5			2,901.3
Intragovernmental transfers	(327.6)	327.6		(343.8)	343.8	
Other – Unmatched transactions and balances (Note 1)	6.7		6.7	11.0		11.0
Net Operating (Cost)/Revenue	(469.3)	193.8	(275.5)	(621.5)	172.0	(449.5)
Net position, beginning of period	(9,335.6)	419.2	(8,916.4)	(8,714.1)	247.2	(8,466.9)
Prior period adjustments – Changes in Accounting Principles(Note 17)	(15.0)	1.1	(13.9)	-	-	-
Net Operating (Cost)/Revenue	(469.3)	193.8	(275.5)	(621.5)	172.0	(449.5)
Net position, end of period	(9,819.9)	614.1	(9,205.8)	(9,335.6)	419.2	(8,916.4)

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

United States Government
Reconciliations of Net Operating Cost and Unified Budget Deficit
for the Years Ended September 30, 2007, and September 30, 2006

(In billions of dollars)	2007	2006
Net operating cost	(275.5)	(449.5)
Components of Net Operating Cost Not Part of the Budget Deficit:		
Increase in Liability for Military Employee Benefits (Note 11):		
Increase in military pension liabilities	61.7	71.7
(Decrease) Increase in military health liabilities	(3.4)	3.3
Increase (Decrease) in other military benefits	2.0	(0.1)
Increase in liability for military employee benefits	60.3	74.9
(Decrease) Increase in Liability for Veterans Compensation (Note 11):		
(Decrease) Increase in liabilities for veterans	(26.8)	45.4
Increase (Decrease) in liabilities for survivors	0.8	(14.3)
(Decrease) in liabilities for burial benefits	(0.1)	0.1
(Decrease) Increase in liability for veteran's compensation	(26.1)	31.2
Increase in Liabilities for Civilian Employee Benefits (Note 11):		
Increase in civilian pension liabilities	37.3	75.1
Increase in civilian health liabilities	16.4	4.6
Increase in other civilian benefits	2.2	1.6
Increase in liabilities for civilian employee benefits	55.9	81.3
Increase in Environmental Liabilities (Note 12):		
Increase in Energy's environmental liabilities	33.3	40.5
Increase in all others' environmental liabilities	3.5	4.9
Increase in environmental liabilities	36.8	45.4
Depreciation expense	45.3	82.9
Property, plant, and equipment disposals and revaluations	10.9	2.4
Increase in benefits due and payable	4.4	12.3
(Decrease) in insurance programs	(1.9)	(20.4)
Increase in other liabilities	23.7	21.0
Seigniorage and sale of gold	(0.8)	(0.7)
Increase (Decrease) in accounts payable	7.8	(9.5)
(Increase) in accounts and taxes receivable	(19.0)	(2.7)
Components of the Budget Deficit Not Part of Net Operating Cost:		
Capitalized Fixed Assets:		
Department of Defense	(29.1)	(76.4)
Civilian Agencies	(29.7)	(27.3)
Total Capitalized Fixed Assets	(58.8)	(103.7)
Decrease (Increase) in inventory	4.2	(9.3)
(Increase) in Securities and Investments	(13.4)	(6.4)
(Increase) Decrease in other assets	(10.0)	1.2
Principal repayments of precredit reform loans	8.5	3.4
All Other Reconciling Items	(15.1)	(1.5)
Unified budget deficit	(162.8)	(247.7)

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

United States Government
Statements of Changes in Cash Balance from Unified Budget and Other Activities for the Years Ended September 30, 2007, and September 30, 2006

(In billions of dollars)		2007			2006	
Unified budget deficit			(162.8)			(247.7)
Adjustments for Noncash Outlays Included in the Budget:						
Interest accrued by Treasury on debt held by the public		(189.4)			(177.6)	
Subsidy expense (Note 4)		9.3			34.3	
Items Affecting the Cash Balance Not Included in the Budget:						
Net Transactions from Financing Activity:						
Repayment of debt held by the public	4,340.4			4,248.5		
Borrowings from the public	(4,547.3)			(4,485.5)		
Total		(206.9)			(237.0)	
Net Transactions from Monetary Activity:						
Increase in special drawing rights	0.6			0.4		
(Decrease) Increase in other monetary assets	(0.2)			2.4		
(Decrease) in loans to the IMF	(2.2)			(6.5)		
Total		(1.8)			(3.7)	
Net Transactions from Other Activities:						
Net direct loan activity	2.8			(3.7)		
Interest paid by Treasury on debt held by the public	186.1			171.4		
Net guaranteed loan activity	4.9			(46.9)		
(Increase) in allocations of special drawing rights	(0.4)			(0.1)		
Decrease in deposit fund balances	3.9			1.0		
Decrease in miscellaneous liabilities	0.8			0.2		
Seigniorage and other equity	(0.8)			(0.7)		
NRRIT non-Federal securities[1]	2.6			2.1		
Prior period adjustment	-			(2.7)		
Total		199.9			120.6	
Disposition of deficit			(188.9)			(263.4)
Increase in Cash held by Treasury for Government operations			26.1			15.7
Cash held by Treasury for Governmentwide operations: (Note 2)						
Balance beginning of period			43.6			27.9
Balance end of period			69.7			43.6

[1] For more information, see Railroad Retirement in the Supplemental Information-Social Insurance section. The amount for the change in the National Railroad Retirement Investment Trust non-Federal Securities reflected above is based on NRRIT amounts reported as of August 31. This differs from the amounts reflected in Note 7, Securities and Investments, for NRRIT which are as of September 30.

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

United States Government
Balance Sheets
as of September 30, 2007, and September 30, 2006

(In billions of dollars)	2007	2006
Assets:		
Cash and other monetary assets (Note 2)	128.0	97.9
Accounts and taxes receivable, net (Note 3)	87.8	68.8
Loans receivable, net (Note 4)	231.9	220.8
Inventories and related property, net (Note 5)	277.1	281.3
Property, plant, and equipment, net (Note 6)	691.1	688.5
Securities and investments (Note 7)	99.8	83.8
Other assets (Note 8)	65.4	55.4
Total assets	1,581.1	1,496.5
Stewardship property, plant, and equipment		
Stewardship Land (Note 23) and Heritage Assets (Note 24)		
Liabilities:		
Accounts payable (Note 9)	66.2	58.4
Federal debt securities held by the public and accrued interest (Note 10)	5,077.7	4,867.5
Federal employee and veteran benefits payable (Note 11)	4,769.1	4,679.0
Environmental and disposal liabilities (Note 12)	342.0	305.2
Benefits due and payable (Note 13)	133.7	129.3
Insurance program liabilities (Note 14)	70.9	72.8
Loan guarantee liabilities (Note 4)	69.1	66.4
Other liabilities (Note 15)	258.2	234.3
Total liabilities	10,786.9	10,412.9
Contingencies (Note 18) and Commitments (Note 19)		
Net position:		
Earmarked funds (Note 20)	614.1	419.2
Non-earmarked funds	(9,819.9)	(9,335.6)
Total net position	(9,205.8)	(8,916.4)
Total liabilities and net position	1,581.1	1,496.5

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

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

(In billions of dollars)	2007	2006	2005	2004	2003
	**********UNAUDITED*********				
Federal Old-Age, Survivors and Disability Insurance (Social Security): (Note 22)					
Revenue (Contributions and Earmarked Taxes) from:					
Participants who have attained age 62	477	533	464	411	359
Participants ages 15-61	17,515	16,568	15,290	14,388	13,576
Future participants (under age 15 and births during period)	16,121	15,006	13,696	12,900	12,213
All current and future participants	34,113	32,107	29,450	27,699	26,147
Expenditures for Scheduled Future Benefits for:					
Participants who have attained age 62	(6,329)	(5,866)	(5,395)	(4,933)	(4,662)
Participants ages 15-61	(27,928)	(26,211)	(23,942)	(22,418)	(21,015)
Future participants (under age 15 and births during period)	(6,619)	(6,480)	(5,816)	(5,578)	(5,398)
All current and future participants	(40,876)	(38,557)	(35,154)	(32,928)	(31,075)
Present value of future expenditures in excess of future revenue	(6,763)[1]	(6,449)[2]	(5,704)[3]	(5,229)[4]	(4,927)[5]
Federal Hospital Insurance (Medicare Part A): (Note 22)					
Revenue (Contributions and Earmarked Taxes) from:					
Participants who have attained eligibility age 65	178	192	162	148	128
Participants who have not attained eligibility age 15-64	5,975	5,685	5,064	4,820	4,510
Future participants (under age 15 and births during period))	4,870	4,767	4,209	4,009	3,773
All current and future participants	11,023	10,644	9,435	8,976	8,411
Expenditures for Scheduled Future Benefits for:					
Participants who have attained eligibility age 65	(2,558)	(2,397)	(2,179)	(2,168)	(1,897)
Participants who have not attained eligibility age 15-64	(15,639)	(15,633)	(12,668)	(12,054)	(10,028)
Future participants (under age 15 and births during period))	(5,118)	(3,904)	(3,417)	(3,246)	(2,653)
All current and future participants	(23,315)	(21,934)	(18,264)	(17,468)	(14,577)
Present value of future expenditures in excess of future revenue	(12,292)[1]	(11,290)[2]	(8,829)[3]	(8,492)[4]	(6,166)[5]
Federal Supplementary Medical Insurance (Medicare Part B): (Note 22)					
Revenue (Premiums) from:					
Participants who have attained eligibility age 65	433	409	363	332	283
Participants who have not attained eligibility age 15-64	3,184	3,167	2,900	2,665	2,148
Future participants (under age 15 and births during period))	1,172	906	924	891	688
All current and future participants	4,789	4,481	4,187	3,889	3,119
Expenditures for Scheduled Future Benefits for:					
Participants who have attained eligibility age 65	(1,834)	(1,773)	(1,622)	(1,475)	(1,306)
Participants who have not attained eligibility age 15-64	(12,130)	(12,433)	(11,541)	(10,577)	(8,845)
Future participants (under age 15 and births during period))	(4,257)	(3,407)	(3,408)	(3,277)	(2,622)
All current and future participants	(18,221)	(17,613)	(16,571)	(15,329)	(12,773)
Present value of future expenditures in excess of future revenue[6]	(13,432)[1]	(13,131)[2]	(12,384)[3]	(11,440)[4]	(9,653)[5]
Federal Supplementary Medical Insurance (Medicare Part D): (Note 22)					
Revenue (Premiums and State Transfers) from:					
Participants who have attained eligibility age 65	167	173	185	176	
Participants who have not attained eligibility age 15-64	1,627	1,700	1,790	1,857	
Future participants (under age 15 and births during period))	611	492	572	618	
All current and future participants	2,405	2,366	2,547	2,651	
Expenditures for Scheduled Future Benefits for:					
Participants who have attained eligibility age 65	(794)	(792)	(880)	(773)	
Participants who have not attained eligibility age 15-64	(7,273)	(7,338)	(7,913)	(7,566)	
Future participants (under age 15 and births during period))	(2,699)	(2,121)	(2,440)	(2,431)	
All current and future participants	(10,766)	(10,250)	(11,233)	(10,770)	
Present value of future expenditures in excess of future revenue[6]	(8,361)[1]	(7,884)[2]	(8,686)[3]	(8,119)[4]	

Totals do not necessarily equal the sum of components due to rounding.

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

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

(In billions of dollars)	2007	2006	2005	2004	2003
			**********UNAUDITED*********		
Railroad Retirement: (Note 22)					
Revenue (Contributions and Earmarked Taxes) from:					
Participants who have attained eligibility	5	5	4	4	4
Participants who have not attained eligibility	41	40	37	37	40
Future participants	54	56	41	39	41
All current and future participants	100	100	82	80	85
Expenditures for Scheduled Future Benefits for:					
Participants who have attained eligibility	(93)	(92)	(84)	(81)	(80)
Participants who have not attained eligibility	(86)	(84)	(73)	(72)	(73)
Future participants	(26)	(25)	(16)	(14)	(14)
All current and future participants	(205)	(201)	(173)	(167)	(167)
Present value of future expenditures in excess of future revenue [7]	(105)[1]	(101)[2]	(91)[3]	(87)[4]	(83)[5]
Black Lung (Part C): (Note 22)					
Present value of future revenue in excess of future expenditures [8]	5 [9]	4 [10]	5 [11]	4 [12]	4 [13]
Total present value of future expenditures in excess of future revenue	(40,948)	(38,851)	(35,689)	(33,363)	(20,825)
Social Insurance Summary					
Participants who have attained eligibility age:					
Revenue (e.g., Contributions and earmarked taxes)	1,260	1,312	1,178	1,071	774
Expenditures for scheduled future benefits	(11,608)	(10,920)	(10,160)	(9,430)	(7,945)
Present value of future expenditures in excess of future revenue	(10,348)	(9,608)	(8,982)	(8,359)	(7,172)
Participants who have attained age 15 up to eligibility age:					
Revenue (e.g., Contributions and earmarked taxes)	28,342	27,160	25,081	23,767	20,274
Expenditures for scheduled future benefits	(63,056)	(61,696)	(56,138)	(52,686)	(39,959)
Present value of future expenditures in excess of future revenue	(34,714)	(34,536)	(31,057)	(28,919)	(19,686)
Closed group – Total present value of future expenditures in excess of future revenue	(45,062)	(44,145)	(40,039)	(37,278)	(26,857)
Future participants (under age 15 and births during period):					
Revenue (e.g., Contributions and earmarked taxes)	22,828	21,227	19,442	18,457	16,715
Expenditures for scheduled future benefits	(18,714)	(15,933)	(15,092)	(14,542)	(10,683)
Present value of future revenue in excess of future expenditures	4,114	5,294	4,350	3,915	6,032
Open group – Total present value of future expenditures in excess of future revenue	(40,948)	(38,851)	(35,689)	(33,363)	(20,825)

Totals do not necessarily equal the sum of components due to rounding.

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

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

**********UNAUDITED*********

(In billions of dollars)	2007	2006	2005	2004	2003

[1] The projection period is 1/1/2007 - 12/31/2081 and the valuation date is 1/1/2007.
[2] The projection period is 1/1/2006 - 12/31/2080 and the valuation date is 1/1/2006.
[3] The projection period is 1/1/2005 - 12/31/2079 and the valuation date is 1/1/2005.
[4] The projection period is 1/1/2004 - 12/31/2078 and the valuation date is 1/1/2004.
[5] The projection period is 1/1/2003 - 12/31/2077 and the valuation date is 1/1/2003.
[6] These amounts represent the present value of the future transfers from the General Fund of the Treasury to the Supplementary Medical Insurance Trust Fund. These future intragovernmental transfers are included as income in both HHS' and the Centers for Medicare & Medicaid Services' (CMS) Financial Report but are not income from the Governmentwide perspective of this report.
[7] These amounts approximate the present value of the future financial interchange and the future transfers from the General Fund of the Treasury to the Social Security Equivalent Benefit (SSEB) Account (see discussion of Railroad Retirement Program in the required supplemental information section of this report). They are included as income in the Railroad Retirement Financial Report but are not income from the Governmentwide perspective of this report.
[8] Does not include interest expense accruing on the outstanding debt.
[9] The projection period is 9/30/2007 - 9/30/2040 and the valuation date is 9/30/2007.
[10] The projection period is 9/30/2006 - 9/30/2040 and the valuation date is 9/30/2006.
[11] The projection period is 9/30/2005 - 9/30/2040 and the valuation date is 9/30/2005.
[12] The projection period is 9/30/2004 - 9/30/2040 and the valuation date is 9/30/2004.
[13] The projection period is 9/30/2003 - 9/30/2040 and the valuation date is 9/30/2003.

Totals do not necessarily equal the sum of components due to rounding.

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

United States Government Notes to the Financial Statements for the Years Ended September 30, 2007, and September 30, 2006

Note 1. Summary of Significant Accounting Policies

A. Reporting Entity

This *Financial Report* includes the financial status and activities of the executive branch, the legislative branch (the U.S. Senate and the U.S. House of the Representatives report on a cash basis), and the judicial branch (which also reports on a cash basis) of the Government. The judicial branch reports on a limited basis primarily related to budget activity because it is not required by law to submit financial statement information to Treasury. The Appendix section of this report contains a list of significant Government entities included in the *Financial Report*, as well as examples of entities excluded. The excluded entities are not part of the *Financial Report* because they are Government sponsored enterprises, such as the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), etc.; or their activities are not included in the Federal budget's totals, such as the Thrift Savings Fund, and the Board of Governors of the Federal Reserve System.

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

B. Basis of Accounting and Revenue Recognition

These financial statements were prepared using U.S. Generally Accepted Accounting Principles (GAAP), primarily based on Statements of Federal Financial Accounting Standards (SFFAS). Under these principles:

- Expenses are generally recognized when incurred except that the costs of social insurance programs including Social Security, Medicare, Railroad Retirement, Black Lung, and Unemployment Insurance are recognized only for amounts currently due and payable.
- Nonexchange (unearned) revenues, including taxes, duties, fines, and penalties, are recognized when collected and adjusted to the change in net measurable and legally collectable amounts receivable. Related refunds and other offsets, including those that are measurable and legally payable, are netted against nonexchange revenue.
- Exchange (earned) revenues are recognized when the Government provides goods and services to the public for a price. Exchange revenues include user charges such as admission to Federal parks and premiums for certain Federal insurance.

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

Beginning in fiscal year 2006, the Federal Government has implemented the requirements of new standards related to earmarked funds, social insurance, heritage assets and stewardship land, and required Governmentwide reporting.

- Earmarked funds:

As required by SFFAS No. 27,[1] the Federal Government now separately identifies: (1) earmarked fund activities in the statement of operations and changes in net position: and (2) the portion of net position attributable to earmarked fund activities on the balance sheet.

- Social Insurance:

As required by SFFAS Nos. 17, 25, 26, and 28,[2] the Statements of Social Insurance and related note on significant underlying assumptions were reclassified from required supplemental stewardship information to basic information. For further information on social insurance, see Note 22—Social Insurance.

- Heritage Assets and Stewardship Land:

As required by SFFAS No. 29,[3] information related to heritage assets and stewardship land was reclassified from required supplemental stewardship information to basic information. For further information on stewardship land and heritage assets, see Note 23—Stewardship Land, and Note 24—Heritage Assets, respectively.

- Governmentwide Reporting:

SFFAS No. 32[4] amends standards issued prior to January 2003 to specify disclosure requirements appropriate for the *Financial Report* based on the guidance contained in Statements of Federal Financial Accounting Concepts No. 4 (SFFAC 4). Some disclosure requirements contained in previously issued standards were modified to allow aggregation and reduce detail for Governmentwide reporting while other disclosure requirements were eliminated because of excessive detailed information required that is inappropriate for a Governmentwide report consistent with the guidance contained in SFFAC 4.

C. Direct Loans and Loan Guarantees

Direct loans obligated and loan guarantees committed after fiscal year 1991 are reported based on the present value of the net cashflows estimated over the life of the loan or guarantee. The difference between the outstanding principal of the direct loans and the present value of their net cash inflows is recognized as a subsidy cost allowance; the present value of estimated net cash outflows of the loan guarantees is recognized as a liability for loan guarantees.

The subsidy expense for direct or guaranteed loans disbursed during a year is the present value of estimated net cash outflows for those loans or guarantees. A subsidy expense also is recognized for modifications made during the year to loans and guarantees outstanding and for reestimates made as of the end of the year to the subsidy allowances or loan guarantee liability for loans and guarantees outstanding.

Direct loans obligated and loan guarantees committed before fiscal year 1992 are valued under two different methodologies within the Government: the allowance-for-loss method and the present-value method. Under the allowance-for-loss method, the outstanding principal of direct loans is reduced by an allowance for uncollectible amounts; the liability for loan guarantees is the amount the agency estimates would more likely than not require future cash outflow to pay default claims.

Under the present-value method, the outstanding principal of direct loans is reduced by an allowance equal to the difference between the outstanding principal and the present value of the expected net cashflows. The liability for loan guarantees is the present value of expected net cash outflows due to the loan guarantees.

D. Accounts and Taxes Receivable

Accounts receivable represents claims to cash or other assets from entities outside the Government that arise from the sale of goods or services, duties, fines, certain license fees, recoveries, or other provisions of the law.

The category taxes receivable consists primarily of uncollected tax assessments, penalties, and interest when taxpayers have agreed the amounts are owed or a court has determined the assessments are owed. The balance sheets

[1] SFFAS No. 27, Identifying and Reporting Earmarked Funds.
[2] SFFAS No. 17, Accounting for Social Insurance, No. 25, Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment; SFFAS No. 26, Presentation of Significant Assumptions for the Statement of Social Insurance: Amending SFFAS 25, and SFFAS No. 28, Deferral of the Effective Date of Reclassification of the Statement of Social Insurance: Amending SFFAS 25 and 26.
[3] SFFAS No. 29, Heritage Assets and Stewardship Land.
[4] SFFAS No. 32, Consolidated Financial Report of the United States Government Requirements: Implementing SFFAC 4 "Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government."

do not include unpaid assessments when neither taxpayers nor a court have agreed that the amounts are owed (compliance assessments) or the Government does not expect further collections due to factors such as the taxpayer's death, bankruptcy, or insolvency (writeoffs). Taxes receivable are reported net of an allowance for the estimated portion deemed to be uncollectible.

E. Inventories and Related Property

Inventories within the Government are valued using historical cost, net realizable value, and latest acquisition cost (see Note 5—Inventories and Related Property, Net). Historical cost methods include first-in-first-out, weighted average, and moving average. Estimated repair costs reduce the value of inventory held for repair. Excess, obsolete, and unserviceable inventories are valued at estimated net realizable value. When latest acquisition cost is used to value inventory held for sale, it is adjusted for holding gains and losses in order to approximate historical cost.

The related property portion of the inventory and related property line includes operating materials and supplies, stockpile materials, commodities, seized and monetary instruments, and forfeited property. Operating materials and supplies are valued at historical cost, latest acquisition cost, and standard price using the purchase and consumption method of accounting. Operating materials and supplies that are valued at latest acquisition cost and standard pricing are not adjusted for holding gains and losses.

F. Property, Plant, and Equipment

Property, plant, and equipment used in Government operations are carried at acquisition cost, with the exception of Department of Defense (DOD) military equipment (e.g., ships, aircraft, combat vehicles, and weapons). DOD comprises approximately 69 percent of the Government's reported property, plant, and equipment as of September 30, 2007. DOD uses an estimation methodology for military equipment based on internal DOD records to calculate a value for military equipment. DOD identified the universe of military equipment by accumulating information relating to program funding and associated military equipment, equipment useful life, and program acquisitions and disposals to create a baseline. The equipment baseline is updated using expenditure information and information related to acquisition and logistics to identify acquisitions and disposals. All property, plant, and equipment is capitalized if the acquisition costs (or estimated acquisition cost for DOD) are in excess of capitalization thresholds that vary considerably between the federal entities. Depreciation and amortization expense applies to property, plant, and equipment reported on the balance sheets except for land, unlimited duration land rights and construction in progress. Depreciation and amortization are recognized using the straight-line method over the estimated useful lives of the assets. All property, plant, and equipment are assigned useful lives depending on their category and vary considerably between the Federal entities. The cost of acquisition, betterment, or reconstruction of all multi-use heritage assets is capitalized as general property, plant, and equipment and is depreciated. Construction in progress is used for the accumulation of the cost of construction or major renovation of fixed assets during the construction period. The assets are transferred out of construction in progress when the project is substantially completed. Internal User (internal use) software includes purchased commercial off-the-shelf software, contractor-developed software, and software that was internally developed by agency employees.

In fiscal year 2007, NASA made a change in its accounting policy for property, plant, and equipment to reclassify costs previously categorized as general property, plant, and equipment to Research and Development (R&D) expenses. Accordingly, NASA applied the provisions of Statement of Financial Accounting Standards (SFAS) No. 2, Accounting for R&D Costs to account for its R&D projects. The cumulative effect of this change in accounting principle is a decrease in the property, plant, and equipment balance by $12.7 billion for those costs not meeting the criteria of general property, plant, and equipment and a corresponding decrease to the Net Position.

Please refer to the individual financial statements of the National Aeronautics and Space Administration (NASA) for a discussion relating to an accounting principle change related to property, plant and equipment.

Please refer to the individual financial statements of DOD, the Department of Energy (DOE), the Tennessee Valley Authority (TVA), the United States Postal Service (USPS), NASA, and the General Services Administration (GSA) for significant detailed information on the useful lives and related capitalization thresholds for property, plant, and equipment. These agencies comprise 85 percent of the Government's total reported net property, plant, and equipment of $691.1 billion as of September 30.

G. Federal Employee and Veteran Benefits Payable

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

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

H. Environmental and Disposal Liabilities

Environmental and disposal liabilities are recorded at the estimated current cost of removing, containing, treating and/or disposing of radioactive waste, hazardous waste, chemical and nuclear weapons, and other environmental contaminations, assuming the use of current technology. Hazardous waste is a solid, liquid, or gaseous waste that, because of its quantity or concentration, presents a potential hazard to human health or the environment. Remediation consists of removal, decontamination, decommissioning, site restoration, site monitoring, closure and post-closure cost, treatment, and/or safe containment. Where technology does not exist to clean up radioactive or hazardous waste, only the estimable portion of the liability, typically monitoring and safe containment, is recorded.

I. Deferred Maintenance

Deferred maintenance is maintenance that was not performed when it should have been or scheduled maintenance that was delayed or postponed. Maintenance is the act of keeping fixed assets in acceptable condition, including preventative maintenance, normal repairs, and other activities needed to preserve the assets, so they continue to provide acceptable services and achieve their expected life. Maintenance excludes activities aimed at expanding the capacity of assets or otherwise upgrading them to serve needs different from those originally intended. Deferred maintenance expenses are not accrued in the Statements of Net Cost or recognized as liabilities on the balance sheets. However, deferred maintenance information is disclosed in the Supplemental Information section of this report.

J. Contingent Liabilities

Liabilities for contingencies are recognized on the balance sheets when both:

- A past transaction or event has occurred.
- A future outflow or other sacrifice of resources is probable and measurable.

The estimated contingent liability may be a specific amount or a range of amounts. If some amount within the range is a better estimate than any other amount within the range, then that amount is recognized. If no amount within the range is a better estimate than any other amount, then the minimum amount in the range is recognized.

Contingent liabilities that do not meet the above criteria for recognition, but for which there is at least a reasonable possibility that a loss may have been incurred, are disclosed in Note 18—Contingencies.

K. Commitments

In the normal course of business, the Government has a number of unfulfilled commitments that may require the use of its financial resources. Note 19—Commitments describes the components of the Government's actual commitments that need to be disclosed because of their nature and/or their amount. They include long-term leases, undelivered orders, and other commitments.

Discussion of treaties and other international agreements entered into by the United States Government are included in the Commitments section.

L. Social Insurance

A liability for social insurance programs (Social Security, Medicare, Railroad Retirement, Black Lung, and Unemployment) is recognized for any unpaid amounts currently due as of the reporting date. No liability is recognized for future benefit payments not yet due. For further information, see the Supplemental Information—Social Insurance section, and Note 20—Earmarked Funds.

M. Related Party Transactions

Federal Reserve banks (FRBs) and private banks, which are not part of the reporting entity, serve as the Government's depositary and fiscal agents. They process Federal payments and deposits to Treasury's account and service Treasury securities. FRBs owned $774.5 billion and $764.6 billion of Treasury securities held by the public as of September 30, 2007, and 2006, respectively. FRB earnings that exceed statutory amounts of surplus established for FRBs are paid to the Government and are recognized as nonexchange revenue. Those earnings totaled $32.0 billion and $29.9 billion for the years ended September 30, 2007, and 2006, respectively. The primary source of these earnings is from interest earned on Treasury securities held by the FRBs. Also, as described in Note 15—Other Liabilities, the FRB holds certificates and special drawing rights certificates.

FRBs issue Federal Reserve notes, the circulating currency of the United States. Specific assets owned by FRBs, typically Treasury securities, collateralize these notes. Federal Reserve notes are backed by the full faith and credit of the Government.

The Government does not guarantee payment of the liabilities of Government-sponsored enterprises such as the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation, which are privately owned. These enterprises also are excluded from the reporting entity.

N. Unmatched Transactions and Balances

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

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

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

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

O. Reclassifications

Certain fiscal year 2006 amounts have been reclassified to conform to the fiscal year 2007 presentation.

Note 2. Cash and Other Monetary Assets

Cash and Other Monetary Assets as of September 30

(In billions of dollars)	2007	2006
Unrestricted Cash:		
Cash held by Treasury for Governmentwide operations	69.7	43.6
Other	18.9	13.2
Restricted Cash	1.0	2.9
Total cash	89.6	59.7
International monetary assets	13.9	15.3
Gold	11.0	11.0
Foreign Currency	13.5	11.9
Total cash and other monetary assets	128.0	97.9

Cash

Total cash consists of:

- Unrestricted cash, includes cash held by the Department of the Treasury for Governmentwide operations (Operating Cash) and all other unrestricted cash held by the Federal agencies. Operating cash represents balances from tax collections, customs duties, other revenue, Federal debt receipts; and other various receipts net of cash outflows for budget outlays and other payments. Operating Cash includes balances invested with commercial depositaries in Treasury Tax and Loan Accounts (including funds invested through the Term Investment Option program and the Repo Pilot program). Treasury checks outstanding are netted against Operating Cash until they are cleared by the Federal Reserve System. Other unrestricted cash not included in Treasury's Operating Cash balance includes balances representing cash, cash equivalents, and other funds held in agencies' books, such as undeposited collections, deposits in transit, demand deposits, amounts held in trust, imprest funds, and amounts representing the balances of petty cash.
- Restricted cash is restricted due to the imposition on cash deposits by law, regulation, or agreement. All cash held by depositary institutions is either insured (for balances up to $100,000) by the Federal Deposit Insurance Corporation or collateralized by securities pledged by the depositary institution or through securities held under reverse repurchase agreements.

International Monetary Assets

International monetary assets include the U.S. reserve position in the International Monetary Fund (IMF) and U.S. holdings of Special Drawing Rights (SDRs)

The U.S. reserve position in the IMF reflects the reserve asset portion of the financial subscription that the United States has paid in as part of its participation in the IMF. The IMF promotes international monetary cooperation and a stable payments system to facilitate growth in the world economy. Its primary activities are surveillance of member economies, financial assistance as appropriate, and technical assistance.

Only a portion of the U.S. financial subscriptions to the IMF is made in the form of reserve assets; the remainder is provided in the form of a letter of credit from the United States to the IMF.

The balance available under the letter of credit totaled $53.2 billion and $48.1 billion for the years ended September 30, 2007, and 2006, respectively. The U.S. reserve position in the IMF has a U.S. dollar equivalent of $4.5 billion and $6.6 billion for the years ended September 30, 2007, and 2006, respectively.

SDRs are international monetary reserves issued by the IMF. These interest-bearing assets can be obtained by IMF allocations, transactions with IMF member countries, interest earnings on SDR holdings, or U.S. reserve position in the IMF. SDR holdings are an asset of Treasury's Exchange Stabilization Fund (ESF), which held SDRs totaling $9.4 billion and $8.7 billion equivalent for the years ended September 30, 2007, and 2006, respectively.

The IMF allocates SDRs to its members in proportion to each member's quota in the IMF. The SDR Act of 1968 authorized the Secretary of the Treasury to issue SDR Certificates (SDRCs) to the Federal Reserve in exchange for dollars. The amount of SDRCs outstanding cannot exceed the dollar value of SDR holdings. The Secretary of the Treasury determines when Treasury will issue or redeem SDRCs. SDRCs outstanding totaled $2.2 billion for the years ended September 30, 2007, and 2006, respectively, and are included in Note 15—Other Liabilities.

As of September 30, 2007, and 2006, other liabilities included $7.6 billion and $7.2 billion, respectively, of interest-bearing liability to the IMF for SDR allocations. The SDR allocation item represents the cumulative total of SDRs distributed by the IMF to the United States in allocations that occurred in 1970, 1971, 1972, 1979, 1980, and 1981.

Foreign Currency

Foreign currency is translated into U.S. dollars at the exchange rate at fiscal yearend. The foreign currency is maintained by various U.S. Federal agencies and foreign banks. Foreign Currency was previously included in the International Monetary assets line in the prior years published *Financial Reports*. The data for fiscal year 2006 has been moved to the Foreign Currency line for comparison.

Gold

Gold is valued at the statutory price of $42.2222 per fine troy ounce. The number of fine troy ounces was 261,498,900 as of September 30, 2007, and 2006, respectively. The market value of gold on the London Fixing as of the reporting date was $743 and $599 per fine troy ounce for the years ended September 30, 2007, and 2006, respectively. Gold totaling $11.0 billion for the years ending September 30, 2007, and 2006, respectively, was pledged as collateral for gold certificates issued and authorized to the FRBs by the Secretary of the Treasury. Treasury may redeem the gold certificates at any time. See Note 15—Other Liabilities.

Note 3. Accounts and Taxes Receivable, Net

Accounts receivable includes related interest receivable of $6.3 billion and $5.4 billion for the years ended September 30, 2007, and 2006, respectively, and represents claims to cash or other assets from entities outside the Government. An allowance for estimated losses due to uncollectible amounts is established when it is more likely than not the receivables will not be totally collected. The allowance method varies among the agencies in the Government and is usually based on past collection experience and are re-estimated periodically as needed. Methods include statistical sampling of receivables, specific identification and intensive analysis of each case, aging methodologies, and percentage of total receivables based on historical collection. Accounts receivable are net of an allowance for uncollectible accounts. The allowance amounts are $14.3 billion and $12.5 billion for the years ended September 30, 2007 and 2006, respectively.

Accounts receivable for HHS increased by $8.4 billion due to the first time recording of a receivable for Medicare Part D overpayments to plans in 2006 and an estimate for the first nine months of the calendar year 2007.

Taxes receivable are the gross tax receivables net of allowance for doubtful accounts. Gross taxes receivable consist primarily of assessments, penalties, and related interest that were not paid or abated and which the taxpayers have agreed the amounts are owed or a court has determined the assessments are owed. The allowance for doubtful accounts is based on projections of collectibility from a statistical sample of unpaid tax assessments.

Accounts and Taxes Receivable as of September 30

(In billions of dollars)	2007	2006
Department of Health and Human Services	13.0	3.2
Department of Agriculture	8.9	8.6
Social Security Administration	8.0	7.6
Department of Defense	7.5	7.9
Pension Benefit Guaranty Corporation	5.8	2.0
Department of Energy	3.9	4.0
Department of Interior	1.9	2.5
Tennessee Valley Authority	1.7	1.4
Department of Treasury	1.7	1.0
Department of Veterans Affairs	1.3	1.2
Department of Labor	1.1	1.1
All other departments	5.1	5.6
Accounts receivable, net	59.9	46.1
Gross taxes receivable	101.5	94.3
Allowance for doubtful accounts	(73.6)	(71.6)
Taxes receivable, net	27.9	22.7
Total accounts and taxes receivable, net	87.8	68.8

Note 4. Loans Receivable and Loan Guarantee Liabilities, Net

The Government uses two methods, direct loans and loan guarantee programs, to accomplish the same goals. These goals are to promote the Nation's welfare by making direct Federal loans and guaranteeing non-federal loans to segments of the population not served adequately by non-federal institutions. For those unable to afford credit at the market rate, Federal credit programs provide subsidies in the form of direct loans offered at an interest rate lower than the market rate. For those to whom non-federal financial institutions are reluctant to grant credit because of the high risk involved, Federal credit programs guarantee the payment of these non-federal loans and absorb the cost of defaults.

The amount of the long-term cost of post-1991 direct loans and loan guarantees outstanding equals the subsidy cost allowance for direct loans and the liability for loan guarantees as of the fiscal yearend. The amount of the long-term cost of pre-1992 direct loans and loan guarantees equals the allowance for uncollectible amounts (or present value allowance) for direct loans and the liability for loan guarantees. The long-term cost is based on all direct loans and guaranteed loans disbursed in this fiscal year and previous years that are outstanding as of the end of this fiscal year. It includes the subsidy cost of these loans and guarantees estimated as of the time of loan disbursement and subsequent adjustments such as modifications, reestimates, amortizations, and writeoffs.

Direct Loans and Loan Guarantees as of September 30

(In billions of dollars)	Face Value of Loans Outstanding 2007	Face Value of Loans Outstanding 2006	Long-term Cost of Loans and Guarantees Outstanding 2007	Long-term Cost of Loans and Guarantees Outstanding 2006	Net Loans Receivable 2007	Net Loans Receivable 2006	Amount Guaranteed by the Government 2007	Amount Guaranteed by the Government 2006	Subsidy Expense for the Fiscal Year Ended September 30 2007	Subsidy Expense for the Fiscal Year Ended September 30 2006
Direct Loan Programs:										
Federal Direct Student Loans - Education	108.0	101.6	8.8	8.3	99.2	93.3			(0.5)	6.6
Electric Loans - USDA	36.0	34.2	1.1	1.6	34.9	32.6			-	(0.3)
Rural Housing Services - USDA	27.1	26.8	6.9	7.0	20.2	19.8			0.1	1.0
Federal Family Education Loans - Education	23.7	21.2	7.1	7.6	16.6	13.6			-	-
Water and Environmental Loans - USDA	9.3	8.7	0.8	0.8	8.5	7.9			-	-
Farm Loans - USDA	6.6	6.7	0.3	0.5	6.3	6.2			-	0.1
Housing and Urban Development	3.9	3.9	(0.9)	(0.4)	4.8	4.3			(0.1)	(0.2)
Housing for the Elderly and Disabled - HUD	4.6	5.5	-	(0.1)	4.6	5.6			-	-
Export-Import Bank Loans	7.3	8.4	2.9	2.9	4.4	5.5			-	-
U.S. Agency for International Development	6.7	7.2	2.3	2.4	4.4	4.8			5.8	-
Telecommunications Loans - USDA	4.0	4.0	(0.3)	-	4.3	4.0			(0.1)	-
Foreign Military Financing Program	3.2	3.7	0.2	-	3.0	3.7			-	-
All Other Direct Loan Programs	29.4	29.3	8.7	9.8	20.7	19.5			0.3	1.2
Total	269.8	261.2	37.9	40.4	231.9	220.8			5.5	8.4
Guaranteed Loan Programs:										
Federal Housing Administration Loans - HUD	438.8	434.2	7.4	3.5			400.0	395.8	(1.0)	(1.4)
Federal Family Education Loans - Education	363.3	324.6	50.8	52.6			359.2	321.0	4.9	28.0
Small Business Loans - SBA	71.5	67.2	1.7	1.6			58.4	54.6	-	-
Export-Import Bank Guarantees	50.2	49.4	1.3	1.3			50.2	49.4	0.1	0.2
Veterans Housing Benefit Programs - VA	207.6	203.2	3.8	3.3			24.9	61.3	0.1	(0.8)
Rural Housing Services - USDA	17.9	15.9	0.7	0.6			16.1	14.3	-	0.1
Israeli Loan Guarantee Program - AID	12.7	12.9	1.4	1.2			12.7	12.9	-	-
Overseas Private Investment Corporation Credit Program	4.1	4.1	0.5	0.6			4.1	4.1	-	-
Federal Ship Financing Fund (Title XI) - DOT	2.7	2.9	0.3	0.3			2.9	2.9	-	-
Business and Industry Loans - USDA	3.7	3.9	0.3	0.3			2.7	2.9	0.1	-
Export Credit Guaranteed Programs - USDA	2.4	3.0	0.2	0.2			2.3	2.9	(0.3)	(0.3)
All Other Guaranteed Loan Programs	18.5	18.2	0.7	0.9			16.6	16.6	(0.1)	0.1
Total Guaranteed Loan Programs	1,193.4	1,139.5	69.1	66.4			950.1	938.7	3.8	25.9

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

The total subsidy expense is the cost of direct loans and loan guarantees recognized during the fiscal year. It consists of the subsidy expense incurred for direct and guaranteed loans disbursed during the fiscal year, for modifications made during the fiscal year of loans and guarantees outstanding, and for reestimates as of the end of the fiscal year of the cost of loans and guarantees outstanding. This expense is included in the Statements of Net Cost.

Major Loan Programs

The Department of Education (Education) has two major education loan programs. The first major education loan program, the Federal Direct Student Loan Program, established in fiscal year 1994, offers four types of education loans: Stafford, Unsubsidized Stafford, PLUS for parents, and consolidation loans. Evidence of financial need is required for a student to receive a subsidized Stafford loan. The other three types of loans are available to borrowers at all income levels. These loans usually mature 9 to 13 years after the student is no longer enrolled. They are unsecured. The second major education loan program, the Federal Family Education Loan Program established in fiscal year 1965, is a guaranteed loan program. Like the Federal Direct Student Loan Program, it offers four types of loans: Stafford, Unsubsidized Stafford, PLUS for parents, and consolidation loans.

The USDA offers direct and guaranteed loans through credit programs in the Farm and Foreign Agricultural Services (FFAS) Mission Area through the Farm Service Agency (FSA), and the Commodity Credit Corporation (CCC), and in the Rural Development Mission Area (RD).

The FFAS delivers commodity, credit, conservation, disaster and emergency assistance programs that help strengthen and stabilize the agricultural economy.

The FSA offers direct and guaranteed loans to farmers who are unable to obtain private commercial credit and through this supervised credit to graduate its borrowers to commercial credit. The CCC offers both guarantee credit and direct credit programs for buyers of U.S. exports, suppliers, and sovereign countries in need of food assistance.

The RD provides affordable housing and essential community facilities to rural communities through its housing loan and grant programs. These programs include:

- Very low- and low-to-moderate-income home ownership loans and guarantees.
- Very low-income housing repair loans.
- Multifamily housing loans and guarantees.
- Domestic farm labor housing loans.
- Housing site loans.
- Credit sales of acquired property.

The Rural Utilities Program administers a variety of loan programs for electric energy, telecommunications, and water and environmental projects in rural America.

The Department of Housing and Urban Development, Federal Housing Administration (FHA) provides mortgage insurance to encourage lenders to make credit available to expand home ownership. FHA predominately serves borrowers that the conventional market does not serve adequately. This includes first-time homebuyers, minorities, low-income families, and residents of under-served areas.

The VA's Veterans Housing Benefit Program provides partial guarantee of residential mortgage loans issued to eligible veterans, reservists, and service members by private lenders. This guarantee allows veterans, reservists, and service members to purchase a home without a substantial down payment.

The Export-Import Bank (EXIM) aids in financing and promoting U.S. exports. To accomplish its objectives, the bank's authority and resources are used to:

- Assume commercial and political risk that exporters or private institutions are unwilling or are unable to undertake.
- Overcome maturity and other limitations in private sector financing.
- Assist U.S. exports to meet foreign officially-sponsored export credit competition.
- Provide leadership and guidance in export financing to the U.S. exporting and banking communities and to foreign borrowers.

The average repayment terms for these loans are approximately 7 years.

The Department of Defense (DOD), on behalf of the Executive Office of the President, provided military assistance to certain countries under the authorities of the Foreign Assistance Act of 1961, as amended, and the Arms Export Control Act of 1976, as amended.

The U.S. Agency for International Development (USAID) provides economic assistance to selected countries in support of U.S. efforts to promote stability and security interests in strategic regions of the world.

Other loan programs include the Small Business Administration general business loan guarantees and disaster loans, and the Farm Service Agency's farm ownership, emergency, and disaster loans and loans and guarantees made by the DOD under its Military Housing Privatization, and Armament Retooling and Manufacturing Support Initiatives.

Government-sponsored enterprises have the authority to request borrowings totaling $10 billion, subject to the approval of the Secretary of the Treasury.

Certain amounts, as of September 30, 2006, for the face value of loans outstanding, the long term cost of direct loans outstanding and net loan receivable amounts included in All Other Direct Loans were reclassified into the Federal Direct Student Loans-Education and Export-Import Bank Loans programs to reflect the amounts that were misclassified in the prior year. The reclassifications are summarized in the table below:

Direct Loan Programs as of September 30, 2006

(In billions of dollars)	Face Value of Loans Outstanding	Long-Term Cost of Loans Outstanding	Net Loans Receivable
Federal Direct Student Loans- Education	0.6	-	0.6
Export-Import Bank Loans	2.4	1.4	1.0
All Other Direct Loan Programs	(3.0)	(1.4)	(1.6)
Total	-	-	-

The reclassifications did not affect the total amounts for the face value of loans outstanding, the long term cost of direct loans outstanding, and the net loan receivable amounts as of September 30, 2006.

Please refer to the individual financial statements of the agencies specified above for significant detailed information regarding direct and guaranteed loans.

Note 5. Inventories and Related Property, Net

Inventories and Related Property as of September 30

(In billions of dollars)	Defense 2007	All Others 2007	Total 2007	Defense 2006	All Others 2006	Total 2006
Inventory purchased for resale	86.5	0.7	87.2	86.5	0.7	87.2
Inventory and operating material and supplies held for repair	48.5	0.6	49.1	48.1	0.5	48.6
Inventory—excess, obsolete, and unserviceable	7.3	-	7.3	9.8	0.1	9.9
Operating materials and supplies held for use	124.0	5.8	129.8	130.5	4.6	135.1
Operating materials and supplies held in reserve for future use	-	0.2	0.2	-	0.2	0.2
Operating materials and supplies—excess, obsolete, and unserviceable	2.4	0.2	2.6	2.1	(0.2)	1.9
Stockpile materials	-	43.9	43.9	0.1	42.9	43.0
Stockpile materials held for sale	0.9	0.3	1.2	1.0	0.3	1.3
Forfeited property	-	0.2	0.2	-	0.2	0.2
Other related property	0.6	0.8	1.4	0.8	0.8	1.6
Total allowance for inventories and related property	(45.3)	(0.5)	(45.8)	(47.2)	(0.5)	(47.7)
Total inventories and related property, net	224.9	52.2	277.1	231.7	49.6	281.3

Inventory is tangible personal property that is (1) held for sale, principally to Federal agencies, (2) in the process of production for sale, or (3) to be consumed in the production of goods for sale or in the provision of services for a fee.

Inventory purchased for resale is the cost or value of tangible personal property purchased by an agency for resale. DOD values approximately 63 percent of its resale inventory using the moving average cost (MAC) method. An additional 9 percent (fuel inventory) is reported using the first-in-first-out method. DOD reports the remaining 28 percent of resale inventories at an approximation of historical cost using latest acquisition cost (LAC) adjusted for holding gains and losses.

Inventory held in reserve for future sale is inventory not readily available, or inventory that will be needed in the future. Inventory and operating materials and supplies held for repair are damaged inventory that require repair to make them suitable for sale (inventory) or is more economic to repair than to dispose of (operating materials and supplies).

Inventory—excess, obsolete, and unserviceable consists of:

- Excess inventory is that which exceeds the demand expected in the normal course of operations and which does not meet management's criteria to be held in reserve for future sale.
- Obsolete inventory is that which no longer is needed due to changes in technology, laws, customs, or operations.
- Unserviceable inventory is inventory damaged beyond economic repair.

Excess, obsolete, and unserviceable inventory is reported at net realizable value.

Please refer to the individual financial statements of DOD and GSA for significant detailed information regarding inventory held for future sale.

Operating materials and supplies held for use are tangible personal property to be consumed in normal operations.

Operating materials and supplies held in reserve for future use are materials retained because they are not readily available in the market or because they will not be used in the normal course of operations, but there is more than a remote chance that they will eventually be needed. DOD, which accounts for most of the reported operating materials and supplies held for use, uses LAC, MAC and Standard Price under the purchase and consumption methods of accounting and does not adjust for holding gains and losses. The DOD valuation methods do not approximate historical cost.

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

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

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

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

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

Other related property consists of:

- Commodities include items of commerce or trade that have an exchange value used to stabilize or support market prices. Please refer to the financial statements of the USDA for detailed information regarding commodities.
- Seized monetary instruments are comprised only of monetary instruments that are awaiting judgment to determine ownership. The related liability is included in other liabilities. Other property seized by the Government, such as real property and tangible personal property, is not considered a Government asset. It is accounted for in agency property-management records until the property is forfeited, returned, or otherwise liquidated. Please refer to the individual financial statements of the Department of Justice (Justice), Treasury, and the Department of Homeland Security (DHS) for significant detailed information regarding seized property.
- Forfeited property is comprised of monetary instruments, intangible property, real property, and tangible personal property acquired through forfeiture proceedings; property acquired by the Government to satisfy a tax liability; and unclaimed and abandoned merchandise. Please refer to the individual financial statements of Justice, Treasury, and DHS for significant detailed information regarding forfeited property.
- Other property not classified above.

Note 6. Property, Plant, and Equipment, Net

The category of property, plant, and equipment consists of tangible assets including land, buildings, structures, Internal Use software, and other assets used to provide goods and services. Depreciation and amortization is recognized using the straight-line method over the estimated useful lives of the assets.

Property, Plant, and Equipment as of September 30, 2007

(In billions of dollars)	Cost		Accumulated Depreciation/ Amortization		Net	
	Defense	All Others	Defense	All Others	Defense	All Others
Buildings, structures, and facilities	173.3	189.3	101.5	96.9	71.8	92.4
Furniture, fixtures, and equipment	728.1	151.0	359.7	84.5	368.4	66.5
Construction in progress	19.5	34.5	N/A	N/A	19.5	34.5
Land	10.5	11.3	N/A	N/A	10.5	11.3
Internal Use software	9.3	10.6	5.8	4.9	3.5	5.7
Assets under capital lease	1.0	1.7	0.5	0.7	0.5	1.0
Leasehold improvements	0.6	4.4	0.3	2.4	0.3	2.0
Other property, plant, and equipment	0.1	8.6	-	5.5	0.1	3.1
Subtotal	942.4	411.4	467.8	194.9	474.6	216.5
Total property, plant, and equipment, net		1,353.8		662.7		691.1

Property, Plant, and Equipment as of September 30, 2006

(In billions of dollars)	Cost		Accumulated Depreciation/ Amortization		Net	
	Defense	All Others	Defense	All Others	Defense	All Others
Buildings, structures, and facilities	167.9	180.2	98.4	91.9	69.5	88.3
Furniture, fixtures, and equipment	700.4	127.7	338.6	76.6	361.8	51.1
Construction in progress	20.0	47.2	N/A	N/A	20.0	47.2
Land	10.5	11.0	N/A	N/A	10.5	11.0
Internal User software	8.7	8.9	5.3	3.8	3.4	5.1
Assets under capital lease	0.6	1.6	0.5	0.6	0.1	1.0
Leasehold improvements	0.3	4.4	0.2	2.5	0.1	1.9
Other property, plant, and equipment	0.1	50.8	-	33.4	0.1	17.4
Subtotal	908.5	431.8	443.0	208.8	465.5	223.0
Total property, plant, and equipment, net		1,340.3		651.8		688.5

For physical quantity information related to multi-use heritage assets, refer to Note 24—Heritage Assets.

Please refer to the individual financial statements of DOD, DOE, USPS, NASA, GSA and TVA for significant detailed information for property, plant and equipment. These agencies comprise 85 percent of the Government's total reported net property, plant, and equipment of $691.1 billion as of September 30, 2007.

Note 7. Securities and Investments

Securities and Investments as of September 30

(In billions of dollars)	2007	2006
Securities and investments:		
Pension Benefit Guaranty Corporation	45.9	35.5
Railroad Retirement Board *	32.0	28.6
Exchange Stabilization Fund	10.0	9.3
Tennessee Valley Authority	9.6	8.5
All other	2.3	1.9
Total Securities and Investments	99.8	83.8

* For more information, see the Social Insurance, Railroad Retirement, segment in the Supplemental Information section.

These securities and investments do not include nonmarketable Treasury securities, which have been eliminated in consolidation. They are presented at cost, net of unamortized premiums and discounts. The Pension Benefit Guaranty Corporation (PBGC) invests primarily in fixed maturity and equity securities. As discussed in the Railroad Retirement section of Supplemental Information—Social Insurance, the National Railroad Retirement Investment Trust manages and invests railroad retirement assets that are to be used to pay retirement benefits to the Nation's railroad workers under the Railroad Retirement Program, a social insurance program. Treasury's Exchange Stabilization Fund invests primarily in foreign currency, bonds, and bills. TVA balance includes $8.4 billion and $7.5 billion for years ending September 30, 2007, and 2006, respectively, relates to the Tennessee Valley Authority Retirement System.

Note 8. Other Assets

Other Assets as of September 30

(In billions of dollars)	2007	2006
Advances and prepayments	30.5	29.9
Other	34.9	25.5
Total other assets	65.4	55.4

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

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

Note 9. Accounts Payable

Accounts Payable as of September 30

(In billions of dollars)	2007	2006
Department of Defense	29.7	27.4
Department of Agriculture	4.4	4.2
Department of Veterans Affairs	3.9	0.8
Department of Homeland Security	3.0	2.8
Department of Justice	2.8	2.3
Tennessee Valley Authority	2.7	1.1
Department of the Treasury	2.5	0.7
Agency for International Development	2.4	2.3
U.S. Postal Service	2.0	2.0
Department of State	2.0	1.3
General Services Administration	1.8	2.0
Department of Energy	1.4	1.3
Department of Interior	1.1	1.1
Department of Labor	1.1	0.9
National Aeronautics and Space Administration	1.0	1.7
All other departments	4.4	6.5
Total accounts payable	66.2	58.4

The accounts payable table includes accounts payable for goods and property ordered and received, services rendered by other than Federal employees, and accounts payable for cancelled appropriations.

Note 10. Federal Debt Securities Held by the Public and Accrued Interest

Definitions of Debt

Debt Held by the Public—Federal debt held outside the Government by individuals, corporations, State or local governments, Federal Reserve banks, foreign governments, and central banks.

Intragovernmental Debt Holdings—Federal debt held by Government trust funds, revolving funds, and special funds.

Federal Debt Securities Held by the Public and Accrued Interest

(In billions of dollars)	Balance September 30, 2006	Net Change During Fiscal Year 2007	Balance September 30, 2007	Average Interest Rate 2007	Average Interest Rate 2006
Treasury Securities (Public):					
Marketable securities:					
Treasury bills	908.5	46.1	954.6	4.6%	5.0%
Treasury notes	2,445.3	10.8	2,456.1	4.4%	4.2%
Treasury bonds	534.5	26.4	560.9	7.4%	7.6%
Treasury inflation-protected securities (TIPS)	395.5	61.3	456.8	2.3%	2.3%
Total marketable Treasury securities	4,283.8	144.6	4,428.4		
Nonmarketable securities	559.3	61.6	620.9	4.9%	5.0%
Net unamortized premium/ (discounts)	(40.2)	0.8	(39.4)		
Total Treasury securities, net (public)	4,802.9	207.0	5,009.9		
Agency Securities:					
Tennessee Valley Authority	22.9	(0.3)	22.6		
All other agencies	0.2	0.2	0.4		
Total agency securities, net of unamortized premiums and discounts	23.1	(0.1)	23.0		
Accrued interest payable	41.5	3.3	44.8		
Total Federal debt securities held by the public and accrued interest	4,867.5	210.2	5,077.7		

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

This table details Government borrowing to finance operations and shows marketable and nonmarketable securities at face value less net unamortized discounts including accrued interest.

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

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

Section 3111 of Title 31, United States Code (U.S.C.) authorizes the Secretary of the Treasury to use money received from the sale of an obligation and other money in the General Fund of the Treasury to buy, redeem, or refund, at or before maturity, outstanding bonds, notes, certificates of indebtedness, Treasury bills, or savings certificates of the Government. There were no buyback operations in fiscal years 2007 and 2006.

As of September 30, 2007, and 2006, respectively, $8,921.3 billion and $8,420.3 billion of debt were subject to a statutory limit (31 U.S.C. § 3101). That limit was $9,815.0 billion as of September 30, 2007, and $8,965.0 billion as of September 30, 2006. The debt subject to the limit includes Treasury securities held by the public and Government guaranteed debt of Federal agencies (shown in the table above) and intragovernmental debt holdings (shown in the table below).

Intragovernmental debt holdings represent the portion of the gross Federal debt held as investments by Government entities. This includes trust funds that are earmarked funds. For more information on earmarked funds, see Note 20─Earmarked Funds. These intragovernmental debt holdings are eliminated in the consolidation of these financial statements.

Intragovernmental Debt Holdings: Federal Debt Securities Held as Investments by Government Accounts as of September 30

(In billions of dollars)	Balance 2006	Net Change During Fiscal Year 2007	Balance 2007
Social Security Administration, Federal Old-Age and Survivors Insurance	1,793.1	175.2	1,968.3
Office of Personnel Management, Civil Service Retirement and Disability	689.9	11.8	701.7
Department of Health and Human Services, Federal Hospital Insurance	302.2	17.2	319.4
Social Security Administration, Federal Disability Insurance	202.2	11.6	213.8
Department of Defense, Military Retirement Fund	181.8	8.4	190.2
Department of Defense, Medicare-Eligible Retiree Health Care Fund	72.7	19.5	92.2
Department of Labor, Unemployment	66.2	8.7	74.9
Federal Deposit Insurance Corporation Funds	49.3	1.4	50.7
Department of Energy, Nuclear Waste Disposal	36.5	2.9	39.4
Department of Health and Human Services, Federal Supplementary Medical Insurance	32.3	6.9	39.2
Pension Benefit Guaranty Corporation Fund	36.6	(0.8)	35.8
Office of Personnel Management, Employees' Life Insurance	31.3	1.7	33.0
Office of Personnel Management, Postal Service Retiree Health Benefits Fund	-	25.5	25.5
Housing and Urban Development, Federal Housing	22.0	0.4	22.4
Department of Treasury, Exchange Stabilization Fund	15.7	0.7	16.4
Office of Personnel Management, Employees' Health Benefits	14.8	1.1	15.9
Department of State, Foreign Services Retirement and Disability Fund	13.9	0.5	14.4
Department of Transportation, Highway Trust Fund	11.0	1.2	12.2
Department of Veterans Affairs, National Service Life Insurance Fund	10.2	(0.4)	9.8
All other programs and funds	82.2	1.0	83.2
Subtotal	3,663.9	294.5	3,958.4
Unamortized net (discounts)/premiums	(1.2)	4.9	3.7
Total intragovernmental debt holdings, net	3,662.7	299.4	3,962.1

Note 11. Federal Employee and Veteran Benefits Payable

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

The Federal Government administers more than 40 pension plans. OPM administers the largest civilian plan. DOD, meanwhile, administers the largest military plan. Other significant pension plans with more than $10 billion in accrued benefits payable include those of the Coast Guard and the Foreign Service. The changes in the accrued post-retirement pension and health benefit liability and components of related expense for the years ended September 30, 2007, and 2006, respectively, are presented below.

Federal Employee and Veteran Benefits Payable as of September 30

	Civilian		Military		Total	
(In billions of dollars)	2007	2006	2007	2006	2007	2006
Pension and accrued benefits	1,386.3	1,349.0	1,028.8	967.1	2,415.1	2,316.1
Post-retirement health and accrued benefits	311.6	295.2	833.8	837.2	1,145.4	1,132.4
Veterans compensation and burial benefits	N/A	N/A	1,127.7	1,153.8	1,127.7	1,153.8
Life insurance and accrued benefits	35.9	34.2	13.1	13.5	49.0	47.7
FECA benefits	15.9	14.4	8.7	8.7	24.6	23.1
Liability for other benefits	0.5	1.5	6.8	4.4	7.3	5.9
Total Federal employee and veteran benefits payable	1,750.2	1,694.3	3,018.9	2,984.7	4,769.1	4,679.0

Change in Pension and Accrued Benefits

(In billions of dollars)	Civilian	Military	Total
Actuarial accrued pension liability as of September 30, 2006	1,349.0	967.1	2,316.1
Pension Expense:			
Prior (and past) service costs from plan amendments	0.4	1.6	2.0
Assumption change	1.2	26.5	27.7
Normal costs	27.3	17.8	45.1
Interest on pension liability during the period	82.5	57.1	139.6
Actuarial (gains)/losses	(10.6)	2.2	(8.4)
Total pension expense	100.8	105.2	206.0
Less benefits paid	63.5	43.5	107.0
Actuarial accrued pension liability as of September 30, 2007	1,386.3	1,028.8	2,415.1

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

(In percentages)	Civilian 2007	Civilian 2006	Military 2007	Military 2006
Rate of interest	6.25%	6.25%	6.00%	6.00%
Rate of inflation	3.50%	3.50%	3.00%	3.00%
Projected salary increases	4.25%	4.25%	3.75%	3.75%

Change in Post-Retirement Health and Accrued Benefits

(In billions of dollars)	Civilian	Military	Total
Actuarial accrued post-retirement health benefits liability, as of September 30, 2006	295.2	837.2	1,132.4
Prior period adjustments	0.4	-	0.4
Corrected beginning post-retirement health benefits liability	295.6	837.2	1,132.8
Post-Retirement Health Benefits Expense:			
Normal costs	11.3	20.3	31.6
Interest on liability	18.2	53.0	71.2
Change in medical inflation rate assumption (gains)/losses	-	(41.2)	(41.2)
Other actuarial (gains)/losses	(1.7)	(16.7)	(18.4)
Total post-retirement health benefits expense	27.8	15.4	43.2
Less claims paid	11.8	18.8	30.6
Actuarial accrued post-retirement health benefits liability, as of September 30, 2007	311.6	833.8	1,145.4

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

(In percentages)	Civilian 2007	Civilian 2006	Military 2007	Military 2006
Rate of interest	6.25%	6.25%	6.00%	6.25%
Rate of health care cost inflation	7.00%	7.00%	6.25%	6.25%

Separate boards of actuaries for OPM and DOD determine the actuarial assumptions used in calculating the pension liability and the post-retirement health benefit liability for the civilian and military personnel. The boards use generally accepted actuarial methodologies. The board for OPM uses a fixed rate of inflation and projected salary increases over all years for both the pension and post-retirement health benefit liabilities. These rates are shown in the tables above. The Board approves the long term assumptions for interest, inflation, and across-the-board salary increases shown in the table above. The DOD Board approves the assumptions used for the Medicare-eligible portion of the military post-retirement health benefit liabilities. DOD uses a range of rates for the health care cost inflation increases, varying by year and type of service, with an ultimate rate for the long term as shown in the table above.

The long-term ultimate rate for fiscal year 2007 of 6.25 percent is shown in the tables above. For disclosure and comparison purposes, DOD's estimate of a single equivalent fixed rate of health care cost inflation for fiscal year 2007 is 6.9 percent, which is an approximation of the single equivalent rate that would produce that same actuarial liability as the actual rates used.

Civilian Employees

Pensions

OPM administers the largest civilian pension plan, which covers approximately 90 percent of all Federal civilian employees. This plan includes two components of defined benefits. These are the Civil Service Retirement System (CSRS) and the Federal Employees' Retirement System (FERS). The basic benefit components of the CSRS and the FERS are financed and operated through the Civil Service Retirement and Disability Fund (CSRDF).

CSRDF monies are generated primarily from employees' contributions, agency contributions, payments from the General Fund, and interest on investments in Treasury securities. See Note 20—Earmarked Funds.

The Federal Retirement Thrift Investment Board, an independent Government agency, administers the Thrift Savings Plan (TSP) Fund. The TSP Fund includes the C-Fund, S-Fund, F-Fund, I-Fund, and G-Fund, and the newly established L-Funds. These financial statements exclude the TSP because the CSRS and FERS employees own its assets.

Treasury securities held in the G-Fund are included and classified as Treasury securities held by the public. There are no limits on the percentage of contribution to the plan for CSRS and FERS employees, as long as they do not exceed the Internal Revenue Service elective deferral limit, which is $15,500 for 2007. FERS participants received the following: Agency Automatic (1 percent) Contributions; Agency Matching Contributions; and vesting is immediate for agency automatic contributions and attributable earnings. Vesting is generally 3 years for agency matching contributions and attributable earnings. To receive the maximum agency Matching Contribution, FERS employees must contribute at least five percent of the basic pay each pay period during the year. (The first five percent of the basic pay each pay period is matched dollar-for-dollar on the first percent, and 50 cents on the dollar for the next two percent.) CSRS employees do not receive any agency contributions.

The G-Fund held $81.4 billion and $72.2 billion in nonmarketable Treasury securities as of September 30, 2007, and 2006, respectively. The Federal Government's related liability is included in total Federal debt securities held by the public and accrued interest in the balance sheets.

The L-Funds, established August 1, 2005, diversifies participant accounts among the G, F, C, S, and I Funds, using professionally determined investment mixes (allocations) that are tailored to different time horizons.

Health Benefits

The post-retirement civilian health benefit liability is an estimate of the Government's future cost of providing post-retirement health benefits to current employees and retirees. Although active and retired employees pay an insurance premium under the Federal Employees Health Benefits Program, these premiums cover only a portion of the costs. The OPM actuary applies economic assumptions to historical cost information to estimate the liability, which is then reduced by certain operating costs and premiums received during the year.

Life Insurance Benefits

One of the largest other employee benefits is the Federal Employee Group Life Insurance Program. Employee and annuitant contributions and interest on investments fund a portion of this liability. The actuarial life insurance liability is the expected present value of future benefits to pay to, or on behalf of, existing Life Insurance Program participants. The OPM actuary uses interest rate, inflation, and salary increase assumptions that are consistent with the pension liability.

Workers' Compensation Benefits

The Department of Labor (DOL) determines both civilian and military agencies' liabilities for future workers' compensation benefits for civilian Federal employees, as mandated by the Federal Employees Compensation Act (FECA) for death, disability, medical, and miscellaneous costs for approved compensation cases, and a component for incurred but not reported claims. The FECA liability is determined annually using historical benefit payment patterns related to a specific incurred period to predict the final payment related to the period. These estimated payments have been discounted to present value using the Office of Management and Budget's economic assumptions for 10-year U.S. Treasury notes and bonds. For 2007, a 4.93 percent interest rate was assumed and 5.08 percent was assumed for year two and thereafter.

The DOL calculates the FECA liability using wage inflation factors (cost of living adjustments or COLA) and medical inflation factors (consumer price index – medical or CPIM). The table below is the compensation COLAs and CPIMs used in the estimations for various charge back years.

Fiscal Year	COLA	CPIM
2007	N/A	N/A
2008	2.63%	3.74%
2009	2.90%	4.04%
2010	2.47%	4.00%
2011	2.37%	3.94%
2012+	2.30%	3.94%

Military Employees (Including Veterans)

Pensions

The DOD Military Retirement Fund (MRF) finances military retirement and survivor benefit programs. The increase in Military Retirement Pension is primarily due to interest on the pension liability. The increase is due largely to the unfunded liability amortization schedule adopted by the Board of Actuaries. The prior plan funded the original unfunded liability over a 50-year period with increasing payments, which did not cover the interest on the unfunded liability, and therefore caused an increase in the total liability. The revised plan, effective in fiscal year 2008, will fund the original unfunded liability over a 42-year period with higher payments. Under the revised plan, the expectation is that the unfunded liability will begin decreasing in fiscal year 2008. Actual results depend on future benefit changes, assumption changes, and actuarial experience.

Projected revenues into the MRF come from three sources: interest earnings on MRF assets, monthly DOD contributions, and annual contributions from the Treasury Department. Beginning with fiscal year 2005, the contributions made by Treasury were increased by an amount equal to the annual expense for the new concurrent receipt provision of the fiscal year 2004 National Defense Authorization Act.

The military retirement system consists of a funded, noncontributory, defined benefit plan. It applies to the Departments of the Army, Navy, Air Force, and Marine Corps. This system includes nondisability retirement pay, disability retirement pay, and retirement pay for reserve service and survivor annuity programs. Military personnel (Army, Navy, Marine Corps, and Air Force) who remain on active duty for 20 years or longer are eligible for retirement. There are three different retirement systems that are currently being used by the military: Final Pay, High-3 Year Average, and the Military Retirement Reform Act of 1986 (REDUX). The date each individual enters the military determines which retirement system they would fall under and if they have the option to pick their retirement system.

Final Pay Retirement System: Final Pay applies to individuals who entered the Service before September 8, 1980. Each year of service is worth 2.5 percent towards the retirement multiplier. The longer an individual stays on active duty, the higher the multiplier and the higher the retirement income, up to the maximum of 75 percent of pre-2007 retirements. Starting with 2007 retirements, the retirement multiplier is not limited for individuals with more than 30 years of service. This multiplier is applied against the final basic pay of the individual's career. A cost of living adjustment (COLA) is given annually based on the increase in the CPI.

High-Year Average Retirement System: High-3 Year Average applies to members who first entered the Service after September 8, 1980, but before August 1, 1986. It also applies to individuals who entered on or after August 1, 1986, who do not elect the REDUX retirement system with the $30,000 career status bonus (CSB) at their 15th year of service. The High-3 Year Average calculation is similar to the Final Pay except the High-3 Year Average uses the multiplier against basic pay for the highest 36 months of the individual's career. A COLA is given annually based on the increase in the CPI.

CSB/REDUX Retirement System: The REDUX applies to those who entered the Service on or after September 8, 1980, and who elected to receive the $30,000 CSB at their 15th year of service. Under the CSB/REDUX retirement system, each of the first 20 years of service is worth 2 percent towards the retirement multiplier and each year after 20 years of service is worth 3.5 percent. The retirement multiplier under this retirement system is applied against the average basic pay for the highest 36 months of the individual's basic pay. A COLA is given annually based on the increase in the CPI minus 1 percent. Members retiring under CSB/REDUX receive a one-time catchup at age 62 that restores the retired pay to what it would have been at that point had the member retired under High-3 Year Average. Thereafter, CSB/REDUX members receive reduced (i.e., based on the increase in the CPI minus 1 percent) COLAs for life.

On October 30, 2000, the Floyd D. Spence National Defense Authorization Act (NDAA) for fiscal year 2001 (Public Law No. 106-398) was signed into law. This law amended the effective date of NDAA for fiscal year 2000 (Public Law No. 106-65), which extended participation in the TSP to members of the uniformed services. Members may contribute from their pay, and their contributions and earnings attributable to their TSP belong to them even if they do not serve the 20 or more years ordinarily required to receive retirement pay.

Health Benefits

Military benefits entitle retirees and their dependents to health care in military medical facilities if a facility can provide the needed care. Until they reach age 65, military retirees and their dependents also are entitled to be reimbursed for the cost of health care from civilian providers. A premium is charged to enroll in DOD's civilian care program. In addition, there are deductible and copayment requirements for civilian care. Medicare, and since fiscal year 2002, Tricare as secondary payer, covers military retirees after they reach 65 years of age.

Military retiree health care figures include the cost of education and training, staffing, buildings and equipment, as well as the operation and maintenance of medical facilities. They also include claims paid to civilian providers and the cost of administering the program.

Chapter 56 of Title 10, U.S.C. created the DOD Medicare-Eligible Retiree Health Care Fund effective October 1, 2002. The purpose of this fund is to account for the health benefits of Medicare-eligible members and former members of the DOD Uniformed Services who are entitled to retirement or retainer pay, and their eligible dependents who are Medicare eligible.

In addition to the health care benefits for civilian and military retirees and their dependents, the VA also provides medical care to veterans on an "as available" basis, subject to the limits of the annual appropriations. In accordance with 38 CFR 17.36 (c), VA's Secretary makes an annual enrollment decision that defines the veterans, by priority, who will be treated for that fiscal year subject to change based on funds appropriated, estimated collections, usage, the severity index of enrolled veterans, and changes in cost. VA recognizes the medical care expenses in the period the medical care services are provided. For the time period 2003 through 2007, the average medical cost per year was $27.1 billion.

Veterans Compensation and Burial Benefits

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

Burial benefits include a burial and plot or interment allowance payable for a veteran who, at the time of death, is qualified to receive compensation or a pension, or whose death occurred in a VA facility.

The liability for veteran's compensation and burial benefits payable decreased by $26.1 billion in fiscal year 2007 and increased by $31.2 billion in fiscal year 2006. The primary factors contributing to these fluctuations were changes in interest rates and other actuarial assumptions; various assumptions in the actuarial model, such as the number of veterans and dependents receiving payments; and life expectancy.

Veterans Compensation and Burial Benefits as of September 30

(In billions of dollars)	2007	2006
Veterans	944.0	970.8
Survivors	179.9	179.1
Burial benefits	3.8	3.9
Total compensation and burial benefits payable	1,127.7	1,153.8

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

(In percentages)	2007	2006
Rate of interest	4.48%	4.76%
Rate of inflation	2.90%	4.10%

Life Insurance Benefits

The largest veterans life insurance programs consist of the following:

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

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

Veteran Life Insurance Liability as of September 30

(In billions of dollars)	2007	2006
Insurance Death Benefits:		
NSLI	8.2	8.6
VSLI	1.6	1.6
VRI	0.3	0.3
Other	0.5	0.4
	10.6	10.9
Death benefit annuities	0.1	0.2
Disability income & waiver	0.5	0.5
Insurance dividends payable	1.9	1.9
Total veterans life insurance liability	13.1	13.5

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

The VA supervises Service members' Group Life Insurance and Veterans' Group Life Insurance programs that provide life insurance coverage to members of the uniformed armed services and veterans who served during the Vietnam era or thereafter. The VA also provides certain veterans and/or their dependents with pension benefits, based on annual eligibility reviews, if the veteran died or was disabled for nonservice-related causes. The actuarial present value of the future liability for pension benefits is a nonexchange transaction and is not required to be recorded on the balance sheet. The projected amounts of future payments for pension benefits as of September 30, 2007, and 2006 were $81.4 billion and $97.0 billion, respectively.

As of September 30, 2006, $13.5 billion of Military FECA Benefits were reclassified to Military Life Insurance to correct their classification in the prior year. The reclassification did not affect total Military Employee and Veteran Benefits Payable as of September 30, 2006.

Note 12. Environmental and Disposal Liabilities

Environmental and Disposal Liabilities as of September 30

(In billions of dollars)	2007	2006
Department of Energy:		
Environmental Management Program	188.6	159.1
Legacy Environmental Liabilities - other	29.4	28.1
Active and Surplus Facilities	29.2	27.6
High-level Waste and Spent Nuclear Fuel	16.4	15.5
Total Department of Energy	263.6	230.3
Department of Defense:		
Environmental Restoration	33.1	33.5
Disposal of Weapon Systems Program	31.4	30.2
Base Realignment and Closure	5.1	4.1
Environmental Corrective Other	2.9	2.2
Total Department of Defense	72.5	70.0
All other agencies	5.9	4.9
Total environmental and disposal liabilities	342.0	305.2

During World War II and the Cold War, DOE (or predecessor agencies) developed a massive industrial complex to research, produce, and test nuclear weapons. The nuclear weapons complex included nuclear reactors, chemical-processing buildings, metal machining plants, laboratories, and maintenance facilities.

At all the sites where these activities took place, some environmental contamination occurred. This contamination was caused by the production, storage, and use of radioactive materials and hazardous chemicals, which resulted in contamination of soil, surface water, and groundwater. The environmental legacy of nuclear weapons production also includes thousands of contaminated areas and buildings, and large volumes of waste and special nuclear materials requiring treatment, stabilization, and disposal.

Of those environmental liabilities, this report presents only cleanup costs from Federal operations known to result in hazardous and radioactive waste that the Government is required to clean up by Federal, State, or local statutes and/or regulations. Some of these statutes are the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA); the Resource Conservation and Recovery Act; the Nuclear Waste Policy Act of 1982, which provides for permanent disposal of the Nation's high-level radioactive waste and spent nuclear fuel; and Public Law No. 105-204, which requires a plan for the conversion of depleted uranium hexafluoride.

DOE is responsible for managing the legacy of contamination from the nuclear weapons complex. The environmental management baseline estimate includes projections of the technical scope, schedule, and costs for environmental restoration; managing nuclear materials waste treatment, storage and disposal activities; and post-cleanup monitoring and stewardship at each installation. The baseline estimate includes costs for related activities such as landlord responsibilities, program management, and legally prescribed grants and cooperative agreements for participation and oversight by Native American tribes, regulatory agencies, and other stakeholders. Active and surplus facilities represent anticipated remediation costs for those facilities that are conducting ongoing operations but ultimately will require stabilization, deactivation, and decommissioning.

Estimated cleanup costs at sites for which there are no current feasible remediation approach are excluded from the baseline estimates, although applicable stewardship and monitoring costs for these sites are included. Significant projects not included are the nuclear explosion test areas (e.g., Nevada test site).

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

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

DOE is also required to recognize closure and post-closure costs for its active and surplus facilities and environmental corrective action costs for current operations. The cleanup cost associated with active and surplus facilities that is allocated to operating periods beyond the balance sheet date is identified as the unrecognized portion. The DOE unrecognized portion of the cleanup cost associated with active and surplus facilities is $760.0 million and $505.0 million for fiscal years 2007 and 2006, respectively. The unrecognized portion of the cleanup cost is recognized over a predetermined period of time.

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

DOD is required by law to adhere to CERCLA and the Superfund Amendment and Reauthorization Act to clean up contamination resulting from waste disposal practices, leaks, spills, and other activities that have created a public health or environmental risk. CERCLA requires DOD to clean up contamination in coordination with regulatory agencies, other responsible parties, and current property owners.

DOD must restore active installations, installations affected by base realignment and closure, and other areas formerly used as defense sites. DOD also bears responsibility for disposal of chemical weapons and environmental costs associated with the disposal of weapons systems (primarily nuclear powered aircraft carriers and submarines). DOD is responsible, as well, for training range and other nonrange unexploded ordnance cleanup.

DOD is currently using two independently validated estimating models, in addition to engineering estimates, to report its environmental liabilities. The models are the Remedial Action Cost Engineering Requirements (RACER) and the Department of Navy Normalization of Data System (NORM). DOD uses the models to estimate cost during the preliminary assessment and initial site investigation phases of restoration projects. Engineering estimates are generally used to estimate cost from the remedial investigation/feasibility phase of the project forward. DOD is also required to recognize closure and post-closure costs for its general property, plant, and equipment and environmental corrective action costs for current operations. The cleanup cost associated with general property, plant, and equipment that is allocated to operating periods beyond the balance sheet date is identified as the unrecognized portion. The DOD unrecognized portion of the cleanup cost associated with general property, plant, and equipment is $1,589.1 million and $1,527.4 million for fiscal years 2007 and 2006, respectively. The unrecognized portion of the cleanup costs is recognized over a predetermined period of time.

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

Note 13. Benefits Due and Payable

These amounts are the benefits owed to program recipients or medical service providers as of the fiscal yearend that have not been paid. For a description of the programs, see the Supplemental Information—Social Insurance section.

Benefits Due and Payable as of September 30

(In billions of dollars)	2007	2006
Federal Old-Age and Survivors Insurance	44.1	41.6
Federal Supplementary Medical Insurance (Medicare Part B)	22.2	21.1
Federal Disability Insurance	21.7	20.9
Federal Hospital Insurance (Medicare Part A)	19.4	19.8
Grants to States for Medicaid	19.4	19.2
Supplemental Security Income	4.2	3.5
Unemployment Insurance	1.3	1.1
All Other Benefit Programs	1.4	2.1
Total benefits due and payable	133.7	129.3

Note 14. Insurance Program Liabilities

Insurance Program Liabilities as of September 30

(In billions of dollars)	2007	2006
Insurance Program Liabilities:		
Pension Benefit Guaranty Corporation - Benefit Pension Plans	69.3	69.1
Department of Homeland Security - National Flood Insurance Program	1.5	3.6
All Other Insurance Programs	0.1	0.1
Total Insurance Programs	70.9	72.8

Insurance programs are Federal programs that provide protection to individuals or entities against specified risks except for those Federal employees or veterans discussed in Note 11—Federal Employee and Veteran Benefits Payable. These funds are commonly held in revolving funds with the Federal Government, and losses sustained by participants are paid from these funds. Many of these programs receive appropriations to pay excess claims and/or have authority to borrow from the Treasury. Insurance programs do not include social insurance, loan guarantee programs, and programs designed to benefit only current, former, and dependents of Federal employees.

PBGC insures pension benefits of participants in covered defined benefit pension plans. As a wholly owned corporation of the U.S. Government, PBGC's financial activity and balances are included in the consolidated financial statements of the U.S. Government. However, under current law, PBGC's liabilities may be paid only from PBGC's assets and not from the General Fund of the Treasury or assets of the Government in general. As of September 30, 2007, PBGC had total liabilities of $82.5 billion, and its total liabilities exceeded its total assets by $14.1 billion. In addition, as discussed in Note 18—Contingencies, PBGC reported reasonably possible contingent losses of about $65.7 billion.

The Federal Emergency Management Agency (FEMA) of DHS administers the National Flood Insurance Program (NFIP). The NFIP is administered through sale or continuation-in-force of insurance in communities that enact and enforce appropriate flood plain management measures. This liability represents an estimate of NFIP losses that are unpaid at the balance sheet date and is based on the loss and loss adjustment expense factors, including interest payments, inherent in the NFIP insurance underwriting operations experience and expectations.

Note 15. Other Liabilities

The other liabilities line item is comprised of liabilities that are not separately identified on the balance sheet. The table below presents other liabilities on a comparative basis by major category. Those that do not fit into these major categories are reported in the miscellaneous liabilities category.

Other Liabilities

(In billions of dollars)	2007	2006
Employee-related liabilities		
Accrued Federal employees wages and benefits	31.2	30.0
Selected DOE contractors' and D.C. employees' pension benefits	28.8	28.4
Subtotal	60.0	58.4
Unearned revenue and assets held for others		
DOE's unearned fees for nuclear waste disposal and other unearned revenue	33.6	35.4
Assets held on behalf of others	38.7	23.2
Subtotal	72.3	58.6
Subsidies and grants		
Farm and other subsidies	17.9	20.0
Grant payments due to State and local governments and others	13.1	13.0
Subtotal	31.0	33.0
International monetary liabilities and gold certificates (see Note 2)	20.8	20.4
Miscellaneous liabilities		
Legal and other contingencies	24.7	17.9
Bonneville Power Administration Non-Federal Power Projects and Capital lease liabilities, and disposal liabilities	12.5	13.2
Other miscellaneous	36.9	32.8
Subtotal	74.1	63.9
Total Other Liabilities	258.2	234.3

Employee-Related Liabilities

This category includes amounts owed to employees at yearend and actuarial liabilities for certain non-Federal employees. Actuarial liabilities for Federal employees and veteran benefits are included in Note 11 and are reported on a separate line on the balance sheet. The largest liability in the employee-related liabilities category is the amount owed at the end of the fiscal year to Federal employees for wages and benefits (including accrued annual leave). In addition, DOE is liable to certain contractors such as the University of California, which operates the Lawrence Livermore National Laboratory, for contractor employee pension and postretirement benefits, which is about $12.3 billion and $12.0 billion as of September 30, 2007, and 2006, respectively. Also, the Federal Government owed about $9.0 billion and $9.1 billion as of September 30, 2007, and 2006 respectively, for estimated future pension benefits of the District of Columbia’s judges, police, firefighters, and teachers.

Unearned Revenue and Funds Held for Others

The Federal Government recognizes a liability when it receives money in advance of providing goods and services or assumes custody of money belonging to others. The Federal Government's unearned revenue from fees DOE has collected from utility companies for the future cost of managing the disposal of nuclear waste is about $24.8 billion and $23.3 billion as of September 30, 2007, and 2006, respectively. Other unearned revenue includes U.S. Postal Service income for such things as prepaid postage, outstanding money orders, and prepaid P.O. Box rentals. Assets held on behalf of others include funds collected in advance and undelivered defense articles and services for future delivery to foreign governments.

Subsidies and Grants

The Federal Government supports the public good through a wide variety of subsidy and grant programs in such areas as agriculture, medical and scientific research, education, and transportation. Department of Agriculture programs such as the Conservation Reserve, Tobacco Transition Payment, and Direct and Counter-Cyclical Payment programs account for the majority of the subsidies due, about $11.5 billion, and $13.5 billion as of September 30, 2007, and 2006 respectively.

The Federal Government awards hundreds of billions of dollars in grants annually. These include project grants that are competitively awarded for agency-specific projects, such as the Department of Health and Human Services' grants to fund projects to "enhance the independence, productivity, integration and inclusion into the community of people with developmental disabilities." Other grants are formula grants, such as matching grants. Formula grants go to State governments for such things as education and transportation programs. These grants are paid in accordance with distribution formulas that have been provided by law or administrative regulations. Of the total liability reported for grants as of September 30, 2007, and September 30, 2006, the Departments of Transportation, Education, and Health and Human Services collectively owed their grantees about $11.6 billion and $10.9 billion, respectively. Refer to the financial statements and footnotes of the respective agencies for additional information.

Miscellaneous Liabilities

Some of the more significant liabilities included in this category are for: (1) legal and other contingencies (see Note 18— Contingencies) (2) Bonneville Power Administration liability to pay annual budgets of several power projects for its electrical generating capacity, and (3) capital leases and disposal liabilities. In addition, many Federal agencies reported relatively small amounts of miscellaneous liabilities that are not otherwise described.

Note 16. Collections and Refunds of Federal Revenue

Collections of Federal Revenue for the Year Ended September 30, 2007

(In billions of dollars)	Federal Revenue Collections	Tax Year to Which Collections Relate 2007	2006	2005	Prior Years
Individual income and tax withholdings	2,201.5	1,408.6	750.6	23.9	18.4
Corporation income taxes	395.3	253.4	116.3	2.9	22.7
Unemployment taxes	39.4	21.9	9.8	7.6	0.1
Excise taxes	69.9	51.8	17.8	0.1	0.2
Estate and gift taxes	27.0	-	16.2	1.6	9.2
Railroad retirement taxes	4.7	3.6	1.1	-	-
Federal Reserve earnings	32.0	26.2	5.8	-	-
Fines, penalties, interest, and other revenue	9.5	9.1	0.4	-	-
Custom duties	26.3	26.3	-	-	-
Subtotal	2,805.6	1,800.9	918.0	36.1	50.6
Less: amounts collected for non-federal entities	(0.5)				
Total	2,805.1				

Treasury is the Government's principal revenue-collecting agency. Collections of individual income tax and tax withholdings consist of Federal Insurance Contributions Act/Self-Employment Contributions Act and other taxes including payroll taxes collected from other agencies.

Federal Tax Refunds Disbursed for the Year Ended September 30, 2007

(In billions of dollars)	Refunds Disbursed	Tax Year to Which Refunds Relate 2007	2006	2005	Prior Years
Individual income and tax withholdings	261.1	1.8	235.2	17.8	6.3
Corporation income taxes	28.2	1.2	8.2	4.3	14.5
Unemployment taxes	0.1	-	0.1	-	-
Excise taxes	2.4	0.4	0.6	0.3	1.1
Estate and gift taxes	1.0	-	0.3	0.5	0.2
Custom duties	6.9	5.6	0.2	0.3	0.8
Total	299.7	9.0	244.6	23.2	22.9

Reconciliation of Collections to Revenue

(In billions of dollars)	2007	2006
Total revenue per the Statements of Operations and Changes in Net Position	2,627.3	2,440.8
Tax refunds	299.7	278.9
Earned Income Tax Credit and Child Tax Credit Imputed Revenue	(58.4)	(57.0)
Nontax related fines and penalties reported by agencies	(33.8)	(23.4)
Nontax related earned revenue	(29.7)	(17.1)
Collections of Federal revenue	2,805.1	2,622.2

Total revenue in the Statements of Operations and Changes in Net Position is presented on a modified cash basis, is net of tax refunds, and includes Earned Income Tax Credit (EITC) payments and other nontax related revenue. EITC and Child Tax Credit amounts (unaudited) are included in gross cost in the Statements of Net Cost as a component of Treasury.

On the other hand, collections of Federal revenue reported in the table in this Note are reported on a gross cash basis. The table above reconciles total revenue to collections.

Collections of Federal Revenue for the Year Ended September 30, 2006

(In billions of dollars)	Federal Revenue Collections	Tax Year to Which Collections Relate 2006	2005	2004	Prior Years
Individual income and tax withholdings	2,034.2	1,309.4	690.8	17.3	16.7
Corporation income taxes	380.4	259.1	103.8	1.7	15.8
Unemployment taxes	41.6	22.8	10.1	8.6	0.1
Excise taxes	74.8	55.5	19.0	0.1	0.2
Estate and gift taxes	28.7	0.1	18.8	1.2	8.6
Railroad retirement taxes	4.7	3.6	1.1	-	-
Federal Reserve earnings	29.9	24.1	5.8	-	-
Fines, penalties, interest, and other revenue	2.4	2.0	0.4	-	-
Custom duties	25.9	25.9	-	-	-
Subtotal	2,622.6	1,702.5	849.8	28.9	41.4
Less: Amounts collected for non-federal entities	(0.4)				
Total	2,622.2				

Federal Tax Refunds Disbursed for the Year Ended September 30, 2006

(In billions of dollars)	Refunds Disbursed	Tax Year to Which Refunds Relate 2006	2005	2004	Prior Years
Individual income and tax withholdings	245.2	0.6	225.5	13.5	5.6
Corporation income taxes	30.5	1.2	8.8	3.9	16.6
Unemployment taxes	0.1	-	0.1	-	-
Excise taxes	0.7	-	0.5	-	0.2
Estate and gift taxes	1.3	0.5	0.2	0.3	0.3
Custom duties	1.1	1.1	-	-	-
Total	278.9	3.4	235.1	17.7	22.7

Note 17. Prior Period Adjustments

Prior Period Adjustments to Fiscal Years 2007 and 2006

(In billions of dollars)	Decreases to Net Position 2007	2006
Prior Period Adjustments		
National Aeronautics and Space Administration	(12.7)	-
Agency for International Development	(1.9)	-
Other prior period adjustments	0.7	-
Total prior period adjustments	(13.9)	-

For fiscal year 2007, NASA recorded prior period adjustments for $12.7 billion (net decrease), primarily to reflect a change in accounting principle for property, plant and equipment to reclassify costs previously categorized as general property, plant, and equipment to Research and Development (R&D) expenses. After a detailed review of all items previously categorized as property, plant, and equipment, NASA concluded certain projects are more properly classified as R&D, and should not be classified, in their entirety, as capital assets under the classification of property, plant, and equipment. Accordingly, NASA applied the provisions of Statement of Federal Financial Accounting Standards (No. 2), Accounting for R&D Costs to account for its R&D projects. NASA believes the recognition and measurement requirements of SFFAS No. 2 result in reporting financial information that is more relevant and accurate. In fiscal year 2007, AID changed its accounting principles as it relates to parent/child reporting. As a result, the fiscal year 2007 beginning balance for total assets, total liabilities, and net position has changed as follows: Total assets decreased by $2.35 billion. This decrease is primarily attributable to a $2.3 billion decrease in the Fund Balance with Treasury. Total liabilities decreased by $427.6 million. This decrease is mostly due to a decrease of $426 million in accounts payable. Net position decreased by $1.9 billion.

Note 18. Contingencies

Financial Treatment of Loss Contingencies

Loss contingencies that are assessed to be at least reasonably possible are disclosed in this note. Loss contingencies involve situations where there is an uncertainty of a possible loss. The reporting of loss contingencies depends on the likelihood that a future event or events will confirm the loss or impairment of an asset or the incurrence of a liability. Terms used to assess the range for the likelihood of loss are probable, reasonably possible, and remote. Loss contingencies that are assessed as probable and measurable are accrued in the financial statements. Loss contingencies that are assessed as remote are not reported in the financial statements, nor disclosed in the notes. All other material loss contingencies are disclosed in this note. For an overview of the standards that provide criteria for how Federal agencies are to account for loss contingencies, based on the likelihood of the loss and measurability,[1] see the following table.

Likelihood of future outflow or other sacrifice of resources.	Loss amount can be reasonably measured.	Loss range can be reasonably measured.	Loss amount or range cannot be reasonably measured.
Probable. Future confirming event(s) are more likely to occur than not.[2]	Accrue the liability. Reported on Balance Sheet & Statements of Net Cost.	Accrue liability of best estimate or minimum amount in loss range if there is no best estimate, and disclose nature of contingency and range of estimated liability.	Disclose nature of contingency and include a statement that an estimate cannot be made.
Reasonably possible. Possibility of future confirming event(s) occurring is more than remote and less than likely.	Disclose nature of contingency and estimated loss amount.	Disclose nature of contingency and estimated loss range.	Disclose nature of contingency and include a statement that an estimate cannot be made.
Remote. Possibility of future event(s) occurring is slight.	No disclosure.	No disclosure.	No disclosure.

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

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

Insurance Contingencies

At the time an insurance policy is issued, a contingency arises. The contingency is the risk of loss assumed by the insurer, that is, the risk of loss from events that may occur during the term of the policy. For example, the estimated aggregate unfunded vested benefits exposure to Pension Benefit Guaranty Corporation (PBGC) for private-sector single-employer and multiemployer defined pension plans that is classified as reasonably possible, is $65.7 billion and $73.4 billion for 2007 and 2006, respectively.

Insurance in Force

Insurance in Force is the accumulation of policy limits for all policies issued and outstanding at a point in time. The Federal Government has Insurance in Force in the amount of $1,157.3 billion for 2007, and $1,048.6 billion for 2006. These amounts represent estimated maximum exposure to insurance claims and guarantee programs. The major types are identified below:

- Department of Homeland Security (DHS) reported $1,100.0 billion and $994.1 billion for 2007 and 2006, respectively for the National Flood Insurance Program (NFIP).
- Export-Import Bank of the United States (EXIM) reported $39.1 billion and $36.4 billion for 2007 and 2006, respectively for Export Credit Insurance (ECI).

Deposit Insurance

Deposit Insurance covers all types of deposits accounts such as checking, NOW and savings accounts, money market deposit accounts, and certificates of deposits (CDs) received at an insured bank, savings association, or credit union. The insurance covers the balance of each depositor's account, dollar-for-dollar, up to the insurance limit, including principal and any accrued interest through the date of the insured financial intuition's closing. As a result, the Federal Government has aggregated insured deposit exposure estimated at approximately $4,800.2 billion for 2007, and $4,627.1 billion for 2006. However, these amounts represent maximum possible losses assuming all the FDIC and NCUA member depository institutions were to fail and the acquired assets provided no recovery of funds. Actual losses have generally been a very small fraction of the aggregate estimated insured deposits. The breakdown by agency is identified below:

- Federal Deposit Insurance Corporation (FDIC) has estimated insured deposits of $4,239.0 billion for 2007, and $4,094.7 billion for 2006, respectively for the Deposit Insurance Fund (DIF).
- National Credit Union Administration (NCUA) has estimated insured deposits of $561.2 billion for 2007, and $532.4 billion for 2006, respectively for the National Credit Union Share Insurance Fund (NCUSIF).

Legal Contingencies

The Legal Contingencies as of September 30, 2007, and 2006, are summarized in the table below:

(In billions of dollars)	2007 Accrued Liabilities [1]	2007 Estimated Range of Loss for Certain Cases [2] Lower End	2007 Estimated Range of Loss for Certain Cases [2] Upper End	2006 Accrued Liabilities [1]	2006 Estimated Range of Loss for Certain Cases [2] Lower End	2006 Estimated Range of Loss for Certain Cases [2] Upper End
Legal contingencies						
Probable............	6.4	6.4	8.0	3.7	2.8	4.3
Reasonably possible		3.6	6.6		7.6	9.5

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

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

Management and legal counsel have determined that it is "probable" that some of these actions will result in a loss to the Federal Government and the loss amounts are reasonably measurable. The estimated liabilities for these cases are $6.4 billion and $3.7 billion for 2007 and 2006, respectively, and are recorded in the balance sheet line items "Insurance Liabilities," or "Other Liabilities." A few of the major cases are summarized below:

- Department of Health and Human Services (HHS) has accrued $4.1 billion for contingent liabilities related to administrative proceedings, legal actions, and tort claims as of September 30, 2007. For example, HHS Centers for Medicare and Medicaid Services has accrued $2.0 billion for contingent liability to providers for previous years' disputed cost report adjustments for disproportionate share hospitals.
- The United States Postal Service (USPS) has accrued $0.7 billion as of September 30, 2007, including contingencies arising from labor cases, equal employment opportunity cases, environmental issues, and property damage claims.

There are also administrative claims and legal actions pending where adverse decisions are considered by management and legal counsel as "reasonably possible" with an estimate of possible liability or a range of possible liability. The estimated potential losses for such claims and actions range from $3.6 billion to $6.6 billion for 2007, and from $7.6 billion to $9.5 billion for 2006. Two of the major cases are summarized below:

- Department of Agriculture (USDA) reported pending class action discrimination suit in the range of $2.9 billion to $3.0 billion as of September 30, 2007.
- Department of the Interior (DOI) has allegations and claims in the range of $0.3 billion to $2.7 billion related to tribes and individual Indians, the trust territory in the Pacific Islands, the operation of wildlife refuges, and reclamation projects, the general management and law enforcement of Interior-managed land, and the use of natural resources as of September 30, 2007.

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

- Native Americans allege that DOI and Department of the Treasury have breached trust obligations with respect to the management of the plaintiffs' individual Indian monies. The plaintiffs have not made claims for specific dollar amounts in the Federal district court proceedings, but in public statements have asserted that the class is owed tens of billions of dollars.

- Numerous complaints have arisen as a result of Hurricane Katrina. These New Orleans Federal Tort Claims Act (FTCA) cases allege personal injury, wrongful death, and property damages as a result of massive flooding caused by the hurricane. There are over 475,000 administrative claims filed in relation to Hurricane Katrina and 300 related suits in Federal district courts. Additional suits are expected. The range of potential loss is $10 billion to an amount perhaps several times larger.

Environmental and Disposal Contingencies

The Environmental and Disposal Contingencies as of September 30, 2007, and 2006, are summarized in the table below:

	2007	2007 Estimated Range of Loss for Certain Cases [2]		2006	2006 Estimated Range of Loss for Certain Cases [2]	
(In billions of dollars)	Accrued Liabilities [1]	Lower End	Upper End	Accrued Liabilities [1]	Lower End	Upper End
Environmental and Disposal Contingencies						
Probable	11.2	11.2	11.3	7.0	7.0	7.4
Reasonably possible		0.3	0.8		0.5	0.5

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

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

Management and legal counsel have determined that it is “probable” that some of these actions will result in a loss to the Federal Government and the loss amounts are reasonably measurable. The estimated liabilities for these cases are $11.2 billion and $7.0 billion for 2007 and 2006, respectively, and are recorded in the balance sheet line item “Other Liabilities.” Department of Energy (DOE) is subject to Spent Nuclear Fuel litigation for damages suffered by all utilities as a result of the delay in beginning disposal of spent nuclear fuel. Significant claims for partial breach of contract have been filed with estimated liability amounts of $11.1 billion and $6.8 billion for 2007 and 2006, respectively.

Other Contingencies

Example of other contingencies include those reported by Department of Transportation (DOT). The major contingencies are summarized below:

- DOT’s Federal Highway Administration (FHWA) reported $46.2 billion and $45.0 billion respectively, for 2007 and 2006 for Advance Construction Projects.
- DOT’s Federal Transit Administration (FTA) reported $3.9 billion and $1.4 billion for 2007 and 2006 respectively, for Full Funding Agreements.

Note 19. Commitments

The Government has entered into contractual commitments that require future use of financial resources. It has significant amounts of long-term lease obligations and undelivered orders as shown in the following table. Undelivered orders represent the value of goods and services ordered that have not yet been received.

The Government has other contractual commitments that may require future use of financial resources. For example, the Government has callable subscriptions in the Multilateral Development Banks (MDB), which are autonomous international financial entities that finance economic and social development projects in developing countries. Callable capital resembles promissory notes to honor MDB debts if the MDB cannot otherwise meet its obligations through its other available resources. MDBs are able to use callable capital as backing to obtain very favorable financing terms when borrowing from world capital markets. Treasury officials do not anticipate any calls on MDB subscriptions. To date, there has never been a call on this capital for any of the major MDBs.

Commitments as of September 30

(In billions of dollars)	Operating Leases 2007	Operating Leases 2006
General Services Administration	23.1	22.9
U.S. Postal Service	8.4	8.4
Department of Justice	3.1	0.9
Department of State	1.8	-
Department of Health and Human Services	1.6	1.1
Department of Defense	1.1	0.4
Department of Homeland Security	0.9	1.8
Other Operating Leases	4.5	4.3
Total long-term operating leases	44.5	39.8

Commitments as of September 30

(In billions of dollars)	Undelivered Orders 2007	Undelivered Orders 2006
Department of Defense	309.8	173.6
Department of Transportation	72.2	67.6
Department of Health and Human Services	72.1	68.6
Department of Housing and Urban Development	65.2	72.0
Department of the Treasury	55.8	51.1
Department of Education	48.2	47.6
Department of Agriculture	34.9	36.0
Department of Homeland Security	29.9	28.2
Department of Energy	12.2	11.1
Agency of International Development	12.0	11.6
Department of State	11.3	8.9
Department of Justice	9.0	8.6
Environmental Protection Agency	8.0	9.2
National Science Foundation	7.7	7.3
Department of the Interior	6.9	6.6
All other agencies	24.2	37.0
Total undelivered orders	779.4	645.0

	Other Commitments 2007	Other Commitments 2006
Callable capital subscriptions for multilateral development banks	62.2	62.1
Sales of Surplus Power	21.2	23.4
Long-term Satellite and Systems	7.7	6.4
Power Purchase Obligations	4.8	4.3
Grant Programs - Airport Improvement Program	4.8	3.8
Fuel Purchase Obligations	3.1	3.0
Agriculture Direct Loans and Guarantees	2.7	2.3
Conservation Reserve Program	1.9	2.0
All other commitments	1.4	2.7
Total other commitments	109.8	110.0

As of September 30, 2006, $20 billion of the Other Commitments amount for the Department of Agriculture's Direct Loans and Guarantees were reclassified to USDA's undelivered orders to correct their classification in the prior year. The reclassification did not affect total Commitments amounts as of September 30, 2006.

Other Commitments and Risks

The U.S. Government is a party to major treaties and other international agreements. These treaties and other international agreements address various issues including, but not limited to, trade, commerce, security, and arms that may involve financial obligations or give rise to possible exposure to losses. A comprehensive analysis to determine any such financial obligations or possible exposure to loss and their related effect on the consolidated financial statements of the U.S. Government has not yet been performed.

In addition, the United States Government has entered into other agreements that could potentially require claims on Government resources in the future. Examples include war risk and terrorism risk insurance.

Note 20. Earmarked Funds

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

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

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

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

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

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

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

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

Most of the earmarked fund assets are invested in intragovernmental debt holdings. The Federal Government does not set aside assets to pay future benefits or other expenditures associated with earmarked funds. The cash receipts collected from the public for an earmarked fund are deposited in the U.S. Treasury, which uses the cash for general Government purposes. Treasury securities are issued to Federal agencies as evidence of its receipts. Treasury securities are an asset to the Federal agencies and a liability to the U.S. Treasury and, therefore, they do not represent an asset or a liability in the *Financial Report of the U.S. Government*. These securities require redemption if a fund's disbursements exceed its receipts. Redeeming these securities will increase the Government's financing needs and require more borrowing from the public (or less repayment of debt), or will result in higher taxes than otherwise would have been needed, or less spending on other programs than otherwise would have occurred, or some combination thereof. See Note 10—Federal Debt Securities Held by the Public and Accrued Interest for further information related to the investments in Federal debt securities.

Earmarked Funds as of September 30, 2007[1,2]

(In billions of dollars)	Federal Old-Age & Survivors Insurance Trust Fund	Military Retirement Fund	Civil Service Retirement & Disability Fund	Medicare-Eligible Retiree Health Care Fund (MERHCF)	Federal Hospital Insurance Trust Fund (Medicare Part A)	Federal Employees Health Benefits Program Fund
Assets:						
Cash and other monetary assets	-	-	-	-	-	-
Fund balance with Treasury	(0.9)	-	-	-	-	0.9
Investments in U.S. Treasury Securities	1,968.3	215.4	701.7	108.4	319.4	41.3
Other Federal assets	25.0	2.8	9.8	1.1	25.4	0.9
Non-federal assets	2.3	-	0.3	-	1.0	0.7
Total assets	1,994.7	218.2	711.8	109.5	345.8	43.8
Liabilities:						
Liabilities due and payable to beneficiaries	44.1	3.5	4.8	0.6	19.4	3.8
Other Federal liabilities	3.9	-	0.1	0.1	29.5	0.3
Other non-federal liabilities	-	1,025.3	1,320.5	516.7	1.9	302.5
Total liabilities	48.0	1,028.8	1,325.4	517.4	50.8	306.6
Total net position	1,946.7	(810.6)	(613.6)	(407.9)	295.0	(262.8)
Total liabilities and net position	1,994.7	218.2	711.8	109.5	345.8	43.8
Change in Net Position:						
Beginning net position	1,771.9	(758.7)	(591.6)	(453.5)	287.9	(273.5)
Prior period adjustment	(5.0)	-	-	-	-	-
Beginning net position, adjusted	1,766.9	(758.7)	(591.6)	(453.5)	287.9	(273.5)
Investment revenue	97.4	10.3	37.2	4.4	16.3	1.0
Revenue from the public	553.4	-	-	-	199.7	-
Other changes in fund balance (e.g., transfers)	10.6	43.1	31.2	27.3	(0.3)	49.9
Non-program expenses	-	-	-	-	-	-
Program expenses	481.6	105.3	90.4	(13.9)	208.6	40.2
Ending net position	1,946.7	(810.6)	(613.6)	(407.9)	295.0	(262.8)

[1] The presentation of earmarked funds was changed in fiscal year 2007 to present only the significant earmarked funds and to show intra-earmarked fund eliminations. The disclosure for fiscal year 2006 earmarked funds was also changed for consistency with the fiscal year 2007 presentation.
[2] By law, certain expenses (costs), revenues, and other financing sources related to the administration of the above funds are not charged to the funds and are therefore financed and/or credited to other sources.

Earmarked Funds as of September 30, 2007[1,2]

(In billions of dollars)	Federal Disability Insurance Trust Fund	Unemployment Trust Fund	Federal Supplementary Medical Insurance Trust Fund (Medicare Parts B and D)	All Other Earmarked Funds	Intra-Earmarked Fund Eliminations	Total Earmarked Funds
Assets:						
Cash and other monetary assets	-	-	0.1	21.8	-	21.9
Fund balance with Treasury	(0.4)	0.1	8.8	64.8	-	73.3
Investments in U.S. Treasury securities	213.8	74.9	39.2	169.4	-	3,851.8
Other Federal assets	2.7	1.2	32.9	17.4	(53.9)	65.3
Non-federal assets	2.8	1.5	10.8	93.3	-	112.7
Total assets	218.9	77.7	91.8	366.7	(53.9)	4,125.0
Liabilities:						
Liabilities due and payable to beneficiaries	21.7	1.3	22.2	2.0	-	123.4
Other Federal liabilities	1.0	1.4	24.8	62.0	(53.9)	69.2
Other non-federal liabilities	2.3	-	0.9	148.2	-	3,318.3
Total liabilities	25.0	2.7	47.9	212.2	(53.9)	3,510.9
Total net position	193.9	75.0	43.9	154.5	-	614.1
Total liabilities and net position	218.9	77.7	91.8	366.7	(53.9)	4,125.0
Change in Net Position:						
Beginning net position	183.0	66.4	41.6	145.7	-	419.2
Prior period adjustment	5.0	-	0.1	1.0	-	1.1
Beginning net position, adjusted	188.0	66.4	41.7	146.7	-	420.3
Investment revenue	11.0	3.3	2.1	9.6	-	192.7
Revenue from the public	94.1	40.9	-	72.3	-	960.4
Other changes in fund balance (e.g., transfers)	(1.6)	(3.5)	159.0	12.4	(0.5)	327.6
Non-program expenses	-	-	-	(2.2)	-	(2.2)
Program net cost	97.6	32.1	158.9	88.7	(0.5)	1,289.1
Ending net position	193.9	75.0	43.9	154.5	-	614.1

[1] The presentation of earmarked funds was changed in fiscal year 2007 to present only the significant earmarked funds and to show intra-earmarked fund eliminations. The disclosure for fiscal year 2006 earmarked funds was also changed for consistency with the fiscal year 2007 presentation.
[2] By law, certain expenses (costs), revenues, and other financing sources related to the administration of the above funds are not charged to the funds and are therefore financed and/or credited to other sources.

Earmarked Funds as of September 30, 2006[1,2]

(In billions of dollars)	Federal Old-Age & Survivors Insurance Trust Fund	Military Retirement Fund	Civil Service Retirement & Disability Fund	Medicare-Eligible Retiree Health Care Fund (MERHCF)	Federal Hospital Insurance Trust Fund (Medicare Part A)	Federal Employees Health Benefits Program Fund
Assets:						
Cash and other monetary assets	-	-	-	-	-	-
Fund balance with Treasury	(0.8)	-	-	-	1.0	0.9
Investments in U.S. Treasury securities	1,793.1	208.4	689.9	85.4	302.2	14.8
Other Federal assets	23.1	-	9.9	-	24.7	0.8
Non-federal assets	2.1	-	0.3	-	0.9	0.4
Total assets	1,817.5	208.4	700.1	85.4	328.8	16.9
Liabilities:						
Liabilities due and payable to beneficiaries	41.7	3.4	4.5	-	19.8	3.5
Other Federal liabilities	3.9	-	-	-	20.5	0.3
Other non-federal liabilities	-	963.7	1,287.2	538.9	0.6	286.6
Total liabilities	45.6	967.1	1,291.7	538.9	40.9	290.4
Total net position	1,771.9	(758.7)	(591.6)	(453.5)	287.9	(273.5)
Total liabilities and net position	1,817.5	208.4	700.1	85.4	328.8	16.9
Change in Net Position:						
Beginning net position	1,595.5	(697.6)	(549.0)	(477.7)	266.8	(271.2)
Investment revenue	89.4	12.3	36.6	4.1	15.5	0.6
Revenue from the public	530.0	-	-	-	180.4	7.4
Other changes in fund balance (e.g., transfers)	9.1	39.4	46.4	27.7	11.0	24.4
Non-program expenses	-	-	-	-	2.9	17.1
Program net cost	452.1	112.8	125.6	7.6	182.9	17.6
Ending net position	1,771.9	(758.7)	(591.6)	(453.5)	287.9	(273.5)

[1] The presentation of earmarked funds was changed in fiscal year 2007 to present only the significant earmarked funds and to show intra-earmarked fund eliminations. The disclosure for fiscal year 2006 earmarked funds was also changed for consistency with the fiscal year 2007 presentation.
[2] By law, certain expenses (costs), revenues, and other financing sources related to the administration of the above funds are not charged to the funds and are therefore financed and/or credited to other sources.

Earmarked Funds as of September 30, 2006[1,2]

(In billions of dollars)	Federal Disability Insurance Trust Fund	Unemployment Trust Fund	Federal Supplementary Medical Insurance Trust Fund (Medicare Parts B and D)	All Other Earmarked Funds	Intra-Earmarked Fund Eliminations	Total Earmarked Funds
Assets:						
Cash and other monetary assets	-	-	0.1	19.5	-	19.6
Fund balance with Treasury	(0.3)	0.1	27.8	62.4	-	91.1
Investments in U.S. Treasury securities	202.2	66.2	33.1	159.5	-	3,554.8
Other Federal assets	2.6	1.1	22.6	18.1	(43.4)	59.5
Non-federal assets	2.8	1.4	2.4	86.0	-	96.3
Total assets	207.3	68.8	86.0	345.5	(43.4)	3,821.3
Liabilities:						
Liabilities due and payable to beneficiaries	20.9	1.1	21.1	1.7	-	117.7
Other Federal liabilities	0.7	1.3	23.0	45.9	(43.4)	52.2
Other non-federal liabilities	2.7	-	0.3	152.2	-	3,232.2
Total liabilities	24.3	2.4	44.4	199.8	(43.4)	3,402.1
Total net position	183.0	66.4	41.6	145.7	-	419.2
Total liabilities and net position	207.3	68.8	86.0	345.5	(43.4)	3,821.3
Change in Net Position:						
Beginning net position	175.1	54.5	9.3	141.5	-	247.2
Investment revenue	10.5	2.8	1.6	11.9	-	185.3
Revenue from the public	90.0	41.4	-	59.4	-	908.6
Other changes in fund balance (e.g., transfers)	(1.5)	(1.8)	182.0	7.6	(0.5)	343.8
Non-program expenses	-	-	2.1	10.3	-	32.4
Program net cost	91.1	30.5	149.2	64.4	(0.5)	1,233.3
Ending net position	183.0	66.4	41.6	145.7	-	419.2

[1] The presentation of earmarked funds was changed in fiscal year 2007 to present only the significant earmarked funds and to show intra-earmarked fund eliminations. The disclosure for fiscal year 2006 earmarked funds was also changed for consistency with the fiscal year 2007 presentation.
[2] By law, certain expenses (costs), revenues, and other financing sources related to the administration of the above funds are not charged to the funds and are therefore financed and/or credited to other sources.

Depicted below is a description of the major earmarked funds shown in the above tables, which also includes the names of the Government agencies that administer each particular fund. For detailed information regarding these earmarked funds, please refer to the financial statements of the corresponding administering agencies. For information on the benefits due and payable liability associated with certain earmarked funds see Note 13—Benefits Due and Payable.

Federal Old-Age and Survivors Insurance Trust Fund

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

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

Military Retirement Fund

The Military Retirement Fund provides retirement benefits for Army, Navy, Marine Corps, and Air Force personnel and their survivors. The fund is financed by DOD contributions, appropriations, and interest earned on investments in Federal debt securities. DOD administers the Military Retirement Fund. The laws establishing the Military Retirement Fund and authorizing the depositing of amounts to the credit of the trust fund are set forth in 10 U.S.C. § 1461-1467.

Civil Service Retirement and Disability Fund

The CSRDF covers two Federal civilian retirement systems: CSRS—for employees hired before 1984, and FERS—for employees hired after 1983. OPM administers the CSRS and the FERS systems. The laws establishing the CSRDF and authorizing the depositing of amounts to the credit of the trust fund are set forth in 5 U.S.C. § 8334-8348. Funding sources include:

- Federal civilian employees' contributions.
- Agencies' contributions on behalf of employees.
- Appropriations.
- Interest earned on investments in Treasury securities.

Medicare-Eligible Retiree Health Care Fund

The Medicare-Eligible Retiree Health Care Fund, administered by DOD and established by 10 U.S.C. § 1111, finances and pays the liabilities under the DOD retiree health care programs for Medicare-eligible beneficiaries. Such beneficiaries include qualifying members, former members, and dependents of the Uniformed Services. The assets of the fund are comprised of any amounts appropriated to the fund, payments to the fund authorized by 10 U.S.C. § 1116, and interest on investments authorized by 10 U.S.C. § 1117.

Federal Hospital Insurance Trust Fund (Medicare Part A)

The Federal Hospital Insurance Trust Fund finances the Hospital Insurance Program (Medicare Part A). This program funds the cost of inpatient hospital and related care for individuals age 65 or older who meet certain insured status requirements, and eligible disabled people. HHS administers the program.

The Federal Hospital Insurance Trust Fund is financed primarily by payroll taxes, including those paid by Federal agencies. It also receives income from interest earnings on Treasury securities and a portion of income taxes collected on Social Security benefits. The law establishing the Federal Hospital Insurance Trust Fund and authorizing the depositing of amounts to the credit of the trust fund is set forth in 42 U.S.C. § 1395i.

Federal Employees Health Benefits Program Fund

The Federal Employees Health Benefits Program (HEPB) provides health benefits to Federal employees and dependents as well as to Federal retirees and survivor annuitants. FEHB administers a wide variety of health and wellness plans including Fee-For-Service and Health Maintenance Organization plans. Retired employees can choose to continue coverage upon separation from the Federal Government. OPM administers the HEBP. The law establishing the FEHB Program Fund and authorizing the depositing of amounts to the credit of the trust fund are set forth in 5 U.S.C. § 8909. The FEHB is funded on a “pay-as-you-go” basis and funding sources include:

- Federal civilian employees’ contributions.
- Agencies’ contributions on behalf of employees.
- Appropriations (for “employer” share related to retirement program annuitants).
- Interest earned on investments in Treasury securities.

Federal Disability Insurance Trust Fund

The Federal Disability Insurance Trust Fund provides assistance and protection against the loss of earnings due to a wage earner’s disability in the form of money payments. SSA administers the Federal Disability Insurance Trust Fund.

Like the Federal Old-Age and Survivors Insurance Trust Fund, payroll taxes primarily fund the Federal Disability Insurance Trust Fund. The fund also receives income from interest earnings on Treasury securities, Federal agencies’ payments for the Social Security benefits earned by military and Federal civilian employees, and a portion of income taxes collected on Social Security benefits. The law establishing the Federal Disability Insurance Trust Fund and authorizing the depositing of amounts to the credit of the trust fund is set forth in 42 U.S.C. § 401.

Unemployment Trust Fund

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

Taxes on employers provide the primary funding source for the UTF and constitute all the earmarked unemployment tax revenues as shown on the consolidated Statement of Operations and Changes in Net Position. For the years ending September 30, 2007, and 2006, UTF unemployment tax revenues were $39.2 billion and $41.4 billion, respectively. However, interest earned on investments in Treasury securities also provides income to the fund. Appropriations have supplemented the fund’s income during periods of high and extended unemployment. The law establishing the UTF and authorizing the depositing of amounts to the credit of the trust fund is set forth in 42 U.S.C. § 1104.

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

The Federal Supplementary Medical Insurance Trust Fund finances the Supplementary Medical Insurance Program (Medicare Part B) and the Medicare Prescription Drug Benefit Program (Medicare Part D) that provides supplementary medical insurance for enrolled eligible participants to cover physician and outpatient services not covered by Medicare Part A and to obtain qualified prescription drug coverage, respectively. HHS administers the programs.

Medicare Part B financing is not based on payroll taxes; it is based on monthly premiums and income from the General Fund of the Treasury. The law establishing the Federal Supplementary Medical Insurance Trust Fund and authorizing the depositing of amounts to the credit of the trust fund is set forth in 42 U.S.C. § 1395t.

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

All Other Earmarked Funds

The above funds represent the Government's major earmarked activity. All other earmarked activity is aggregated as "all other" in accordance with SFFAS No. 27. This "all other" aggregate includes earmarked funds that are designated as significant funds by the agencies in their respective financial statements. For the years ending September 30, 2007 and 2006, there were approximately 223 and 217 agency-designated significant earmarked funds, respectively. These funds address a variety of issues and are managed by a widespread number of agencies. Some of the funds that comprise the "all other" earmarked funds include the following:

- Department of the Treasury-Exchange Stabilization Fund
- Railroad Retirement Board-Railroad Retirement Trust Fund
- Federal Communications Commission-Universal Service Fund
- United States Department of Agriculture-Federal Crop Insurance Corporation Fund and Funds for Strengthening Markets, Income, and Supply
- Environmental Protection Agency-Superfund (Hazardous Substance) and Leaking Underground Storage Tanks
- Department of Commerce-U.S. Patent and Trademark Office
- Department of the Interior-Land and Water Conservation Fund, Historical Preservation Fund and Reclamation Fund
- Department of Veterans Affairs-Medical Care
- Department of Homeland Security-Customs User Fees, Immigration Examination Fees and the National Flood Insurance Program
- Department of Housing and Urban Development-Government National Mortgage Association.

In addition to the above "all other" earmarked funds, also depicted below are the descriptions of three non-major earmarked funds (included in the "all other" aggregate) that contribute all of the earmarked excise tax revenue as shown on the consolidated Statement of Operations and Changes in Net Position. The descriptions also include the names of the Government agencies that administer each of these funds. For detailed information regarding these three earmarked funds, please refer to the financial statements of the corresponding administering agencies.

The Highway Trust Fund was established to promote domestic interstate transportation and to move people and goods. The fund provides Federal grants to States for highway construction, certain transit programs, and related transportation purposes. DOT administers programs financed by the Highway Trust Fund. The law establishing the Highway Trust Fund and authorizing the depositing of amounts to the credit of the trust fund is set forth in 26 U.S.C. § 9503. Funding sources include earmarked excise taxes on gasoline and other fuels, certain tires, the initial sale of heavy trucks, and highway use by commercial motor vehicles. For the years ending September 30, 2007 and 2006, Highway Trust Fund excise tax revenues were $39.2 billion and $38.8 billion, respectively. As funds are needed for payments, the Highway Trust Fund Corpus investments are liquidated and funds are transferred to the

Federal Highway Administration, the Federal Transit Administration, or other DOT entity, for payment of obligations.

The Airport and Airway Trust Fund provides for airport improvement and airport facilities maintenance. It also funds airport equipment, research, and a portion of the Federal Aviation Administration's administrative operational support. DOT administers the Airport and Airway Trust Fund. The law establishing the Airport and Airway Trust Fund and authorizing the depositing of amounts to the credit of the trust fund is set forth in 26 U.S.C. § 9502. Funding sources include:

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

For the years ending September 30, 2007 and 2006, Airport and Airway Trust Fund excise tax revenues were $12.4 billion and $10.2 billion, respectively. The above tables do not reflect any transfers from the Highway Trust Fund to the Airport and Airway Trust Fund for fuel which was used in aviation, but which was taxed at highway rates under P.L. 109-59 (SAFETEA-LU).

The Black Lung Disability Trust Fund (BLDTF) provides disability benefits to coal miners who are totally disabled due to pneumoconiosis (black lung disease) and death benefits for the eligible survivors of those miners who die from the disease. Excise taxes on coal mine operators, based on the sale of coal, partially fund black lung disability payments as well as related administrative and interest costs. For the years ending September 30, 2007 and 2006, Black Lung Disability Trust Fund excise tax revenues were $0.6 billion and $0.6 billion, respectively. Intragovernmental advances to the BLDTF that must be repaid with interest, fund the shortfall. DOL administers the BLDTF. The law establishing the BLDTF and authorizing the depositing of amounts to the credit of the trust fund is set forth in 26 U.S.C. § 9501.

Intra-Earmarked Fund Eliminations

The intra-earmarked fund eliminations represent the activity between earmarked funds that are administered by different Federal agencies and which are eliminated to produce consolidated earmarked revenues and net costs as shown on the Statement of Operations and Changes in Net Position. Significant examples of such intra-earmarked fund activity include the financial interchanges and transactions between the Railroad Retirement Trust Fund, the Social Security and Medicare Trust Funds, which are administered by the Railroad Retirement Board (RRB), SSA and HHS, respectively. The financial interchanges and transactions between RRB's Railroad Retirement Trust Fund, SSA's Federal Old-Age and Survivors Insurance Trust Fund and the Disability Insurance Trust Fund, and HHS' Federal Hospital Insurance Trust Fund are intended to put the latter three trust funds in the same position they would have been had railroad employment been covered under the Social Security Act. For further information, see the Railroad Retirement program description within Note 22—Social Insurance.

As of September 30, 2006, various reclassifications were made to certain line items to correct their presentation. The following reclassifications were made:

- A net $2.5 billion was reclassified from total Liabilities Due and Payable to total Other non-Federal Liabilities. This net amount is comprised of the following reclassifications:
  - $3.4 billion of Other non-Federal Liabilities were reclassified to Liabilities Due and Payable for the Military Retirement Fund;
  - $3.2 billion of Liabilities Due and Payable were reclassified to Other non-Federal Liabilities for All Other Earmarked Funds; and
  - $2.7 billion of Liabilities Due and Payable were reclassified to Other non-Federal Liabilities for the Federal Disability Trust Fund.
- $4 billion of Cash and Other Monetary Assets for All Other Earmarked Funds were reclassified to Fund Balance with Treasury for All Other Earmarked Funds.

These reclassifications did not affect total assets or liabilities for Earmarked Funds as of September 30, 2006.

Note 21. Indian Trust Funds

DOI has responsibility for the assets held in trust on behalf of American Indian tribes and individuals.

DOI, through the Office of the Special Trustee (OST), holds trust funds in accounts for Indian tribes. It maintains over 1,800 accounts for Tribal and Other Trust Funds (including the Alaska Native Escrow Fund). The OST was established by the American Indian Trust Fund Management Reform Act of 1994 (Public Law 103-412) and was created to improve the accountability and management of Indian funds held in trust by the Federal Government.

The balances that have accumulated in the Tribal and Other Trust Funds have resulted from judgment awards, settlements of claims, land use agreements, royalties on natural resource depletion, and other proceeds derived directly from trust resources and investment income.

The trust fund balances included in the Trust Funds Held for Indian Tribes and Other Trust Funds contain two categories: trust funds held for Indian tribes (considered non-federal funds) and trust funds held by DOI for future transfer to a tribe upon satisfaction of certain conditions or where the corpus of the fund is non-expendable (considered Federal funds).

The following tables depict the U.S. Government as trustee for Indian Trust Funds Held for Indian Tribes and Other Trust Funds. The Other Trust Funds included in the following tables ($289.9 million and $284.2 million for fiscal years 2007 and 2006, respectively, identified in DOI's financial statements) and trust funds considered Federal funds are included in DOI's financial statements, and other DOI special reports.

U.S. Government as Trustee for Indian Trust Funds Held for Indian Tribes and Other Special Trust Funds
Statement of Assets and Trust Fund Balances as of September 30

(In millions of dollars)	2007	2006
Assets		
Current Assets:		
Cash and cash equivalents	602.5	503.4
Investments	2,278.2	2,417.8
Total assets	2,880.7	2,921.2
Trust fund balances, held for Indian Tribes and by DOI	2,880.7	2,921.2

Tribal and Other Trust Funds
Statement of Changes in Trust Fund Balances – Cash Basis
For the Fiscal Years Ended September 30, 2007, and 2006

(In millions of dollars)	2007	2006
Receipts	339.2	338.9
Interest received	139.3	121.6
Gain (loss) on disposition of investments, net	0.6	-
Disbursements	(519.6)	(421.1)
Increase (decrease) in trust fund balances, net	(40.5)	39.4
Trust fund balances, beginning of year	2,921.2	2,881.8
Trust fund balances, end of year	2,880.7	2,921.2

OST also maintains over 370,000 open Individual Indian Monies (IIM) accounts. The IIM fund is primarily a deposit fund for individuals who have a beneficial interest in the trust funds. The IIM account-holders realize receipts primarily from royalties on natural resource depletion, land use agreements, and enterprises that have a direct relationship to trust fund resources and investment income. Funds related to the IIM Trust Fund are included in the following tables.

U.S. Government as Trustee for Indian Trust Funds Held for Individual Indian Monies Trust Funds
Statement of Assets and Trust Fund Balances as of September 30

(In millions of dollars)	2007	2006
Assets:		
Cash and cash equivalents	48.3	61.9
Investments	372.6	353.9
Accrued interest receivable	2.8	2.5
Total assets	423.7	418.3
Trust fund balances, held for individual Indians	423.7	418.3

Individual Indian Monies Trust Funds
Statement of Changes in Trust Fund Balances – Modified Cash Basis
For the Fiscal Years Ended September 30, 2007, and 2006

(In millions of dollars)	2007	2006
Receipts	303.7	355.1
Interest received	20.8	20.5
Gain (loss) on disposition of investments, net	0.4	(2.7)
Disbursements	(319.5)	(374.5)
Increase (decrease) in trust fund balances, net	5.4	(1.6)
Trust fund balances, beginning of year	418.3	419.9
Trust fund balances, end of year	423.7	418.3

The amounts presented in the four tables of this note were prepared using a cash basis of accounting, which is a comprehensive basis of accounting other than GAAP. Receivables and payables are not recorded, and investment premiums and discounts are not amortized in the Trust Funds Held for Indian Tribes and Other Trust Funds. Receipts are recorded when received and disbursements when paid, and investments are stated at historical cost. The only basis of accounting difference between the Trust Funds Held for Indian Tribes and Other Trust Funds and the IIM Trust Fund is that the latter records the receivables and payables related to accrued interest and dividends when earned, including amortization of investment discounts and premiums, and investments are stated at amortized cost.

Note 22. Social Insurance

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

Contributions and earmarked taxes consist of payroll taxes from employers, employees, and self-employed persons; revenue from Federal income taxation of OASDI and railroad retirement benefits; excise tax on coal (Black Lung); and premiums from, and State transfers on behalf of, participants in Medicare. Income for all programs is presented from a consolidated perspective. Future interest payments and other future intragovernmental transfers have been excluded upon consolidation. Expenditures include scheduled benefit payments and administrative expenses. Scheduled benefits are projected based on the benefit formulas under current law. However, current Social Security and Medicare law does not provide for full benefit payments after the trust funds are exhausted.

Future participants for Social Security and Medicare include births during the projection period and individuals below age 15 as of January 1 of the valuation year. Railroad Retirement's future participants are the projected new entrants as of January 1 of the valuation year.

The present values of future expenditures less future revenue is the current amount of funds needed to cover projected shortfalls, excluding the starting trust fund balances, over the projection period. They are calculated by subtracting the actuarial present values of future scheduled contributions and dedicated tax income by and on behalf of current and future participants from the actuarial present value of the future scheduled benefit payments to them or on their behalf. For these calculations, the trust fund balances at the beginning of the valuation period are not included. The trust fund balances in billions of dollars, as of the valuation date, for the respective programs, including interest earned, are shown in the following table. Substantially all of the OASDI, HI, and SMI trust fund balances consist of investments in special non-marketable U.S. Treasury securities that are guaranteed for principal and interest by the full faith and credit of the U.S. Government.

Social Insurance Program			***************UNAUDITED****************		
	2007	**2006**	**2005**	**2004**	**2003**
Social Security........................	2,048	1,859	1,687	1,531	1,378
Medicare................................					
HI	300	285	268	256	235
SMI Part B	38	23	19	24	34
SMI Part D	1	-	-	-	-
Railroad Retirement	32	30	28	26	22
Black Lung.............................	(10)	(10)	(9)	(8)	(8)

The projection period for future participants covers the next 75 years for the Social Security, Medicare, and Railroad Retirement programs. The projection period for current participants in the Social Security and Medicare programs (i.e., those age 14 and over on January 1 of the valuation year, referred to as the "closed group") would theoretically cover all of their working and retirement years, a period that could be greater than 75 years in a relatively small number of instances.

Social Security – Program Description

The OASDI program, created in 1935, collectively referred to as "Social Security," provides cash benefits for eligible U.S. citizens and residents. Eligibility and benefit amounts are determined under the laws applicable for the period. Current law provides that the amount of the monthly benefit payments for workers, or their eligible dependents or survivors, is based on the workers' lifetime earnings histories.

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

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

Medicare – Program Description

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

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

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

SMI Part B Physician Update Factor

The projected Part B expenditure growth reflected in the accompanying 2007 Statement of Social Insurance is significantly reduced as a result of the structure of physician payment updates under current law. In the absence of legislation, this structure would result in multiple years of significant reductions in physician payments, totaling an estimated 41 percent over the next 9 years. Reductions of this magnitude are not feasible and are very unlikely to occur fully in practice. For example, Congress has overridden scheduled negative updates for each of the last 5 years in practice. However, since these reductions are required in the future under the current-law payment system, they are reflected in the accompanying 2007 Statement of Social Insurance as required under GAAP. Consequently, the projected actuarial present values of Part B expenditure shown in the accompanying 2007 Statement of Social Insurance, is likely understated.

The potential magnitude of the understatement of Part B expenditures due to the physician payment mechanism can be illustrated using two hypothetical examples of changes to current law. These examples were developed by management for illustrative purposes only; the calculations have not been audited, and the examples do not attempt to portray likely or recommended future outcomes. Thus, the illustrations are useful only as general indicators of the substantial impacts that could result from future legislation on physician payments under Medicare and of the broad range of uncertainty associated with such impacts. Under current law, the projected 75-year present value of future Part B expenditures is $18.2 trillion. An alternative scenario indicated that if Congress were to set future physician payment updates at zero percent per year, then absent other provisions to offset these costs, the projected present value would increase to $22.6 trillion. Similarly, if Congress were to set future physician payment updates equal to the Medicare Economic Index (projected to be 2 to 2.5 percent per year), the present value would be $25.4 trillion.

The extent to which actual future Part B costs could exceed the projected current-law amounts due to physician payments depends on both the level of physician payment updates that might be legislated and on whether Congress would pass further provisions to help offset such costs (as it did, for example, in the Deficit Reduction Act in 2006). As noted, these examples only reflect hypothetical changes to physician payments. It is likely that in the coming years Congress will consider and pass numerous other legislative proposals affecting Medicare. Many of these would likely be designed to reduce costs in an effort to make the program more affordable. In practice, it is not possible to anticipate what actions Congress might take, either in the near term or over longer periods.

Hospice Benefits Mis-Posting

Beginning in May 2005, expenditures for certain Part A hospice benefits were posted to the Part B account of the SMI trust fund, rather than from the HI trust fund. Correction of this mis-posting will increase Part A expenditures and reduce Part B expenditures in 2008 and later years, compared to the projections shown in the 2007 Medicare Trustees Report. It also resulted in adjustments to the HI and SMI trust funds to account for the misallocated hospice expenditures during fiscal years 2005 through 2007. The present values displayed in the Statement of Social Insurance have been revised to include the estimated impact of correcting this mis-posting. As a result, the summation of the present value of future expenditures in excess of future revenue amounts for Parts A, B, and D included in the 2007 consolidated Statement of Social Insurance is less than the summation of the related amounts included in the 2007 Medicare Trustees Report, by an amount that is insignificant relative to the Trustees Report.

Social Security and Medicare – Demographic and Economic Assumptions

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

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

Table 1A
Social Security – Demographic and Economic Assumptions

Demographic Assumptions

Year	Total Fertility Rate[1]	Age-Sex Adjusted Death Rate[2]	Net Immigration[3] (persons)	Period Life Expectancy at Birth[4]	
				Male	Female
2007	2.04	839.8	1,075,000	75.1	79.7
2010	2.03	825.3	1,000,000	75.5	79.9
2020	2.02	764.5	950,000	76.7	80.7
2030	2.00	705.4	900,000	77.7	81.6
2040	2.00	652.8	900,000	78.6	82.4
2050	2.00	606.6	900,000	79.5	83.1
2060	2.00	565.7	900,000	80.3	83.8
2070	2.00	529.3	900,000	81.1	84.5
2080	2.00	496.8	900,000	81.9	85.1

Economic Assumptions

Year	Real Wage Differential[5] (percent)	Average Annual Wage in Covered Employment[6] (percent change)	CPI[7] (percent change)	Real GDP[8] (percent change)	Total Employment[9] (percent change)	Average Annual Interest Rate[10] (percent)
2007	2.7	4.6	1.9	2.6	1.0	4.6
2010	1.4	4.2	2.8	2.6	0.8	5.7
2020	1.0	3.8	2.8	2.1	0.4	5.7
2030	1.1	3.9	2.8	2.0	0.3	5.7
2040	1.1	3.9	2.8	2.0	0.4	5.7
2050	1.1	3.9	2.8	2.0	0.3	5.7
2060	1.1	3.9	2.8	1.9	0.3	5.7
2070	1.1	3.9	2.8	1.9	0.3	5.7
2080	1.1	3.9	2.8	1.9	0.3	5.7

[1] The total fertility rate for any year is the average number of children who would be born to a woman in her lifetime if she were to experience the birth rates by age observed in, or assumed for, the selected year, and if she were to survive the entire childbearing period. The ultimate total fertility rate of 2.0 is assumed to be reached in 2031.
[2] The age-sex-adjusted death rate is a weighted average of age-sex-specific death rates (deaths per 100,000) in a year where the weights are the number of people in the corresponding age-sex group as of April 1, 2000. The death rate is a summary measure and not a basic assumption; it summarizes the effects of the basic assumptions from which it is derived.
[3] Net immigration is the number of persons who enter during the year (both legally and otherwise) minus the number of persons who leave during the year.
[4] The period life expectancy for a group of persons born in a given year is the average that would be attained by such persons if the group were to experience in succeeding years the death rates by age observed in, or assumed for, the given year. It is a summary measure and not a basic assumption; it summarizes the effects of the basic assumptions from which it is derived.
[5] The real-wage differential is the difference between the percentage increases, before rounding, in the average annual wage in covered employment, and the average annual CPI.
[6] The average annual wage in covered employment is the total amount of wages and salaries for all employment covered by the OASDI program in a year divided by the number of employees with any such earnings during the year.
[7] The calendar price index (CPI) is the annual average value for the calendar year of the CPI for urban wage earners and clerical workers.
[8] The real Gross Domestic Product (GDP) is the value of total output of goods and services, expressed in 2000 dollars. It is a summary measure and not a basic assumption; it summarizes the effects of the basic assumptions from which it is derived.
[9] Total employment represents total of civilian and military employment in the U.S. economy.
[10] The average annual interest rate is the average of the nominal interest rates, which, in practice, are compounded semiannually for special-issue Treasury obligations sold only to the trust funds in each of the 12 months of the year.

Table 1B
Medicare – Demographic and Economic Assumptions

Demographic Assumptions

Year	Total Fertility Rate[1]	Age-Sex Adjusted Death Rate[2]	Net Immigration[3] (persons)
2007	2.04	839.8	1,075,000
2010	2.03	825.3	1,000,000
2020	2.02	764.5	950,000
2030	2.00	705.4	900,000
2040	2.00	652.8	900,000
2050	2.00	606.5	900,000
2060	2.00	565.7	900,000
2070	2.00	529.3	900,000
2080	2.00	496.8	900,000

Economic Assumptions

Year	Real Wage Differ-ential[4] (percent)	Average Annual Wage in Covered Employment (percent change)	CPI[5] (percent change)	Real GDP[6] (percent)	Per Beneficiary Cost (percent change)[7] HI	Per Beneficiary Cost (percent change)[7] SMI Part B	Per Beneficiary Cost (percent change)[7] SMI Part D	Real Interest Rate[8] (percent)
2007	2.7	4.6	1.9	2.6	6.4	6.2	0.1	2.9
2010	1.4	4.2	2.8	2.6	5.0	4.6	8.6	2.8
2020	1.0	3.8	2.8	2.1	4.5	4.7	7.6	2.9
2030	1.1	3.9	2.8	2.0	5.8	5.6	5.5	2.9
2040	1.1	3.9	2.8	2.0	5.8	5.4	5.2	2.9
2050	1.1	3.9	2.8	2.0	4.9	4.8	4.9	2.9
2060	1.1	3.9	2.8	1.9	4.7	4.8	4.6	2.9
2070	1.1	3.9	2.8	1.9	4.6	4.5	4.4	2.9
2080	1.1	3.9	2.8	1.9	4.3	4.3	4.3	2.9

[1] The total fertility rate for any year is the average number of children who would be born to a woman in her lifetime if she were to experience the birth rates by age observed in, or assumed for, the selected year, and if she were to survive the entire childbearing period. The ultimate total fertility rate of 2.0 is assumed to be reached in 2031.
[2] The age-sex-adjusted death rate is a weighted average of age-sex-specific death rates (deaths per 100,000) in a year where the weights are the number of people in the corresponding age-sex group as of April 1, 2000. The death rate is a summary measure and not a basic assumption; it summarizes the effects of the basic assumptions from which it is derived.
[3] Net immigration is the number of persons who enter during the year (both legally and otherwise) minus the number of persons who leave during the year.
[4] The real-wage differential is the difference between the percentage increases, before rounding, in the average annual wage in covered employment, and the average annual CPI.
[5] The calendar price index (CPI) is the annual average value for the calendar year of the CPI for urban wage earners and clerical workers.
[6] The real Gross Domestic Product (GDP) is the value of total output of goods and services, expressed in 2000 dollars. It is a summary measure and not a basic assumption; it summarizes the effects of the basic assumptions from which it is derived.
[7] These increases reflect the overall impact of more detailed assumptions that are made for each of the different types of service provided by the Medicare program (for example, hospital care, physician services, and pharmaceutical costs). These assumptions include changes in the payment rates, utilization, and intensity of each type of service.
[8] The average annual interest rate earned on new trust fund securities, above and beyond the rate of inflation.

Railroad Retirement – Program Description

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

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

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

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

Railroad Retirement – Employment, Demographic and Economic Assumptions

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

Three employment assumptions were used in preparing the projections and reflect optimistic, moderate and pessimistic future passenger rail and freight employment. The average railroad employment is assumed to be 232,000 in 2007. This employment assumption, based on a model developed by the Association of American Railroads, assumes that (1) passenger service employment will remain at the level of 43,000 and (2) the employment base, excluding passenger service employment, will decline at a constant 2.5 percent annual rate for 25 years, at a falling rate over the next 25 years, and remain level thereafter. All the projections are based on an open group (i.e., future entrants) population.

The moderate (middle) economic assumptions include a long-term cost of living increase of 3.0 percent, an interest rate of 7.5 percent, and a wage increase of 4 percent. The cost of living assumption reflects the expected level of price inflation. The interest rate assumption reflects the expected return on National Railroad Retirement Investment Trust (NRRIT) investments. The wage increase reflects the expected increase in railroad employee earnings.

The demographic assumptions, including rates for mortality and total termination rates, remarriage rates for widows, retirement rates and withdrawal rates are listed in Table 2. For further details on the employment, demographic, economic and all other assumptions, refer to the *Railroad Retirement System Annual Report*, June 2007 and the 23^{rd} *Actuarial Valuation of the Assets and Liabilities under the Railroad Retirement Acts* (Valuation Report) as of December 31, 2004, with Technical Supplement.

Table 2
Railroad Retirement Demographic Actuarial Assumptions

Mortality Rates[1]	Mortality after age retirement	2004 RRB Annuitants Mortality Table
	Mortality after disability retirement	2004 RRB Disabled Mortality Table for Annuitants with Disability Freeze
		2004 RRB Disabled Mortality Table for Annuitants without Disability Freeze
	Mortality during active service	1994 RRB Active Service Mortality Table
	Mortality of widow annuitants	1995 RRB Mortality Table for Widows
Total Termination Rates[2]	Termination for spouses	2004 RRB Spouse Total Termination Table
	Termination for disabled children	2004 RRB Total Termination Table for Disabled Children
Widow Remarriage Rate[3]	1997 RRB Remarriage Table	
Retirement Rates[4]	Age retirement	See the Valuation Report
	Disability retirement	See the Valuation Report
Withdrawal Rates[5]	See the Valuation Report	

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

Black Lung – Program Description

The Black Lung Disability Benefit Program provides compensation for medical and survivor benefits for eligible coal miners who are disabled due to pneumoconiosis (black lung disease) arising out of their coal mine employment. The DOL operates the Black Lung Disability Benefit Program. The Black Lung Disability Trust Fund (BLDTF) provides benefit payments to eligible coal miners disabled by pneumoconiosis when no responsible mine operator can be assigned the liability.

Excise taxes on coal mine operators, based on the sale of coal, are the primary source of financing black lung disability payments and related administrative costs. Though excise tax revenues currently exceed costs (and are expected to in the future), that was not always the case. The Black Lung Benefits Revenue Act provides for repayable advances to the BLDTF from the General Fund of the Treasury, in the event that BLDTF resources are not adequate to meet program obligations. During earlier years of the program, general revenues were needed to pay for cash shortfalls in the program.

Black Lung – Demographic and Economic Assumptions

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

The economic assumptions used for the most recent set of projections are coal excise tax revenue estimates, the tax rate structure, Federal civilian pay raises, medical cost inflation, and the interest rate on new repayable advances from the Treasury.

Estimates of future receipts of the black lung excise tax are based on projections of future coal production and sale prices prepared by the Energy Information Agency of DOE. Treasury's Office of Tax Analysis provides the first 11 years of tax receipt estimates. The remaining years are estimated using a growth rate based on both historical tax receipts and Treasury's estimated tax receipts. The coal excise tax rate structure is $1.10 per ton of underground-mined coal and $0.55 per ton of surface-mined coal sold, with a cap of 4.40 percent of sales price, through December 31, 2013. Starting in 2014, the tax rates revert to $0.50 per ton of underground-mined coal and $0.25 per ton surface-mine coal sold, and a limit of 2 percent of sales price.

OMB supplies assumptions for future monthly benefit rate increases based on increases in the Federal pay scale and future medical cost inflation based on increases in the consumer price index-medical, which are used to calculate future benefit costs. During the current projection period, future benefit rate increases range from 2.50 percent to 4.20 percent, and medical cost increases range from 3.80 percent to 4.10 percent. Estimates for administrative costs for the first 11 years of the projection are supplied by DOL's Budget Office, while later years are based on the number of projected beneficiaries. Estimates for future interest on advances are based on the interest rates on outstanding advances ranging from 4.5 percent to 13.9 percent and new borrowings ranging from 5.2 percent to 5.6 percent.

Note 23. Stewardship Land

Stewardship land refers to federally-owned land that is set aside for the use and enjoyment of present and future generations and land on which military bases are located. Except for military bases, this land is not used or held for use in general Government operations. Stewardship land is land that the Government does not expect to use to meet its obligations, unlike the assets listed in the balance sheets. Stewardship land is measured in non-financial units such as acres of land and lakes, number of National Parks and square miles of National Marine Sanctuaries. Examples of stewardship land include national parks, national forests, wilderness areas, and land used to enhance ecosystems to encourage animal and plant species and to conserve nature. This category excludes lands administered by the Bureau of Indian Affairs and held in trust.

Most stewardship land managed by the Government was once part of the 1.8 billion acres of public domain land acquired between 1781 and 1867. Stewardship land accounts for 28 percent of the current U.S. landmass.

DOI uses units as a measure to more accurately reflect the major categories of uses of stewardship land. As of fiscal year 2007, they have 548 national wildlife refuges, 391 park units, 126 geographic management areas, 87 fish hatcheries, and many other categories. At the end of fiscal year 2007, the Department of Agriculture's Forest Services managed an estimated 192.8 million acres of public land, while DOC had 13 National Marine Sanctuaries, which included near–shore coral reefs and open ocean, covering a total of 19 thousand square miles.

Stewardship lands are used and managed in accordance with the statutes authorizing their acquisition or directing their use and management. Additional detailed information concerning stewardship land can be obtained in the financial statements of DOI, DOC, DOD, and USDA.

Note 24. Heritage Assets

Heritage assets are Government-owned assets that have one or more of the following characteristics:

- Historical or natural significance.
- Cultural, educational, or artistic importance.
- Significant architectural characteristics.

The cost of heritage assets often is not determinable or relevant to their significance. Like stewardship land, the Government does not expect to use these assets to meet its obligations. The most relevant information about heritage assets is nonfinancial. The public entrusts the Government with these assets and holds it accountable for their preservation. Examples of heritage assets include Mount Rushmore National Memorial and Yosemite National Park. Other examples of heritage assets include the Declaration of Independence, the U.S. Constitution, and the Bill of Rights preserved by the National Archives. Also included are national monuments/structures such as the Vietnam Veterans Memorial, the Jefferson Memorial, and the Washington Monument, as well as the Library of Congress. Many other sites such as battlefields, historic structures, and national historic landmarks are placed in this category, as well.

Many laws and regulations have been put in place that govern the preservation and management of heritage assets. Established policies, by individual Federal agencies, for heritage assets ensure the proper care and handling of the assets under their controls and preserve these assets for the benefit of the American public.

Some heritage assets are used both to remind us of our heritage and for day-to-day operations. These assets are referred to as multi-use heritage assets. One typical example is the White House. The cost of acquisition, betterment or reconstruction of all multi-use heritage assets is capitalized as general property, plant, and equipment and is depreciated.

The discussion of the Government's heritage assets is not all-inclusive. Rather, it highlights significant heritage assets reported by Federal agencies.

The Government classifies heritage assets into two broad categories:

- Collection type
- Non-collection type

Collection type heritage assets include objects gathered and maintained for museum and library collections. Non-collection type heritage assets include national wilderness areas, wild and scenic rivers, natural landmarks, forests, grasslands, historic places and structures, memorials and monuments, buildings, national cemeteries and archeological sites.

Please refer to the individual financial statements of the Department of the Interior, the Department of Agriculture-Forest Service, the National Archives and Records Administration, and the websites for the Library of Congress (http://www.loc.gov/index.html) and Smithsonian Institution (http://www.si.edu), for additional information on multi-use heritage assets, agency stewardship policies, and physical units by major categories and conditions.

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United States Government Supplemental Information (Unaudited) for the Years Ended September 30, 2007, and September 30, 2006

Social Insurance

The social insurance programs were developed to provide income security and health care coverage to citizens under specific circumstances as a responsibility of the Government. Because taxpayers rely on these programs in their long-term planning, social insurance program information should indicate whether they are sustainable under current law, as well as what their effect will be on the Government's financial condition. The resources needed to run these programs are raised through taxes and fees. Eligibility for benefits rests in part on earnings and time worked by the individuals. Social Security benefits are generally redistributed intentionally toward lower-wage workers (i.e., benefits are progressive). In addition, each social insurance program has a uniform set of entitling events and schedules that apply to all participants.

Social Security and Medicare

Social Security

The Federal Old-Age and Survivors Insurance (OASI) Trust Fund was established on January 1, 1940, as a separate account in the Treasury. The Federal Disability Insurance (DI) Trust Fund, another separate account in the Treasury, was established on August 1, 1956. OASI pays cash retirement benefits to eligible retirees and their eligible dependents and survivors, and the much smaller DI fund pays cash benefits to eligible individuals who are unable to work due to medical conditions. Though the events that trigger benefit payments are quite different, both trust funds have the same earmarked financing structure: primarily payroll taxes and income taxes on benefits. All financial operations of the OASI and DI Programs are handled through these respective funds. The two funds are often referred to as simply the combined OASDI Trust Funds. At the end of calendar year 2006, OASDI benefits were paid to approximately 49 million beneficiaries.

The primary financing of these two funds are taxes paid by workers, their employers, and individuals with self-employment income, based on work covered by the OASDI Program. Since 1990, employers and employees have each paid 6.2 percent of taxable earnings. The self-employed pay 12.4 percent of taxable earnings. Payroll taxes are computed on wages and net earnings from self-employment up to a specified maximum annual amount, referred to as maximum taxable earnings ($97,500 in 2007), that increases each year with economy-wide wages.

Since 1984, up to one-half of OASDI benefits have been subject to Federal income taxation. Effective for taxable years beginning after 1993, the maximum percentage of benefits subject to taxation was increased from 50 percent to 85 percent. The revenue from income taxes on up to 50 percent of benefits is allocated to the OASDI Trust Funds and the rest is allocated to the Hospital Insurance (HI) Trust Fund.

Medicare

The Medicare Program, created in 1965, also has two separate trust funds: the Hospital Insurance (HI, Medicare Part A) and Supplementary Medical Insurance (SMI, Medicare Parts B and D) Trust Funds.[1] HI pays for inpatient acute hospital services and major alternatives to hospitals (skilled nursing services, for example) and SMI pays for hospital outpatient services, physician services, and assorted other services and products through the Part B account and pays for prescription drugs through the Part D account. Though the events that trigger benefit payments are similar, HI and SMI have different earmarked financing structures. Similarly to OASDI, HI is financed primarily by payroll contributions. Employers and employees each pay 1.45 percent of earnings, while self-employed workers pay 2.9 percent of their net earnings. Other income to the HI fund includes a small amount of premium income from voluntary enrollees, a portion of the Federal income taxes that beneficiaries pay on Social Security benefits (as explained above), and interest credited on Treasury securities held in the HI Trust Fund. These Treasury securities and related interest are excluded upon consolidation at the Governmentwide level.

For SMI, transfers from the General Fund of the Treasury represent the largest source of income covering about 74 percent and 78 percent of program costs for Parts B and D, respectively. Beneficiaries pay monthly premiums that finance approximately 26 percent and 28 percent of costs for Parts B and D, respectively. With Part D drug coverage, Medicaid will no longer be the primary payer for beneficiaries dually eligible for Medicare and Medicaid. For those beneficiaries, States must pay the Part D account a portion of their estimated foregone drug costs for this population (referred to as State transfers). As with HI, interest received on Treasury securities held in the SMI Trust Fund is credited to the fund. These Treasury securities and related interest are excluded upon consolidation at the Governmentwide level. Refer to Note 22—Social Insurance, for additional information on Medicare program financing.

Social Security, Medicare, and Governmentwide Finances

The current and future financial status of the separate Social Security and Medicare Trust Funds is the focus of the trustees' reports, a focus that may appropriately be referred to as the "trust fund perspective." In contrast, the Federal Government primarily uses the *unified budget* concept as the framework for budgetary analysis and presentation. It represents a comprehensive display of all Federal activities, regardless of fund type or on- and off-budget status, and has a broader focus than the trust fund perspective that may appropriately be referred to as the "budget perspective" or the "Governmentwide perspective." Social Security and Medicare are among the largest expenditure categories of the U.S. Federal budget. Together, they now account for more than a third of all Federal spending and the percentage is projected to rise dramatically for the reasons discussed below. This section describes in detail the important relationship between the trust fund perspective and the Governmentwide perspective.

Figure 1 is a simplified graphical depiction of the interaction of the Social Security and Medicare Trust Funds with the rest of the Federal budget.[2] The boxes on the left show sources of funding, those in the middle represent the trust funds and other Government accounts (of which the General Fund is a part) into which that funding flows, and the boxes on the right show simplified expenditure categories. The figure is intended to illustrate how the various sources of program revenue flow through the budget to beneficiaries. The general approach is to group revenues and expenditures that are linked specifically to Social Security and/or Medicare separately from those for other Federal programs. (For ease of understanding, these other Federal programs are referred to here as *other Government* programs.)

[1] Medicare legislation in 2003 created the new Part D account in the SMI Trust Fund to track the finances of a new prescription drug benefit that began in 2006. As in the case of Medicare Part B, approximately three-quarters of revenues to the Part D account will come from future transfers from the General Fund of the Treasury. Consequently, the nature of the relationship between the SMI Trust Fund and the Federal budget described below is largely unaffected by the presence of the Part D account though the magnitude will be greater.

[2] The Federal unified budget encompasses all Federal Government financing and is synonymous with a Governmentwide perspective.

Each of the trust funds has its own sources and types of revenue. With the exception of General Fund transfers to SMI, each of these revenue sources is earmarked specifically for the respective trust fund, and cannot be used for other purposes. In contrast, personal and corporate income taxes and other revenue go into the General Fund of the Treasury and are drawn down for any Government program for which Congress has approved spending.[3] The arrows from the boxes on the left represent the flow of these revenues into the trust funds and other Government accounts.

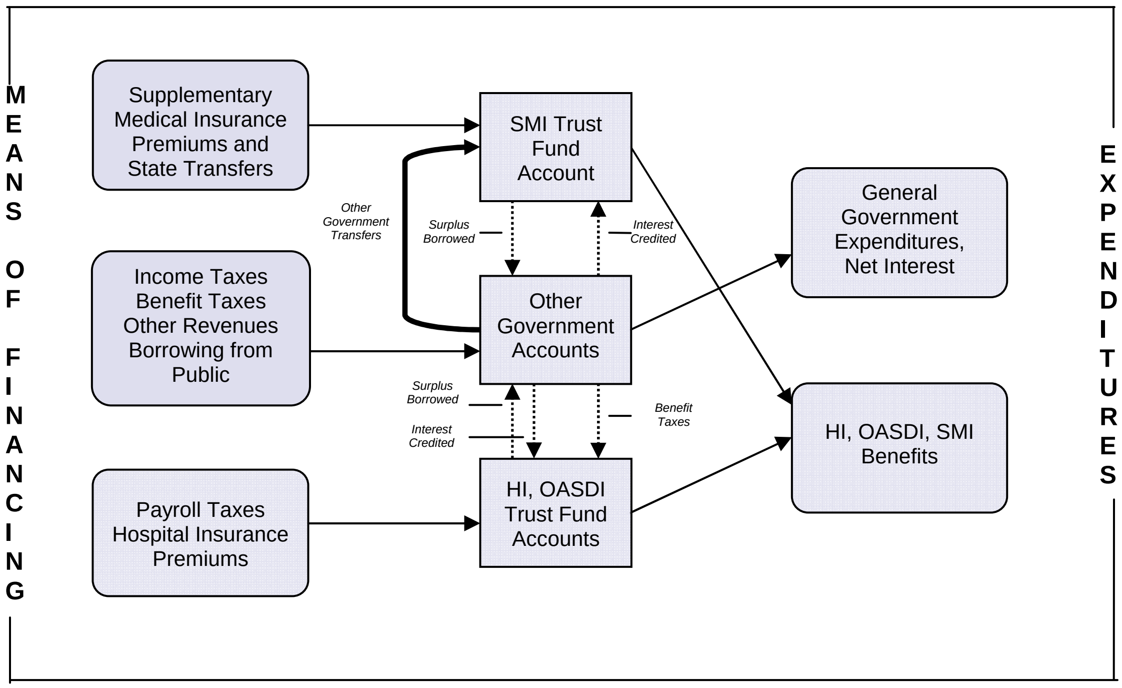
The heavy line between the top two boxes in the middle of Figure 1 represents intragovernmental transfers between the SMI Trust Fund and other Government accounts. The Medicare SMI Trust Fund is shown separately from the two Social Security trust funds (OASI and DI) and the Medicare HI Trust Fund to highlight the unique financing of SMI. SMI is currently the only one of the four programs that is funded through transfers from the General Fund of the Treasury, which is part of the other Government accounts (the Part D account will receive transfers from the States). The transfers finance roughly three-fourths of SMI Program expenses. While the transfers currently support the Part B account, general fund transfers are expected to finance about three-fourths of expenses in the Part D account. The transfers are automatic; their size depends on how much the program requires, not on how much revenue comes into the Treasury. If General Fund revenues become insufficient to cover both the mandated transfer to SMI and expenditures on other general Government programs, Treasury would have to borrow to make up the difference. In the longer run, if transfers to SMI are increasing—as shown below, they are projected to increase significantly in coming years—then Congress must either raise taxes, cut other Government spending, reduce SMI benefits, or borrow even more.

The dotted lines between the middle boxes of Figure 1 also represent intragovernmental transfers but those transfers arise in the form of "borrowing/lending" between the Government accounts. Interest credited to the trust funds arises when the excess of program income over expenses is loaned to the General Fund. The vertical lines labeled *Surplus Borrowed* represent these flows from the trust funds to the other Government accounts. These loans reduce the amount the General Fund has to borrow from the public to finance a deficit (or likewise increase the amount of debt paid off if there is a surplus). But the General Fund has to credit interest on the loans from the trust fund programs, just as if it borrowed the money from the public. The credits lead to future obligations for the General Fund (which is part of the other Government accounts). These transactions are indicated in Figure 1 by the vertical arrows labeled *Interest Credited*. The credits increase trust fund income exactly as much as they increase credits (future obligations) in the General Fund. So from the standpoint of the Government as a whole, at least in an accounting sense, these interest credits are a wash.

It is important to understand the additional implications of these loans from the trust funds to the other Government accounts. When the trust funds get the receipts that they loan to the General Fund, these receipts provide additional authority to spend on benefits and other program expenses. The General Fund, in turn, has taken on the obligation of paying interest on these loans every year and repaying the principal when trust fund income from other sources falls below expenditures—the loans will be called in and the General Fund will have to reduce other spending, raise taxes, or borrow more from the public to finance the benefits paid by the trust funds.

[3] Other programs also have dedicated revenues in the form of taxes and fees (and other forms of receipt) and there are a large number of earmarked trust funds in the Federal budget. Total trust fund receipts account for about 40 percent of total Government receipts with the Social Security and Medicare Trust Funds accounting for about two-thirds of trust fund receipts. For further discussion, see the report issued by the Government Accountability Office, *Federal Trust and Other Earmarked Funds*, GAO-01-199SP, January 2001. In the figure and the discussion that follows, we group all other programs, including these other earmarked trust fund programs, under "Other Government Accounts" to simplify the description and maintain the focus on Social Security and Medicare.

Figure 1
Social Security, Medicare, and Governmentwide Finances



Actual dollar amounts roughly corresponding to the flows presented in Figure 1 are shown in Table 1 for fiscal year 2007. The first three columns show revenues and expenditures for HI, SMI, and OASDI, respectively, and the fourth column is the sum of these three columns. The fifth column has total revenues and expenditures for all other Government programs, which includes the General Fund account, and the last column is the sum of the “combined” and “other Government” columns. In Table 1, revenues from the public (left side of Figure 1) and expenditures to the public (right side of Figure 1) are shown separately from transfers between Government accounts (middle of Figure 1). Note that the transfers ($179.8 billion) and interest credits ($124.5 billion) received by the trust funds appear as negative entries under other Government and are thus offsetting when summed for the total budget column. These two intragovernmental transfers are key to the differences between the trust fund and budget perspectives.

From the Governmentwide perspective, only revenues received from the public (and States in the case of Medicare, Part D) and expenditures made to the public are important for the final balance. Trust fund revenue from the public consists of payroll taxes, benefit taxes, and premiums. For HI, the difference between total expenditures made to the public ($202.8 billion) and revenues ($202.4 billion) was ($0.4 billion) in 2007, indicating that HI had a relatively small negative effect on the overall budget outcome *in that year*. For the SMI account, revenues from the public (premiums) were relatively small, representing about a quarter of total expenditures made to the public in 2007. The difference, ($175.3 billion), resulted in a net draw on the overall budget balance in that year. For OASDI, the difference between total expenditures made to the public ($585.3 billion) and revenues from the public ($665.4 billion) was $80.1 billion in 2007, indicating that OASDI had a positive effect on the overall budget outcome *in that year*.

The trust fund perspective is captured in the bottom section of each of the three trust fund columns. For HI, total revenues exceeded total expenditures by $16.4 billion 2007, as shown at the bottom of the first column. This surplus would be added to the beginning trust fund (not shown) that leads to budget obligations in future years. For SMI, total revenues of $238.0 billion ($56.8 + $181.2), including $179.2 billion transferred from other Government accounts (the General Fund), exceeded total expenditures by $5.9 billion. Transfers to the SMI Program from other Government accounts (the General Fund), amounting to about 75 percent of program costs, are obligated under current law and therefore appropriately viewed as revenue from the trust fund perspective. For OASDI, total revenues of $771.8 billion ($665.4 + $106.4), including interest and a small amount of other Government transfers, exceeded total expenditures of $585.3 billion by $186.5 billion.

Table 1
Annual Revenues and Expenditures for Medicare and Social Security Trust Funds and the Total Federal Budget, Fiscal Year 2007

(In billions of dollars)

Revenue and Expenditure Categories	Trust Funds: HI	Trust Funds: SMI	Trust Funds: OASDI	Trust Funds: Combined	Other Government	Total[1]
Revenues from the Public:						
Payroll and benefit taxes	198.6		665.4	864.0	-	864.0
Premiums	3.9	49.8	-	53.7	-	53.7
Other taxes and fees		7.0	-	7.0	-	7.0
Total	202.4	56.8	665.4	924.6	1,643.0	2567.6
Total expenditures to the public[2]	202.8	232.1	585.3	1,020.2	1,710.3	2,730.5
Net results for budget perspective[3]	(0.4)	(175.3)	80.1	(95.5)	(67.3)	(162.8)
Revenues from Other Government Accounts:						
Transfers	0.6	179.2	-	179.8	(179.8)	-
Interest credits	16.1	2.0	106.4	124.5	(124.5)	-
Total	16.8	181.2	106.4	304.3	(304.3)	-
Net results for trust fund perspective[3]	16.4	5.9	186.5	208.8	N/A	N/A

[1] This column is the sum of the preceding two columns and shows data for the total Federal budget. The figure $162.8 was the total Federal deficit in fiscal year 2007.
[2] The OASDI figure includes $4.0 billion transferred to the Railroad Retirement Board for benefit payments and is therefore an expenditure to the public.
[3] Net results are computed as revenues less expenditures.

Notes: Details may not add to totals due to rounding.
"N/A" indicates not applicable.

Cashflow Projections

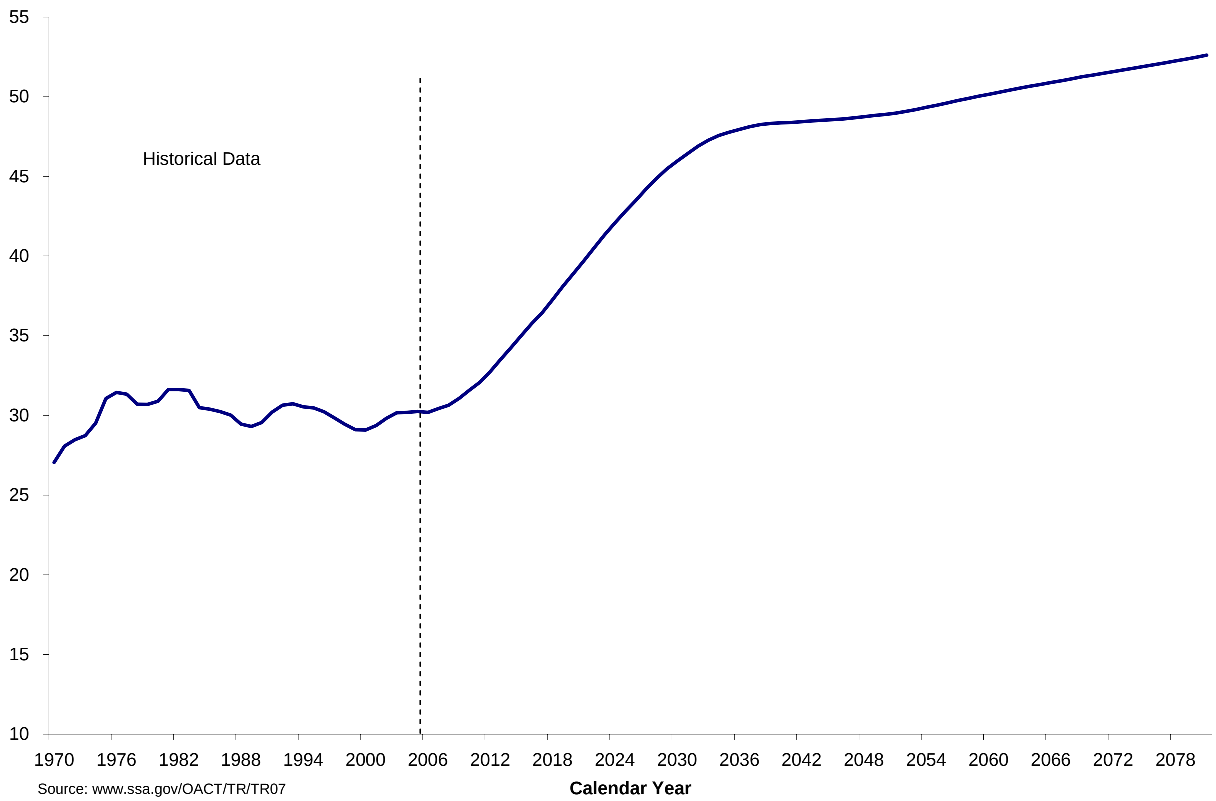
Background

Economic and Demographic Assumptions. The Boards of Trustees[4] of the OASDI and Medicare Trust Funds provide in their annual reports to Congress short-range (10-year) and long-range (75-year) actuarial estimates of each trust fund. Because of the inherent uncertainty in estimates for 75 years into the future, the Boards use three alternative sets of economic and demographic assumptions to show a range of possibilities. The economic and demographic assumptions used for the most recent set of intermediate projections for Social Security and Medicare are shown in the "Social Security" and "Medicare" sections of Note 22—Social Insurance.

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

Beneficiary-to-Worker Ratio. Underlying the pattern of expenditure projections for both the OASDI and Medicare Programs is the impending demographic change that will occur as the large baby-boom generation, born in the years 1946 to 1964, retires or reaches eligibility age. The consequence is that the number of beneficiaries will increase much faster than the number of workers who pay taxes that are used to pay benefits. The pattern is illustrated in Chart 1 which shows the ratio of OASDI beneficiaries to 100 covered workers for the historical period and estimated for the next 75 years. In 2006, there were about 30 beneficiaries for every 100 workers. By 2030, there will be about 46 beneficiaries for every 100 workers. A similar demographic pattern confronts the Medicare Program. For example, for the HI Program, there were about 26 beneficiaries for every 100 workers in 2007; by 2030, there are expected to be about 42 beneficiaries for every 100 workers. This ratio for both programs will continue to increase to about 50 beneficiaries for every 100 workers by the end of the projection period, after the baby-boom generation has moved through the Social Security system as well as declining birth rates and increasing longevity.

Chart 1—OASDI Beneficiaries per 100 Covered Workers
1970-2081

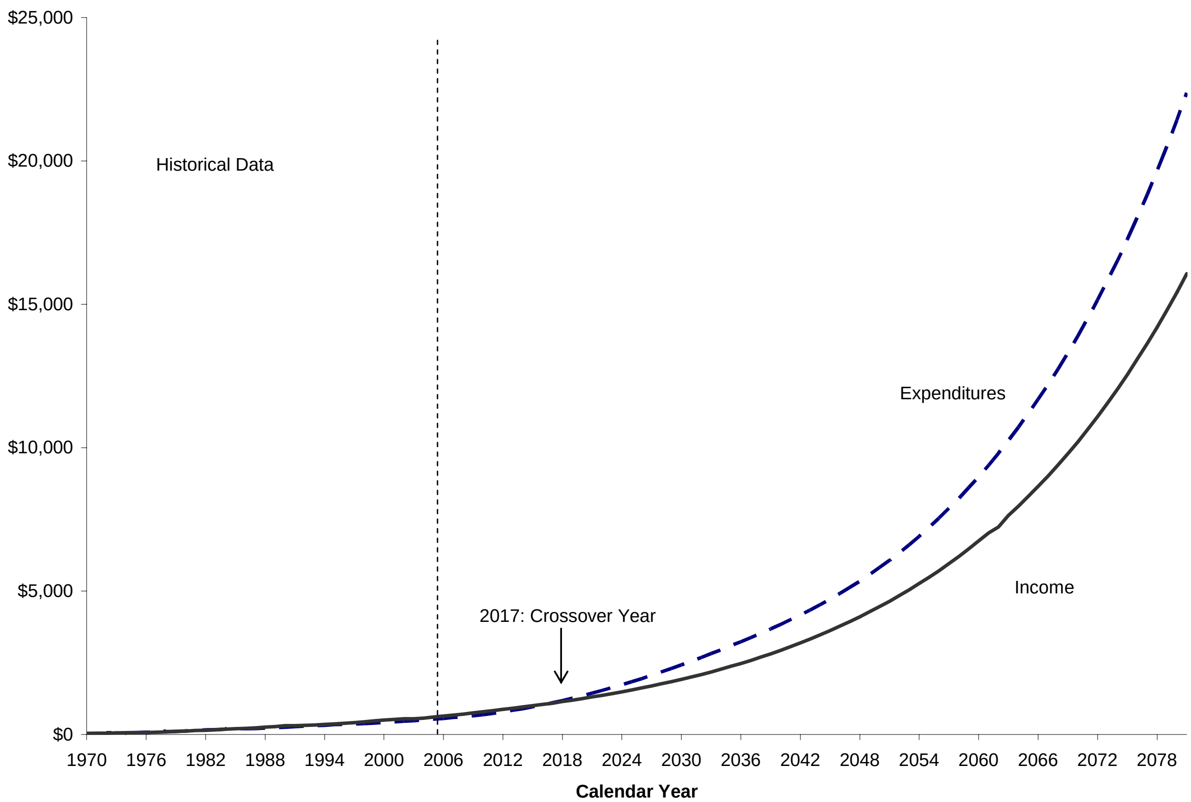


Social Security Projections

Nominal Income and Expenditures. Chart 2 shows historical values and actuarial estimates of combined OASDI annual income (excluding interest) and expenditures for 1970-2081 in nominal dollars. The estimates are for the open-group population. That is, the estimates include taxes paid from, and on behalf of, workers who will enter covered employment during the period, as well as those already in covered employment at the beginning of that period. These estimates also include scheduled benefit payments made to, and on behalf of, such workers during that period. Note that expenditure projections in Chart 2 and subsequent charts are based on current-law benefit formulas, regardless of whether the income and assets are available to finance them.

Chart 2—OASDI Income (Excluding Interest) and Expenditures 1970-2081

(In billions of nominal dollars)



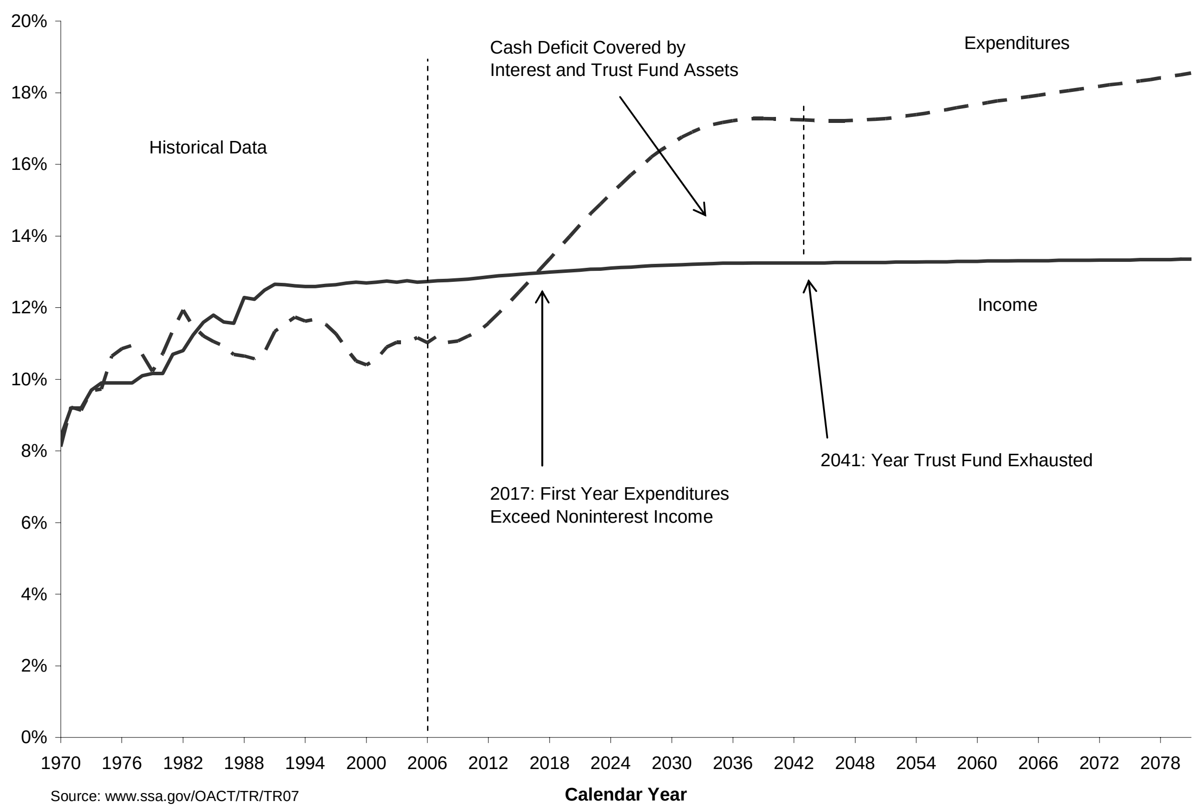
Source: www.ssa.gov/OACT/TR/TR07

Currently, Social Security tax revenues exceed benefit payments and will continue to do so until 2017, when revenues are projected to fall below benefit payments, after which the gap between expenditures and revenues continues to widen.

Income and Expenditures as a Percent of Taxable Payroll. Chart 3 shows annual income (excluding interest but including both payroll and benefit taxes) and expenditures expressed as percentages of taxable payroll, commonly referred to as the income rate and cost rate, respectively.

The OASDI cost rate is projected to decline slightly until about 2008. It then begins to increase rapidly and first exceeds the income rate in 2017, producing cashflow deficits thereafter. As described above, surpluses that occur prior to 2017 are “loaned” to the General Fund and accumulate, with interest, reserve spending authority for the trust fund. The reserve spending authority represents an obligation for the General Fund. Beginning in 2017, Social Security will start using interest credits to meet full benefit obligations. The Government will need to raise taxes, reduce benefits, increase borrowing from the public, and/or cut spending for other programs to meet its obligations to the trust fund. By 2041, the trust fund reserves (and thus reserve spending authority) are projected to be exhausted. Even if a trust fund's assets are exhausted, however, tax income will continue to flow into the fund. Present tax rates would be sufficient to pay 75 percent of scheduled benefits after trust fund exhaustion in 2041 and 70 percent of scheduled benefits in 2081.

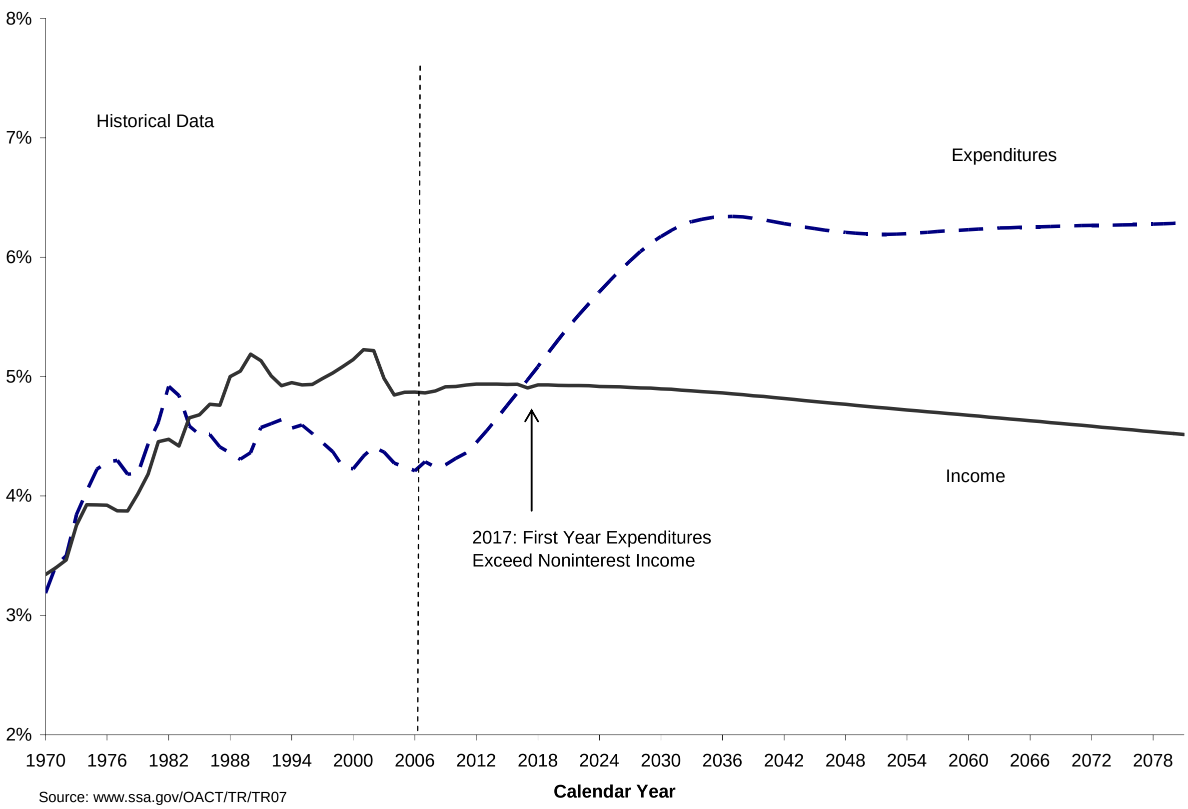
Chart 3—OASDI Income (Excluding Interest) and Expenditures as a Percent of Taxable Payroll 1970-2081



Source: www.ssa.gov/OACT/TR/TR07

Income and Expenditures as a Percent of GDP. Chart 4 shows estimated annual income (excluding interest) and expenditures, expressed as percentages of GDP, the total value of goods and services produced in the United States. This alternative perspective shows the size of the OASDI Program in relation to the capacity of the national economy to sustain it. The gap between expenditures and income widens continuously with expenditures generally growing as a share of GDP and income declining slightly relative to GDP. Social Security's expenditures are projected to grow from 4.3 percent of GDP in 2007 to 6.3 percent in 2081. In 2081, expenditures are projected to exceed income by 1.8 percent of GDP.

Chart 4—OASDI Income (Excluding Interest) and Expenditures as a Percent of GDP 1970-2081



Sensitivity Analysis. Actual future income from OASDI payroll taxes and other sources and actual future expenditures for scheduled benefits and administrative expenses will depend upon a large number of factors: the size and composition of the population that is receiving benefits, the level of monthly benefit amounts, the size and characteristics of the work force covered under OASDI, and the level of workers' earnings. These factors will depend, in turn, upon future marriage and divorce rates, birth rates, death rates, migration rates, labor force participation and unemployment rates, disability incidence and termination rates, retirement age patterns, productivity gains, wage increases, cost-of-living increases, and many other economic and demographic factors.

This section presents estimates that illustrate the sensitivity of long-range expenditures and income for the OASDI Program to changes in *selected individual assumptions*. In this analysis, the intermediate assumption is used as the reference point, and one assumption at a time is varied. The variation used for each individual assumption reflects the levels used for that assumption in the low cost (Alternative I) and high cost (Alternative III) projections. For example, when analyzing sensitivity with respect to variation in real wages, income and expenditure projections using the intermediate assumptions are compared to the outcome when projections are done by changing only the real wage assumption to either low cost or high cost alternatives.

The low cost alternative is characterized by assumptions that generally improve the financial status of the program (relative to the intermediate assumption) such as slower improvement in mortality (beneficiaries die younger). In contrast, assumptions under the high cost alternative generally worsen the financial outlook. One exception occurs with the CPI assumption (see below).

Table 2 shows the effects of changing individual assumptions on the present value of estimated OASDI expenditures in excess of income (the *shortfall* of income relative to expenditures in present value terms). The assumptions are shown in parentheses. For example, the intermediate assumption for the annual rate of *reduction in age-sex-adjusted death rates* is 0.71 percent. For the low cost alternative, a slower reduction rate (0.30 percent) is assumed as it means that beneficiaries die at a younger age relative to the intermediate assumption, resulting in lower expenditures. Under the low cost assumption, the shortfall drops from $6,763 billion to $5,233 billion, a 23 percent smaller shortfall. The high cost death rate assumption (1.26 percent) results in an increase in the shortfall, from $6,763 billion to $8,595 billion, a 27 percent increase in the shortfall. Clearly, alternative death rate assumptions have a substantial impact on estimated future cashflows in the OASDI Program.

A higher fertility rate means more workers relative to beneficiaries over the projection period, thereby lowering the shortfall relative to the intermediate assumption. An increase in the rate from 2.0 to 2.3 results in an 11 percent smaller shortfall (i.e., expenditures less income), from $6,763 billion to $6,016 billion.

Higher real wage growth results in faster income growth relative to expenditure growth. Table 2 shows that a real wage differential that is 0.5 greater than the intermediate assumption of 1.1 results in a drop in the shortfall from $6,763 billion to $5,757 billion, a 15 percent decline.

The CPI change assumption operates in a somewhat counterintuitive manner, as seen in Table 2. A lower rate of change results in a higher shortfall. This arises as a consequence of holding the real wage assumption constant while varying the CPI so that wages (the income base) are affected sooner than benefits. If the rate is assumed to be 1.8 percent rather than 2.8 percent, the shortfall rises about 7 percent, from $6,763 billion to $7,218 billion.

The effect of net immigration is similar to fertility in that, over the 75-year projection period, higher immigration results in proportionately more workers (taxpayers) than beneficiaries. The low-cost assumption for net immigration results in a 7 percent drop in the shortfall, from $6,763 billion to $6,266 billion, relative to the intermediate case; and the high-cost assumption results in a 5 percent higher shortfall.

Finally, Table 2 shows the sensitivity of the shortfall to variations in the real interest rate or, in present value terminology, the sensitivity to alternative discount rates. Assuming a higher discount rate results in a lower present value. The shortfall of $5,120 billion is 24 percent lower when the real interest rate is 3.6 percent rather than 2.9 percent, and 39 percent higher when the real interest rate is 2.1 percent rather than 2.9 percent.

Table 2
Present Values of Estimated OASDI Expenditures in Excess of Income Under Various Assumptions, 2007-2081

(Dollar values in billions; values of assumptions shown in parentheses)

	Shortfall		
Assumption	Low	Intermediate	High
Average annual reduction in death rates	5,233 (0.30)	6,763 (0.71)	8,595 (1.26)
Total fertility rate	6,016 (2.3)	6,763 (2.0)	7,488 (1.7)
Real wage differential	5,757 (1.6)	6,763 (1.1)	7,482 (0.6)
CPI change	6,301 (1.8)	6,763 (2.8)	7,218 (3.8)
Net immigration	6,266 (1,300,000)	6,763 (900,000)	7,112 (672,500)
Real interest rate	5,120 (3.6)	6,763 (2.9)	9,414 (2.1)

Numbers in parentheses are the values of the assumptions used in the respective scenario.

Source: 2007 OASDI Trustees Report and SSA.

Medicare Projections

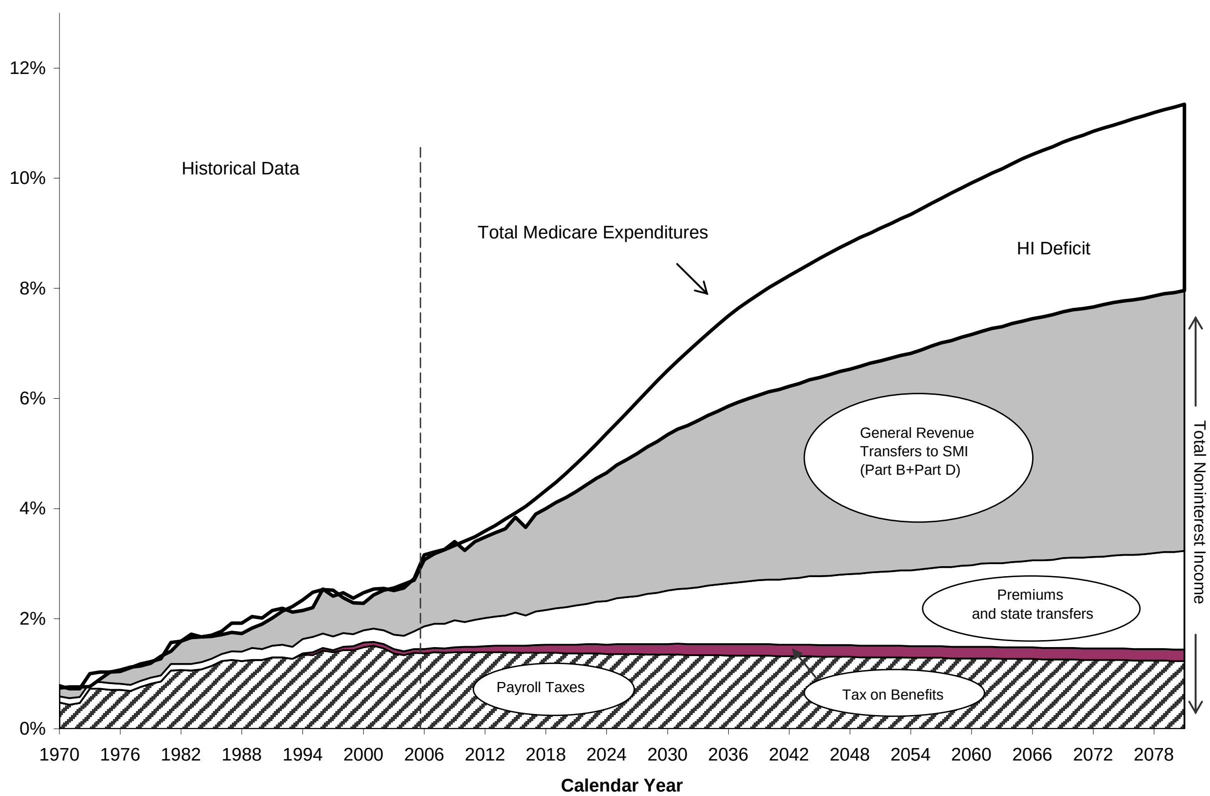
Recent Medicare Legislation. On December 8, 2003, President Bush signed into law the Medicare Prescription Drug, Improvement, and Modernization Act of 2003. The 2003 law has a major impact on the operations and finances of Medicare. The law added a prescription drug benefit to Medicare beginning in 2006 and a new prescription drug account in the SMI Trust Fund. The benefit can be obtained through a private drug-only plan, a private preferred-provider organization or health maintenance organization, or through an employer-sponsored retiree health plan. The preferred-provider organizations are new to the Medicare Program and operate on a regional basis. The Federal Government assumes some of the costs of providing prescription drug coverage to people eligible for both Medicare and Medicaid.

The legislation also includes provisions not related to the prescription drug benefit. It includes increases in Medicare provider reimbursements, higher Medicare Part B premiums for people at higher income levels, and an expansion of tax-deductible health savings accounts. The 2003 legislation is expected to have a significant effect on future Medicare finances as seen below and earlier in the Statement of Social Insurance.

Health Care Cost Growth. In addition to the growth in the number of beneficiaries per worker, the Medicare Program has the added pressure of expected growth in the use and cost of health care per person. Continuing development and use of new technology is expected to cause health care expenditures to grow faster than GDP in the long run. For the intermediate assumption, health care expenditures per beneficiary are assumed to grow, on average, about one percentage point faster than per capita GDP over the long range.

Total Medicare. It is important to recognize the rapidly increasing long-range cost of Medicare and the large role of general revenues and beneficiary premiums in financing the SMI Program. Chart 5 shows expenditures and current-law noninterest revenue sources for HI and SMI combined as a percentage of GDP. The total expenditure line shows Medicare costs rising to 11.3 percent of GDP by 2081. Revenues from taxes and premiums (including State transfers under Part D) are expected to increase from 1.9 percent of GDP in 2007 to 3.2 percent of GDP in 2081. Payroll tax income declines gradually as a percent of GDP as growth in the number of workers paying such taxes slows and wages as a portion of compensation declines, offset by higher premiums combined for Parts B and D of SMI as a percent of GDP. General revenue contributions for SMI, as determined by current law, are projected to rise as a percent of GDP from 1.3 percent to 4.7 percent over the same period. Thus, revenues from taxes and premiums (including State transfers) will fall substantially as a share of total noninterest Medicare income (from 60 percent in 2007 to 41 percent in 2081) while general revenues will rise (from 40 percent to 59 percent). The gap between total noninterest Medicare income (including general revenue contributions) and expenditures begins around 2010 and then steadily continues to widen, reaching 3.4 percent of GDP by 2081.

Chart 5—Total Medicare (HI and SMI) Expenditures and Noninterest Income as a Percent of GDP 1970-2081

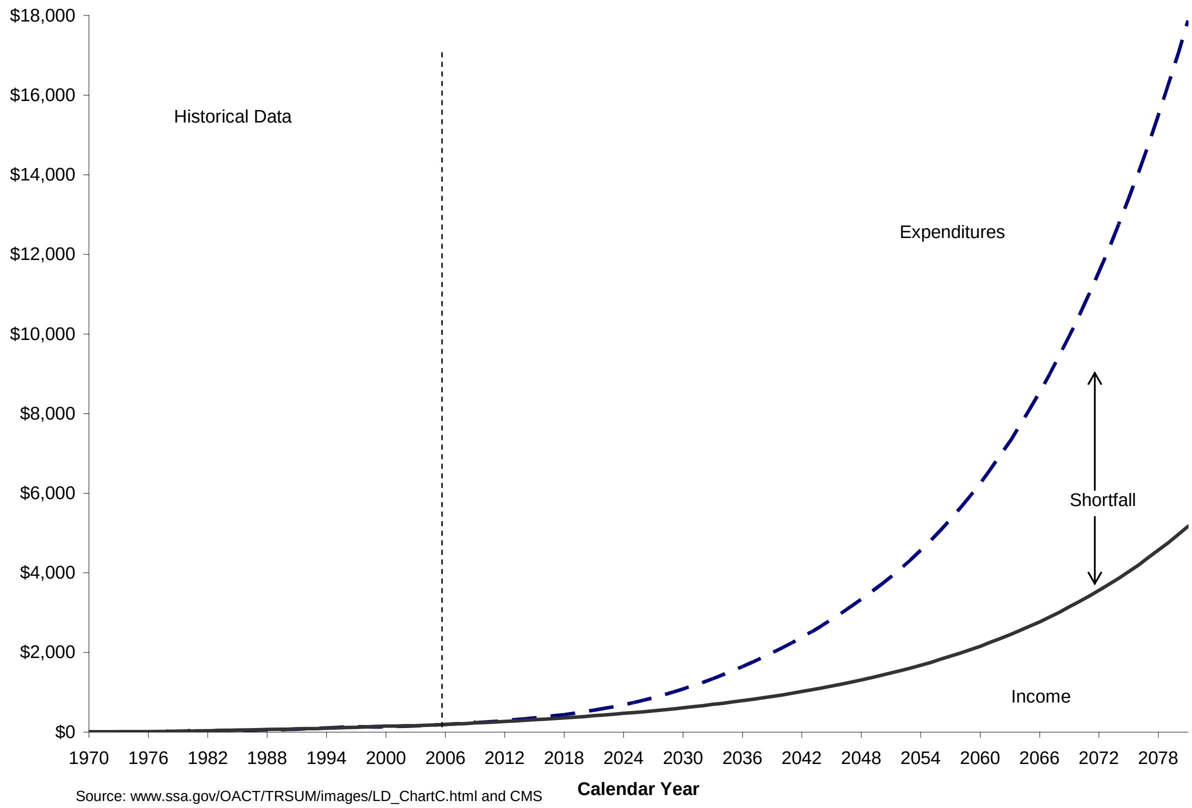


Source: www.ssa.gov/OACT/TRSUM/trsummary.html

Medicare, Part A (Hospital Insurance)—Nominal Income and Expenditures. Chart 6 shows historical and actuarial estimates of HI annual income (excluding interest) and expenditures for 1970-2081 in nominal dollars. The estimates are for the open-group population. The figure reveals a widening gap between projected income and expenditures.

Chart 6—Medicare Part A Income (Excluding Interest) and Expenditures 1970-2081

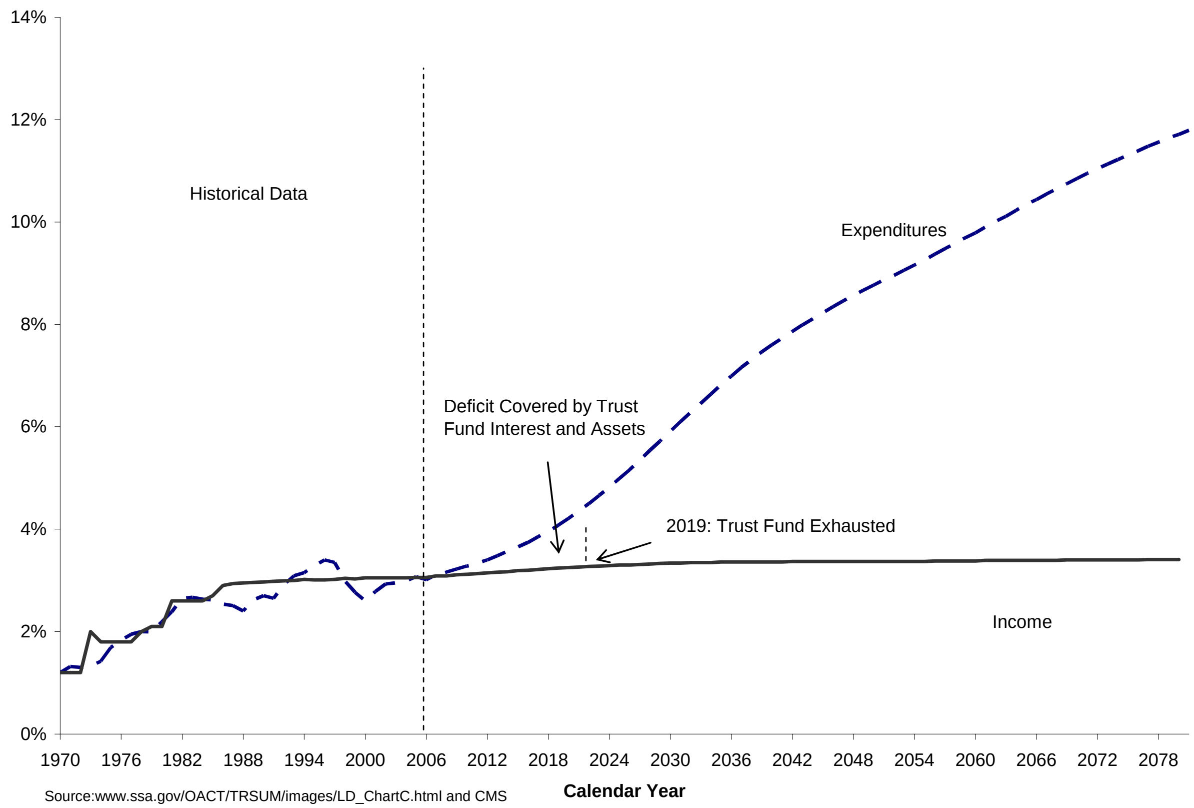
(In billions of nominal dollars)



Source: www.ssa.gov/OACT/TRSUM/images/LD_ChartC.html and CMS

Medicare, Part A Income and Expenditures as a Percent of Taxable Payroll. Chart 7 illustrates income (excluding interest) and expenditures as a percentage of taxable payroll over the next 75 years. The chart shows that the expenditure rate exceeds the income rate in 2007, and cash deficits continue thereafter. Trust fund interest earnings and assets provide enough resources to pay full benefit payments until 2019 with general revenues used to finance interest and loan repayments to make up the difference between cash income and expenditures during that period. Pressures on the Federal budget will thus emerge well before 2019. Present tax rates would be sufficient to pay 79 percent of scheduled benefits after trust fund exhaustion in 2019 and 29 percent of scheduled benefits in 2081.

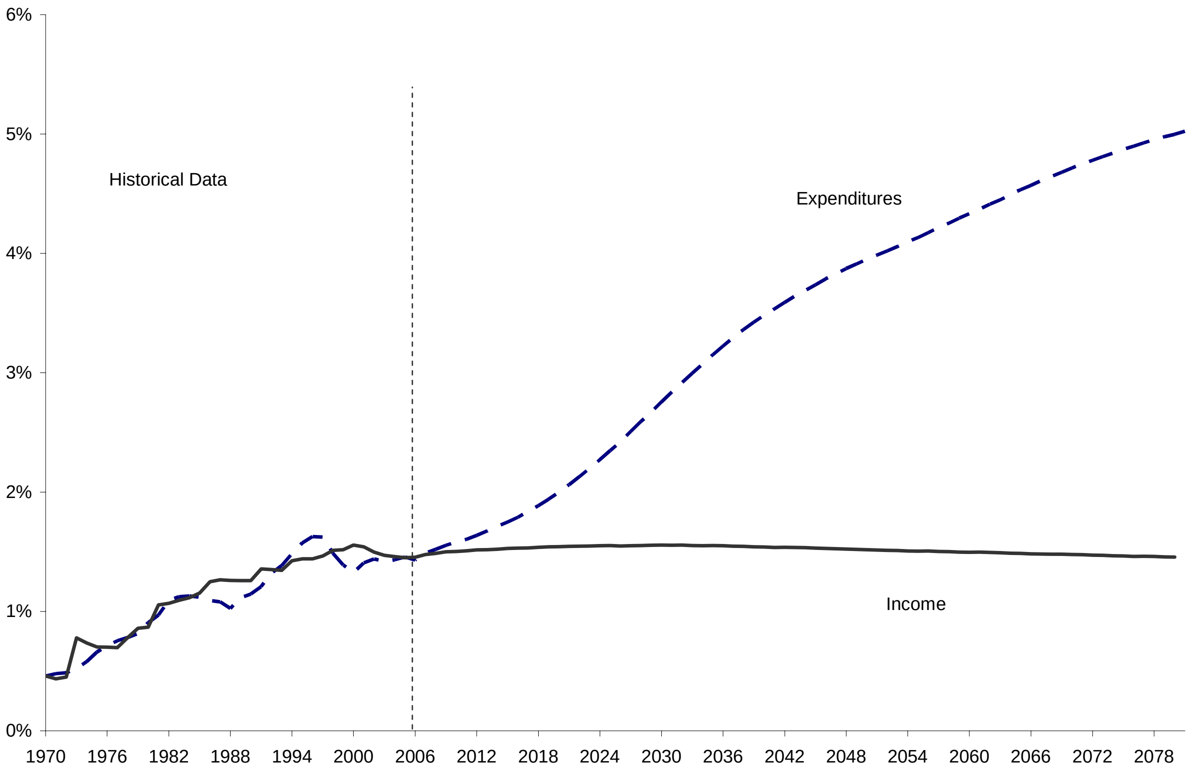
Chart 7—Medicare Part A Income (Excluding Interest) and Expenditures as a Percent of Taxable Payroll 1970-2081



Source:www.ssa.gov/OACT/TRSUM/images/LD_ChartC.html and CMS

Medicare Part A Income and Expenditures as a Percent of GDP. Chart 8 shows estimated annual income (excluding interest) and expenditures, expressed as percentages of GDP, the total value of goods and services produced in the United States. This alternative perspective shows the size of the HI Program in relation to the capacity of the national economy to sustain it. Medicare Part A's expenditures are projected to grow from 1.5 percent of GDP in 2007, to 2.6 percent in 2030, and to 5.0 percent by 2081. The gap between expenditures and income widens continuously with expenditures growing as a share of GDP and income declining slightly relative to GDP. By 2081, expenditures are projected to exceed income by 3.5 percent of GDP.

Chart 8—Medicare Part A Income (Excluding Interest) and Expenditures as a Percent of GDP 1970-2081

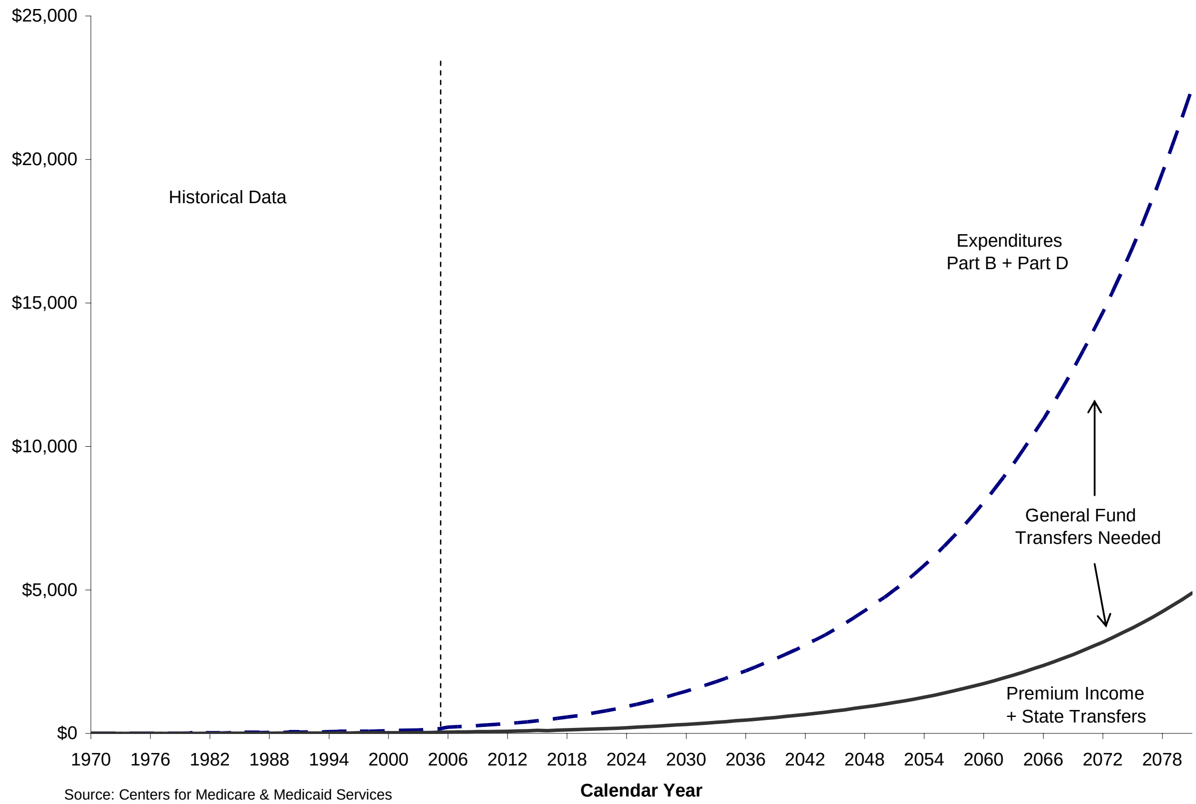


Source:www.ssa.gov/OACT/TRSUM/images/LD_ChartC.html and CMS

Medicare, Parts B and D (Supplementary Medical Insurance). Chart 9 shows historical and actuarial estimates of Medicare Part B and Part D premiums (and Part D State transfers) and expenditures for each of the next 75 years, in nominal dollars. The gap between premiums and State transfer revenues and program expenditures, a gap that will need to be filled with transfers from general revenues, grows throughout the projection period.

Chart 9—Medicare Part B and Part D Premium and State Transfer Income and Expenditures 1970-2081

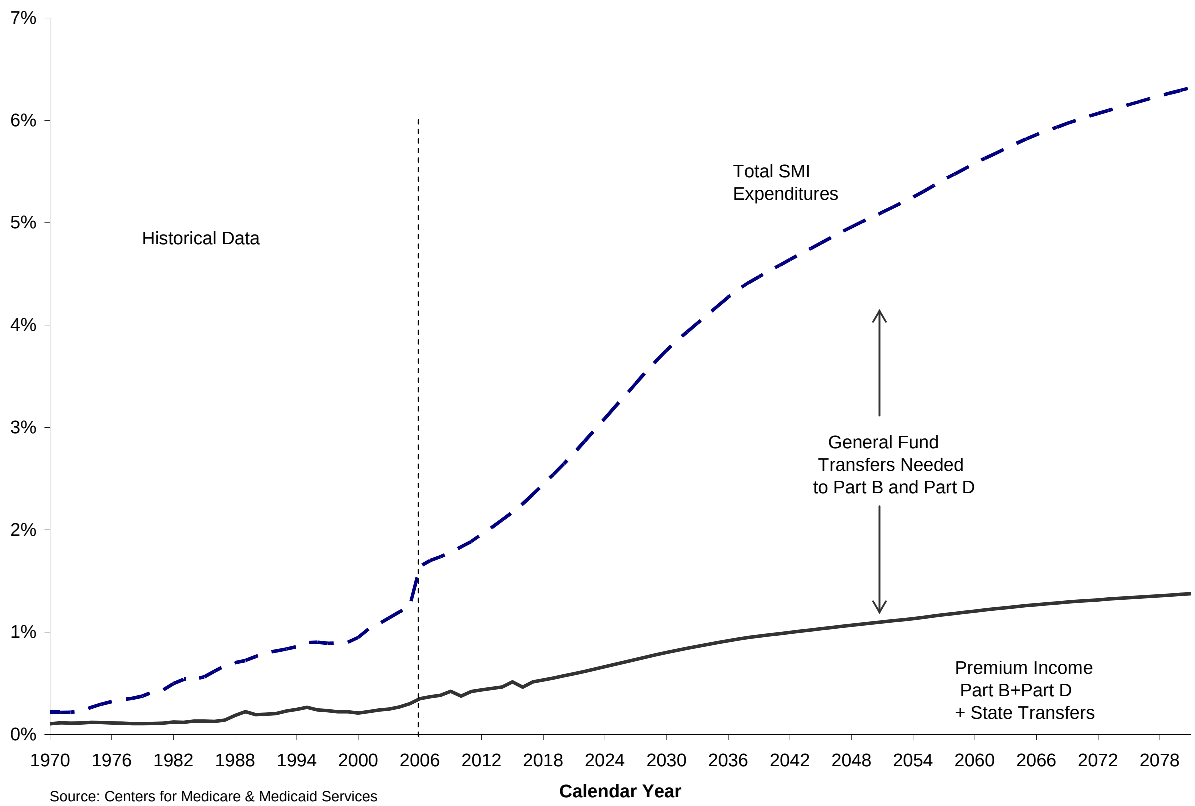
(In billions of nominal dollars)



Source: Centers for Medicare & Medicaid Services

Medicare Part B and Part D Premium and State Transfer Income and Expenditures as a Percent of GDP. Chart 10 shows expenditures for the Supplementary Medical Insurance Program over the next 75 years expressed as a percentage of GDP, providing a perspective on the size of the SMI Program in relation to the capacity of the national economy to sustain it. In 2007, SMI expenditures are expected to be $231 billion or 1.7 percent of GDP. After 2007, this percentage is projected to increase steadily reaching 6.2 percent in 2081. This reflects growth in the volume and intensity of Medicare services provided per beneficiary throughout the projection period, including the prescription drug benefits, together with the effects of the baby boom retirement. Premium and State transfer income grows from about 0.4 percent in 2007 to 1.4 percent of GDP in 2081, so the portion financed by General Fund transfers to SMI is projected to be about 75 percent throughout the projection period.

Chart 10—Medicare Part B and Part D Premium and State Transfer Income and Expenditures as a Percent of GDP 1970-2081



Medicare Sensitivity Analysis. This section illustrates the sensitivity of long-range cost and income estimates for the Medicare Program to changes in *selected individual assumptions*. As with the OASDI analysis, the intermediate assumption is used as the reference point, and one assumption at a time is varied. The variation used for each individual assumption reflects the levels used for that assumption in the low cost and high cost projections (see description of sensitivity analysis for OASDI).

Table 3 shows the effects of changing various assumptions on the present value of estimated HI expenditures in excess of income (the *shortfall* of income relative to expenditures in present value terms). The assumptions are shown in parentheses. Clearly, net HI expenditures are extremely sensitive to alternative assumptions about the growth in health care cost. For the low cost alternative, the slower growth in health costs causes the shortfall to drop from $12,292 billion to $5,053 billion, a 61 percent smaller shortfall. The high cost assumption results in a near doubling of the shortfall, from $12,292 billion to $24,051 billion.

Variations in the next four assumptions in Table 3 result in relatively minor changes in net HI expenditures. The higher or lower fertility assumptions cause a less than 2 percent change in the shortfall relative to the intermediate case. The higher real wage growth rate results in about a 7 percent greater shortfall while a lower growth rate reduces the shortfall by about 9 percent. Wages are a key cost factor in the provision of health care. Higher wages also result in greater payroll tax income. HI expenditures exceed HI income by a wide and increasing margin in the future (Charts 6 to 8). As a result, an assumed higher real wage differential has a larger impact on HI expenditures than HI income, thereby increasing the shortfall of income relative to expenditures. CPI and net immigration changes have very little effect on net HI expenditures. Higher immigration increases the net shortfall modestly as higher payroll tax revenue is more than offset by higher medical care expenditures.

Table 3 also shows that the present value of net HI expenditures is 25 percent lower if the real interest rate is 3.6 percent rather than 2.9 percent and 40 percent higher if the real interest rate is 2.1 percent rather than 2.9 percent.

Table 3
Present Values of Estimated Medicare Part A Expenditures in Excess of Income Under Various Assumptions, 2007-2081

(Dollar values in billions; values of assumptions shown in parentheses)

	Shortfall		
Assumption[1]	Low	Intermediate	High
Average annual growth in health costs[2]	5,053 (3.1)	12,292 (4.1)	24,051 (5.1)
Total fertility rate[3]	12,091 (2.3)	12,292 (2.0)	12,503 (1.7)
Real wage differential	13,376 (1.6)	12,292 (1.1)	11,411 (0.6)
CPI change	12,230 (1.8)	12,292 (2.8)	12,299 (3.8)
Net immigration	12,516 (1,300,000)	12,292 (900,000)	12,149 (672,500)
Real interest rate	9,264 (3.6)	12,292 (2.9)	17,269 (2.1)

[1] The sensitivity of the projected HI net cashflow to variations in future mortality rates is also of interest. At this time, however, relatively little is known about the relationship between improvements in life expectancy and the associated changes in health status and per beneficiary health expenditures. As a result, it is not possible at present to prepare meaningful estimates of the Part A mortality sensitivity.
[2] Annual growth rate is the aggregate cost of providing covered health care services to beneficiaries. The low cost and high cost alternatives assume that costs increase 1 percent slower or faster, respectively, than the intermediate assumption, *relative to growth in taxable payroll*.
[3] The total fertility rate for any year is the average number of children who would be born to a woman in her lifetime if she were to experience the birth rates by age observed in, or assumed for, the selected year and if she were to survive the entire childbearing period.

Table 4 shows the effects of various assumptions about the growth in health care costs on the present value of estimated SMI (Medicare Parts B and D) expenditures in excess of income. As with HI, net SMI expenditures are very sensitive to changes in the health care cost growth assumption. For the low cost alternative, the slower assumed growth in health costs reduces the Governmentwide resources needed for Part B from $13,432 billion to $9,448 billion and in Part D from $8,361 billion to $5,833 billion, about a 30 percent difference in each case. The high-cost assumption increases Governmentwide resources needed to $19,756 billion for Part B and to $12,362 billion for Part D, just over a 47 percent increase in each case.

Table 4
Present Values of Estimated Medicare Parts B and D Future Expenditures Less Premium Income and State Transfers Under Three Health Care Cost Growth Assumptions, 2007-2081

(In billions of dollars)

	Governmentwide Resources Needed		
Medicare Program[1]	Low (4.1)	Intermediate (5.1)	High (6.1)
Part B	9,448	13,432	19,756
Part D	5,833	8,361	12,362

[1] Annual growth rate is the aggregate cost of providing covered health care services to beneficiaries. The low and high scenarios assume that costs increase one percent slower or faster, respectively, than the intermediate assumption.

Source: Centers for Medicare & Medicaid Services.

Sustainability of Social Security and Medicare

75-Year Horizon

According to the 2007 Medicare Trustees Report, the HI Trust Fund is projected to remain solvent until 2019 and, according to the 2007 Social Security Trustees Report, the OASDI Trust Funds are projected to remain solvent until 2041. In each case, some general revenues must be used to satisfy the authorization of full benefit payments until the year of exhaustion. This occurs when the trust fund balances accumulated during prior years are needed to pay benefits, which leads to a transfer from general revenues to the trust funds. Moreover, under current law, General Fund transfers to the SMI Trust Fund will occur into the indefinite future and will continue to grow with the growth in health care expenditures.

The potential magnitude of future financial obligations under these three social insurance programs is therefore important from a unified budget perspective as well as for understanding generally the growing resource demands of the programs on the economy. A common way to present future cashflows is in terms of their *present value*. This approach recognizes that a dollar paid or collected next year is worth less than a dollar today, because a dollar today could be saved and earn a year's-worth of interest (see footnote 1).

Table 5 shows the magnitudes of the primary expenditures and sources of financing for the three trust funds computed on an open-group basis for the next 75 years and expressed in present values. The data are consistent with the Statements of Social Insurance included in the principal financial statements. For HI, revenues from the public are projected to fall short of total expenditures by $12,292 billion in present value terms which is the additional amount needed in order to pay scheduled benefits over the next 75 years. [5] From the trust fund perspective, the amount needed is $11,992 billion in present value after subtracting the value of the existing trust fund balances (an asset to the trust fund account but an intragovernmental transfer to the overall budget). For SMI, revenues from the public for Parts B and D combined are estimated to be $21,793 billion less than total expenditures for the two accounts, an amount that, from a budget perspective, will be needed to keep the SMI program solvent for the next 75 years. From the trust fund perspective, however, the present values of total revenues and total expenditures for the SMI Program are roughly equal due to the annual adjustment of revenue from other Government accounts to meet

[5] Interest income is not a factor in this table as dollar amounts are in present value terms.

program costs.[6] For OASDI, projected revenues from the public fall short of total expenditures by $6,763 billion in present value dollars and, from the trust fund perspective, by $4,715 billion.

From the Governmentwide perspective, the present value of the total resources needed for the Social Security and Medicare Programs equals $40,848 billion, in addition to payroll taxes, benefit taxes, and premium payments from the public. From the trust fund perspective, which counts the trust funds and the general revenue transfers to the SMI Program as dedicated funding sources additional resources in the amount of $16,668 billion in present value terms are needed, beyond the $21,793 billion in present value of required general revenue transfers already scheduled for the SMI Program and the $2,387 billion to honor the trust fund investments in Treasury securities.

Table 5
Present Values of Costs Less Revenues of 75-Year Open Group Obligations HI, SMI, and OASDI

(In billions of dollars, as of January 1, 2007)

		SMI			
	HI	Part B	Part D	OASDI	Total
Revenues from the Public:					
Taxes	11,023	-	-	34,113	45,136
Premiums, State transfers	-	4,789	2,405	-	7,194
Total	11,023	4,789	2,405	34,113	52,330
Total costs to the public	23,315	18,221	10,766	40,876	93,178
Net results for Government-wide (budget) perspective*	12,292	13,432	8,361	6,763	40,848
Revenues from other Government accounts	-	13,432	8,361	-	21,793
Trust fund as of 1/1/2007	300	38	1	2,048	2,387
Net results for trust fund perspective*	11,992	(38)	(1)	4,715	16,668

*Net results are computed as costs less revenues.

Note: Details may not add to totals due to rounding.

Source: 2007 OASDI and Medicare Trustees' Reports.

Infinite Horizon

The 75-year horizon represented in Table 5 is consistent with the primary focus of the Social Security and Medicare Trustees' Reports. For the OASDI Program, for example, an additional $6.8 trillion in present value will be needed above currently scheduled taxes to pay for scheduled benefits ($4.7 trillion from the trust fund perspective). Yet, a 75-year projection is not a complete representation of all future financial flows through the infinite horizon. For example, when calculating unfunded obligations, a 75-year horizon includes revenue from some future workers but only a fraction of their future benefits. In order to provide a more complete estimate of the long-run unfunded obligations of the programs, estimates can be extended to the infinite horizon. The open-group infinite horizon net obligation is the present value of all expected future program outlays less the present value of all expected future program tax and premium revenues. Such a measure is provided in Table 6 for the three trust funds represented in Table 5.

From the budget or Governmentwide perspective, the values in line 1 plus the values in line 4 of Table 6 represent the value of resources needed to finance each of the programs into the infinite future. The sums are shown in the last line of the table (also equivalent to adding the values in the second and fifth lines). The total resources

[6] The SMI Trust Fund also has a very small amount of existing assets.

needed for all the programs sums to more than $90 trillion in present value terms. This need can be satisfied only through increased borrowing, higher taxes, reduced program spending, or some combination.

The second line shows the value of the trust fund at the beginning of 2007. For the HI and OASDI Programs this represents, from the trust fund perspective, the extent to which the programs are funded. From that perspective, when the trust fund is subtracted, an additional $30.2 trillion and $13.5 trillion, respectively, are needed to sustain the programs into the infinite future. As described above, from the trust fund perspective, the SMI Program is fully funded. The substantial gap that exists between premiums and State transfer revenue and program expenditures in the SMI Program ($26.8 trillion + $17.1 trillion) represents future general revenue obligations of the Federal budget.

In comparison to the analogous 75-year number in Table 5, extending the calculations beyond 2081 captures the full lifetime benefits and taxes and premiums of all current and future participants. The shorter horizon understates financial needs by capturing relatively more of the revenues from current and future workers and not capturing all of the benefits that are scheduled to be paid to them.

Table 6
Present Values of Costs Less Tax, Premium and State Transfer Revenue through the Infinite Horizon, HI, SMI, OASDI

(In trillions of dollars as of January 1, 2007)

	HI	SMI Part B	SMI Part D	OASDI	Total
Present value of future costs less future taxes and premiums and State transfers for current participants	12.0	10.3	6.3	16.3	44.9
Less current trust fund	0.3	-	-	2.0	2.3
Equals net obligations for past and current participants	11.7	10.3	6.3	14.3	42.6
Plus net obligations for future participants	18.5	16.5	10.8	(0.8)	45.0
Equals net obligations through the infinite future for all participants	30.2	26.8	17.1	13.5	87.6
Present value of future costs less the present values of future income over the infinite horizon	30.5	26.8	17.1	15.7	90.1

Details may not add to totals due to rounding.

Source: 2007 OASDI and Medicare Trustees' Reports.

Railroad Retirement, Black Lung, and Unemployment Insurance

Railroad Retirement

The RRB was created in the 1930s to establish a retirement benefit program for the nation's railroad workers. As the Social Security Program legislated in 1935 would not give railroad workers credit for service performed prior to 1937, legislation was enacted in 1934, 1935, and 1937 (collectively the Railroad Retirement Acts of the 1930s) to establish a railroad retirement program separate from the Social Security Program.

Railroad retirement pays full retirement annuities at age 60 to railroad workers with 30 years of service. The program pays disability annuities based on total or occupational disability. It also pays annuities to spouses, divorced spouses, widow(er)s, remarried widow(er)s, surviving divorced spouses, children, and parents of deceased railroad workers. Medicare covers qualified railroad retirement beneficiaries in the same way as it does Social Security beneficiaries.

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

Other sources of program income include: financial interchanges with the Social Security and Medicare trust funds, earnings on investments, Federal income taxes on railroad retirement benefits, and appropriations (provided after 1974 as part of a phase out of certain vested dual benefits). Refer to Note 22—Social Insurance, for additional information on railroad retirement program financing.

The Railroad Retirement and Survivors Improvement Act of 2001 (RRSIA) liberalized benefits for 30-year service employees and their spouses, eliminated a cap on monthly benefits for retirement and disability benefits, lowered minimum service requirements from 10 to 5 years, and provided for increased benefits for widow(er)s. Per the RRSIA, amounts in the Railroad Retirement Account and the Social Security Equivalent Benefit (SSEB) Account that are not needed to pay current benefits and administrative expenses are transferred to the National Railroad Retirement Investment Trust (NRRIT) whose sole purpose is to manage and invest railroad retirement assets. NRRIT's Board of Trustees is empowered to invest trust assets in nongovernmental assets, such as equities and debt, as well as, in Government securities. Prior to RRSIA, all investments were limited to Government securities.

Since its inception, NRRIT has received $21.3 billion from RRB (including $19.2 billion in fiscal year 2003, pursuant to RRSIA) and returned $5.0 billion. During fiscal year 2007, the NRRIT made net transfers of $1.4 billion to the RRB to pay retirement benefits. Administrative expenses of the trust are paid out of trust assets. The balance as of September 30, 2007, and 2006, of non-federal securities and investments of the NRRIT are disclosed in Note 7—Securities and Investments.

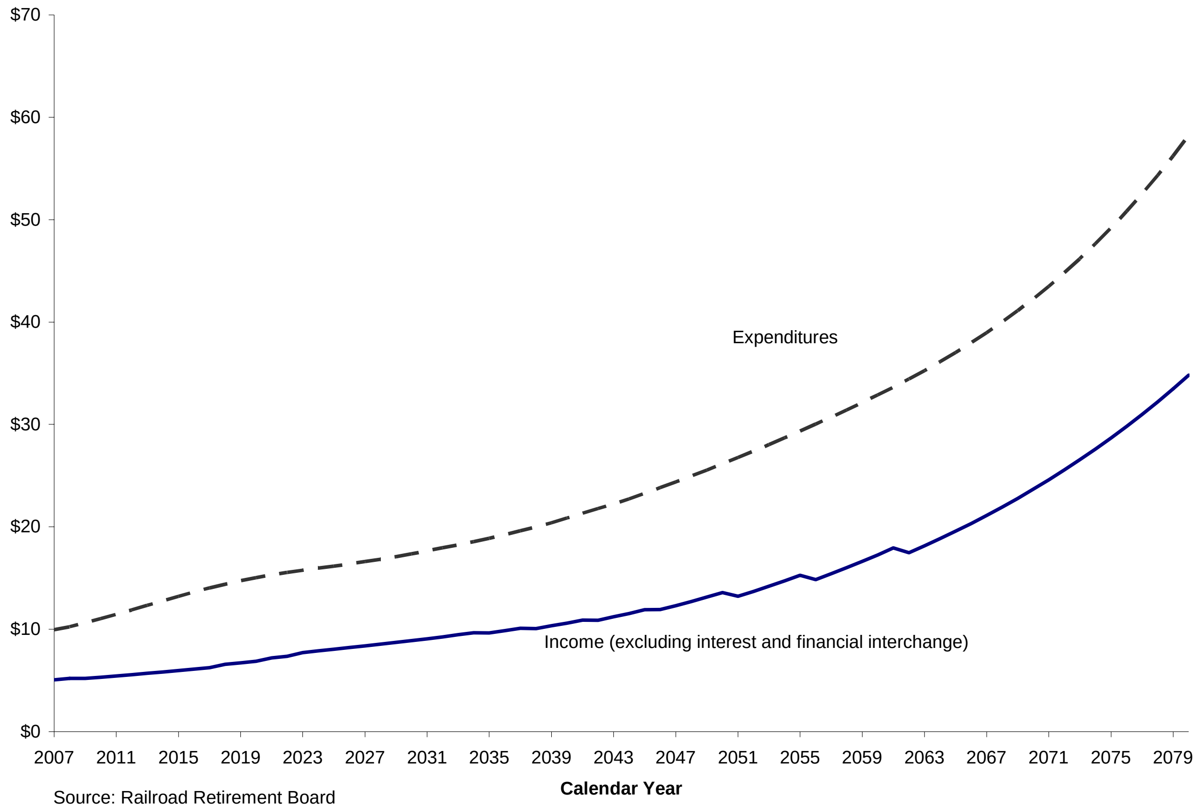
Cashflow Projections

Economic and Demographic Assumptions. The economic and demographic assumptions used for the most recent set of projections are shown in the "Railroad Retirement" section of Note 22—Social Insurance.

Nominal Income and Expenditures. Chart 11 shows, in nominal dollars, estimated railroad retirement income (excluding interest and financial interchange income) and expenditures for the period 2007-2081 based on the intermediate set of assumptions used in the RRB's actuarial evaluation of the program. The estimates are for the open-group population, which includes all persons projected to participate in the Railroad Retirement Program as railroad workers or beneficiaries during the period. Thus, the estimates include payments from, and on behalf of, those who are projected to be employed by the railroads during the period as well as those already employed at the beginning of the period. They also include expenditures made to, and on behalf of, such workers during that period.

Chart 11—Estimated Railroad Retirement Income (Excluding Interest and Financial Interchange Income) and Expenditures 2007-2081

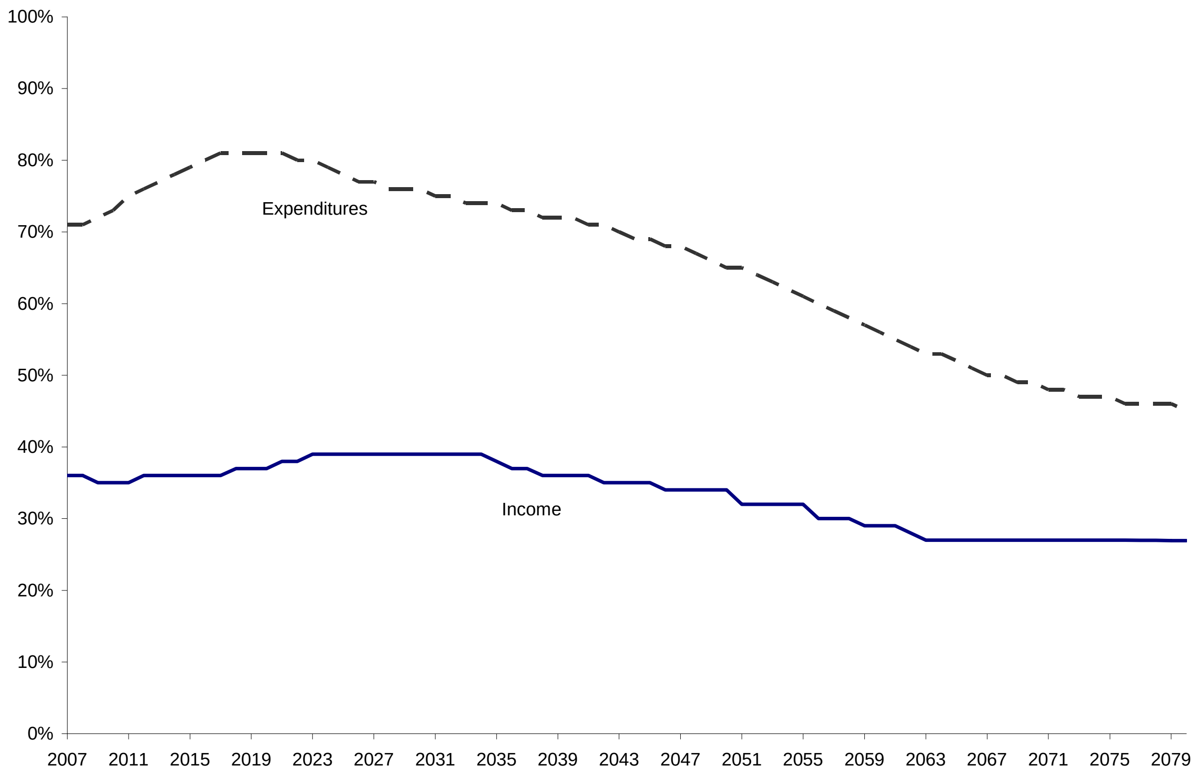
(In billions of nominal dollars)



As Chart 11 shows, expenditures are expected to exceed tax income for the entire projection period. The imbalances continue to widen until about 2020, hold steady for the next 15 years, and begin to grow steadily after 2035.

Income and Expenditures as a Percent of Taxable Payroll. Chart 12 shows estimated expenditures and income as a percent of tier II taxable payroll. The imbalances grow until 2017 but then begin to decrease steadily as expenditures fall. Tax rates begin to decline after 2035, stabilizing after 2062. Compared to last year, projected tax rates are slightly lower, on average. The tier II tax rate is determined from a tax rate table based on the average account benefit ratio.

Chart 12—Estimated Railroad Retirement Income (Excluding Interest and Financial Interchange Income) and Expenditures as a Percent of Tier II Taxable Payroll 2007-2081



Source: Railroad Retirement Board

Sensitivity Analysis. Actual future income from railroad payroll taxes and other sources and actual future expenditures for scheduled benefits and administrative expenses will depend upon a large number of factors as mentioned above. Two crucial assumptions are employment growth and the interest rate. Table 7 shows the sensitivity of the shortfall in the Railroad Retirement Program to variations in these two assumptions. The low-cost employment scenario has a 4.5 percent smaller shortfall of income to expenditures, and the high-cost scenario has a 3.6 percent higher shortfall. A higher discount rate reduces future values relative to a lower rate. As seen in the table, the shortfall is 29.8 percent lower if the interest rate is 11 percent rather than 7.5 percent and 72.1 percent higher when the interest rate is 4 percent rather than 7.5 percent.

Table 7
Present Values of Railroad Retirement Expenditures in Excess of Income Under Various Employment and Interest Rate Assumptions

(Dollar values in millions; values of assumptions shown in parentheses)

Assumption	Low	Middle	High
Employment[1]	99,803 (1.0%)	104,489 (2.5%)	108,210 (4.0%)
Interest rate...................	73,305 (11%)	104,489 (7.5%)	179,789 (4%)

[1] The low and middle employment scenarios have passenger service employment remaining at 43,000 workers per year and the remaining employment base declining at 1.0 percent and 2.5 percent, respectively, for the next 25 years. The high cost scenario has passenger service employment declining by 500 per workers per year until a level of 35,000 is reached with the remaining employment base declining by 4.0 percent per year for 25 years, at a reducing rate over the next 25 years, and remaining level thereafter.

Source: Railroad Retirement Board.

Sustainability of Railroad Retirement

Table 8 shows the magnitudes of the primary expenditures and sources of financing for the Railroad Retirement Program computed on an open-group basis for the next 75 years and expressed in present values as of January 1, 2007. The data are consistent with the statements of social insurance.

From a Governmentwide perspective, revenues are expected to fall short of expenditures by approximately $104.5 billion, which represents the present value of resources needed to sustain the Railroad Retirement Program. From a trust fund perspective, when the trust fund balance and the financial interchange and transfers are included, the combined balance of the NRRIT, the Railroad Retirement Account, and the SSEB Account show a slight surplus.

Table 8
Present Values of 75-Year Projections of Revenues and Expenditures for the Railroad Retirement Program[1,2]

(In billions of present-value dollars as of January 1, 2007)

Estimated Future Income (Excluding Interest)[3] Received from or on Behalf of:	
Current participants who have attained retirement age	4.7
Current participants not yet having attained retirement age	41.0
Those expected to become participants	54.1
All participants	99.8
Estimated Future Expenditures:[4]	
Current participants who have attained retirement age	92.8
Current participants not yet having attained retirement age	86.0
Those expected to become participants	25.5
All participants	204.3
Net obligations from budget perspective (expenditures less income)	104.5
Railroad Retirement Program assets (mostly investments stated at market)[5]	32.0
Financial Interchange from Social Security Trust	73.4
Net Obligations from Trust Fund Perspective	(0.9)

[1] Represents combined values for the Railroad Retirement Account, SSEB Account, and NRRIT, based on middle employment assumption.
[2] The data used reflect the provisions of RRSIA of 2001.
[3] Future income (excluding interest) includes tier I taxes, tier II taxes, and income taxes on benefits.
[4] Future expenditures include benefits and administrative expenditures.
[5] The value of the fund reflects the 7.5 percent interest rate assumption. The RRB uses the relatively high rate due to investments in private securities.

Note: Detail may not add to totals due to rounding. Employee and beneficiary status are determined as of 1/1/2006 whereas present values are as of 1/1/2007.

Black Lung

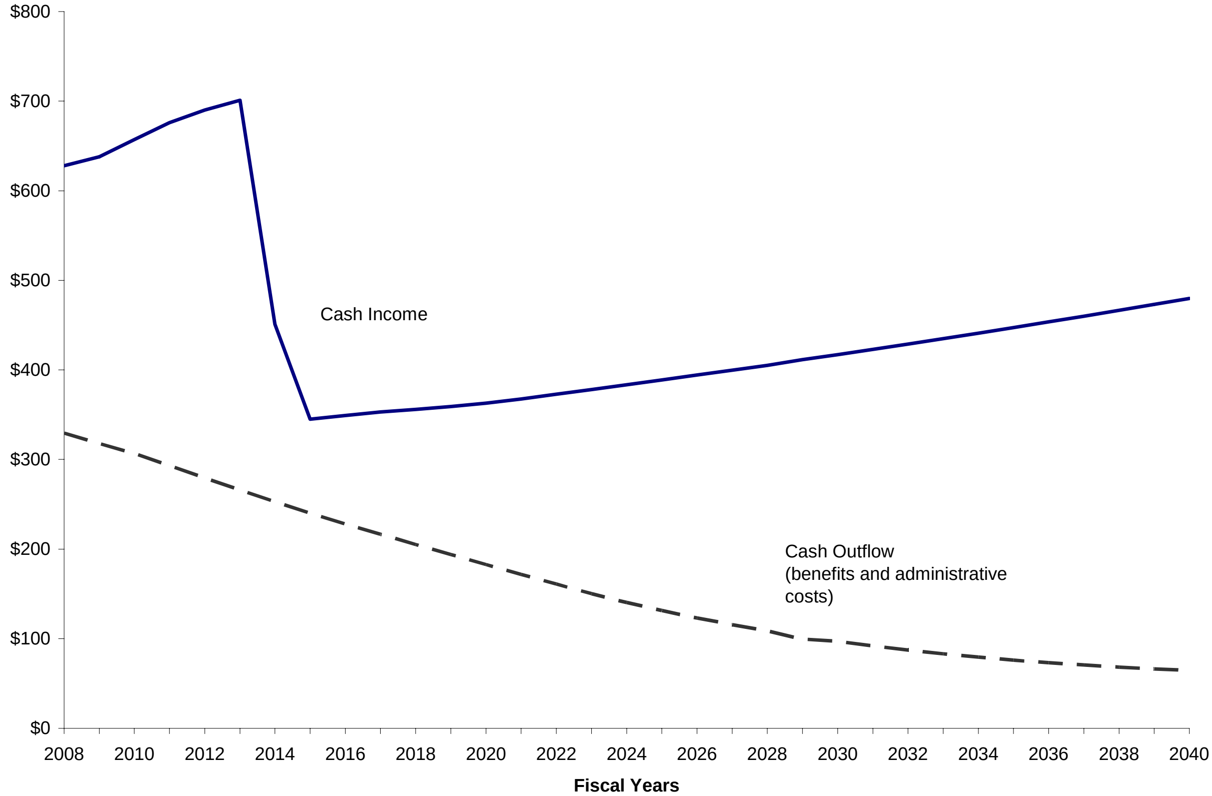
The Federal Coal Mine Health and Safety Act of 1969 created the Black Lung Disability Benefit Program to provide compensation and medical benefits for eligible coal miners who are disabled due to pneumoconiosis (black lung disease) arising out of their coal mine employment. The DOL operates the Black Lung Disability Benefit Program. The 1977 Black Lung Amendments established a Black Lung Disability Trust Fund (BLDTF) to provide benefit payments to eligible coal miners disabled by pneumoconiosis when no responsible mine operator can be assigned the liability. The beneficiary population has been declining as the incidence of black lung disease has fallen, and the group of miners affected by the disease (and their widows) has been dying at a more rapid rate than new awards have been made.

Excise taxes on coal mine operators, based on the sale of coal, is the primary source of financing black lung disability payments and related administrative costs. The Black Lung Benefits Revenue Act provides for repayable advances to the BLDTF from the General Fund of the Treasury in the event that BLDTF resources are not adequate to meet program obligations. On September 30, 2007, total liabilities of the BLDTF exceed assets by $10.1 billion. This deficit fund balance represents the accumulated shortfall of excise taxes necessary to meet benefit payment and interest expenses. This shortfall was funded by repayable advances to the BLDTF which are repayable with interest. Estimates for future interest on advances are based on the interest rates on outstanding advances ranging from 4.5 percent to 13.9 percent and new borrowings ranging from 5.2 percent to 5.6 percent.

From the budget or consolidated financial perspective, Chart 13 shows projected black lung expenditures (excluding interest) and excise tax collections for the period 2008-2040. The significant assumptions used in the most recent set of projections are shown in the “Black Lung” section of Note 22—Social Insurance. Analysts project that a scheduled reduction in taxes on coal sales will decrease cash inflows by 51 percent between the years 2013 to 2015. After 2015, cash surpluses widen due to a declining beneficiary population and increasing revenues. However, the picture dramatically changes when including projected interest payments that the program must make.

Chart 13—Estimated Black Lung Income and Expenditures (Excluding Interest) 2008-2040

(In millions of nominal dollars)

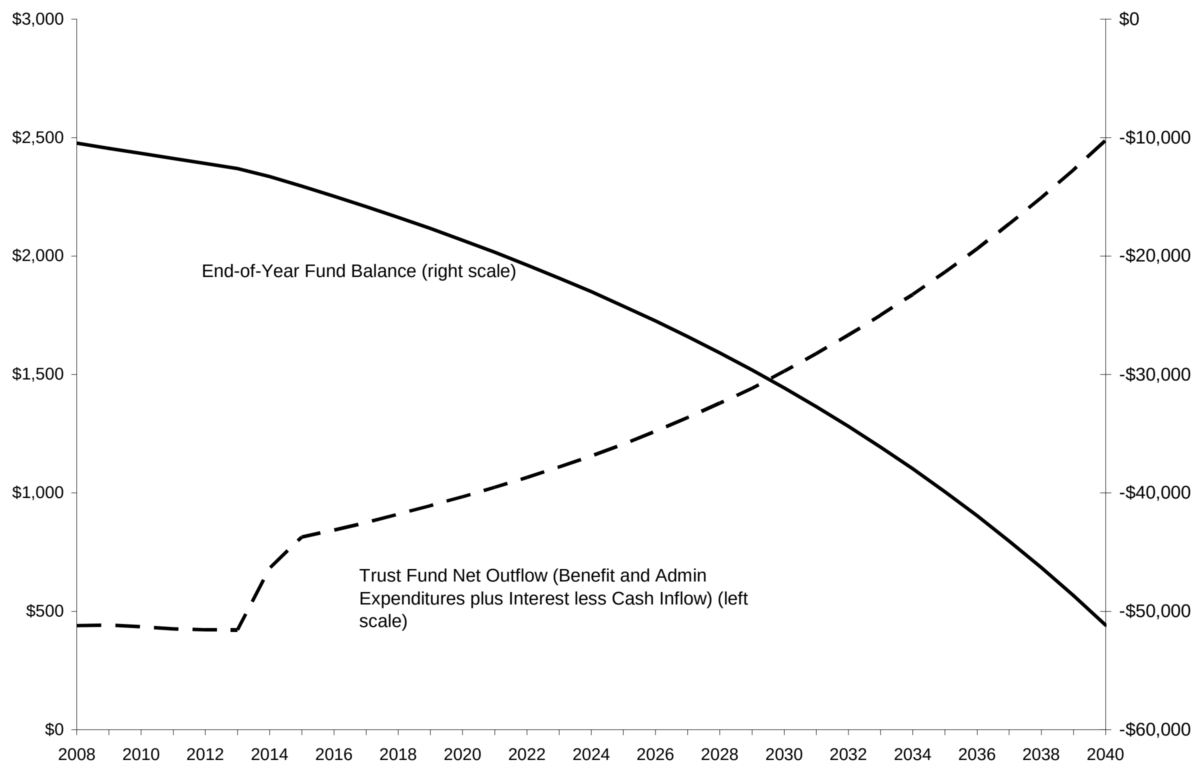


Source: Department of Labor

Chart 14 shows the projected financial status of the program from a trust fund perspective that includes interest outflows from the program to the General Fund. Trust fund net outflows (benefits plus interest payments less cash income from excise taxes) grow without bound, as a result of projected interest payments on the large accumulated liability to the General Fund. This deficit fund balance represents the accumulated shortfall between excise taxes and benefit payment plus interest expenses.

Chart 14—Estimated Black Lung Trust Fund Net Outflow and End of Year Fund Balance 2008-2040

(In millions of nominal dollars)



Source: Department of Labor

Table 9 shows present values of 33-year projections of expenditures and revenues for the Black Lung Program computed as of September 30, 2007, using a discount rate equivalent to 6.21 percent. (The discount rate is higher than the current Government borrowing rate because the program borrowed from the General Fund during periods of relatively high interest rates). From a Governmentwide (budget) perspective, the present value of expenditures is expected to be less than the present value of income by $3.8 billion (a surplus). From a trust fund perspective, a large balance ($10.0 billion) is owed to the General Fund. From that perspective, when that accumulated balance is combined with the cashflow surplus, the program shows a negative balance of $6.2 billion in present value dollars.

Table 9
Present Values of 33-Year Projections of Revenues and Expenditures for the Black Lung Program

(In billions of present value dollars, as of September 30, 2007)

Estimated future tax income	6.7
Estimated future expenditures	2.9
Net obligations from budget perspective (expenditures less income)	(3.8)
Accumulated balance due General Fund	10.0
Net obligations from trust fund perspective	6.2

Note: Detail may not add to totals due to rounding.

Source: Department of Labor projections and Treasury Department calculations.

Unemployment Insurance

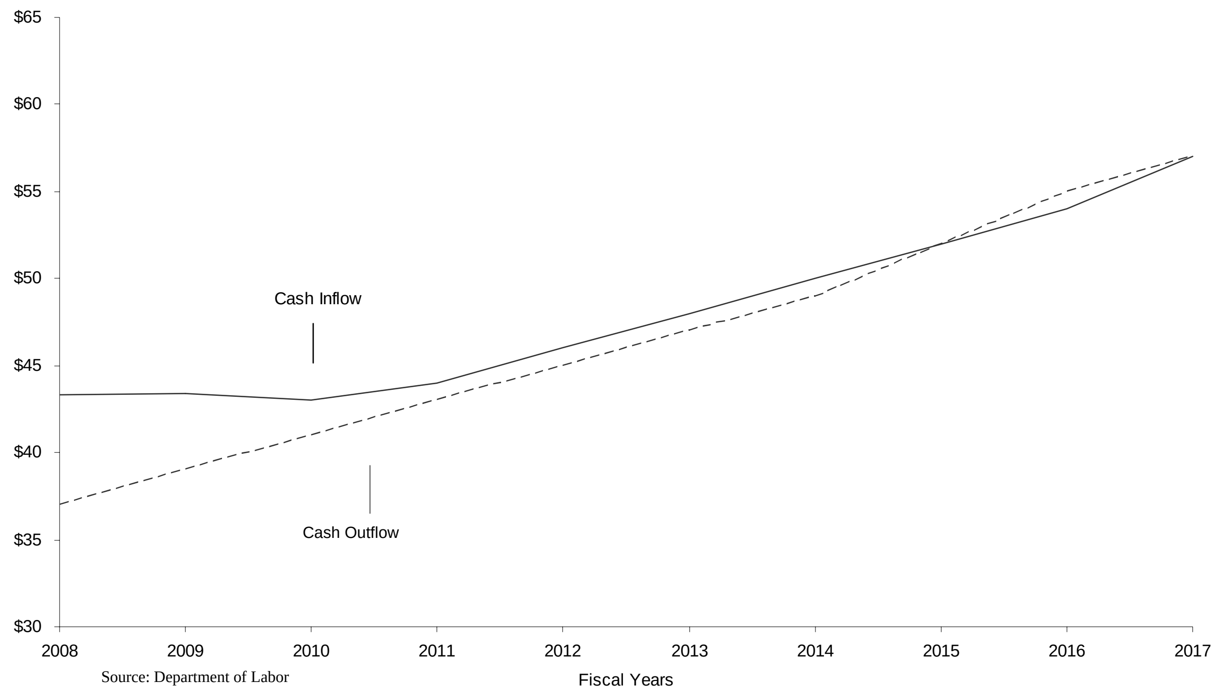
The Unemployment Insurance Program was created in 1935 to provide temporary partial wage replacement to unemployed workers who lost their jobs. The program is administered through a unique system of Federal and State partnerships established in Federal law but administered through conforming State laws by State agencies. DOL interprets and enforces Federal law requirements and provides broad policy guidance and program direction, while program details such as benefit eligibility, duration, and amount of benefits are established through individual State unemployment insurance statutes and administered through State unemployment insurance agencies.

The program is financed through the collection of Federal and State unemployment taxes that are credited to the Unemployment Trust Fund (UTF) and reported as Federal tax revenue. The fund was established to account for the receipt, investment, and disbursement of unemployment taxes. Federal unemployment taxes are used to pay for Federal and State administration of the Unemployment Insurance Program, veterans' employment services, State employment services, and the Federal share of extended unemployment insurance benefits. Federal unemployment taxes are also used to maintain a loan account within the UTF, from which insolvent State accounts may borrow funds to pay unemployment insurance benefits.

Chart 15 shows the projected cash contributions and expenditures over the next 10 years under expected economic conditions (described below). The significant assumptions used in the projections include total unemployment rates, civilian labor force levels, percent of unemployed receiving benefits, total wages, distribution of benefit payments by State, State tax rate structures, State taxable wage bases, and interest rates on UTF investments. These projections, excluding interest earnings, indicate positive net cash inflows until 2015, when net outflows begin.

Chart 15—Estimated Unemployment Fund Cashflow Using Expected Economic Conditions 2008-2017

(In billions of nominal dollars)



Source: Department of Labor

Table 10 shows present values of 10-year projections of revenues and expenditures for the Unemployment Insurance Program using a discount rate of 6.04 percent, the average of the interest rates underlying the 10-year projections. Three sets of numbers are presented in order to show the effects of varying economic conditions as reflected in different assumptions about the unemployment rate. For expected economic conditions, the estimates are based on an unemployment rate of 4.65 percent during fiscal year 2008, increasing to 4.80 percent in fiscal year 2009 and thereafter. Under the mild recessionary scenario, the unemployment rate peaks at 7.43 percent in fiscal year 2010 and declines gradually until reaching 4.80 percent in 2016. Finally, under the deep recession scenario, the unemployment rate is assumed to peak at 10.14 percent in 2011 and gradually fall to 5.25 percent by the end of the projection period.

Each scenario uses an open group that includes current and future participants of the Unemployment Insurance Program. Table 10 shows that, as economic conditions worsen, while tax income is projected to increase as higher layoffs result in higher employer taxes, benefit outlays increase much faster. From the Governmentwide (budget) perspective, under expected conditions, the present value of income exceeds the present value of expenditures by $11 billion. From the same perspective, under a deep recession scenario, the present value of expenditures exceeds the present value of income by $60 billion. From a trust fund perspective, the program has nearly $75 billion in assets. When combined with the present value of net cash income under expected economic conditions, the program has a surplus of $86 billion.

Table 10
Present Values of 10-Year Projections of Revenues and Expenditures for Unemployment Insurance Under Three Alternative Scenarios for Economic Conditions

(In billions of present value dollars, as of September 30, 2007)

	Economic Conditions		
	Expected	Mild Recession	Deep Recession
Future cash income	346.4	411.4	467.3
Future expenditures	335.3	413.9	526.9
Net obligations from budget perspective (expenditures less income)	(11.1)	2.6	59.6
Trust fund assets	74.8	74.8	74.8
Net obligations from trust fund perspective[1]	(85.9)	(72.3)	(15.2)

[1]Net obligations from the trust fund perspective equals net obligations from the budget perspective minus trust fund assets. The negative values in this line are indicative of surpluses.

Note: Detail may not add to totals due to rounding.

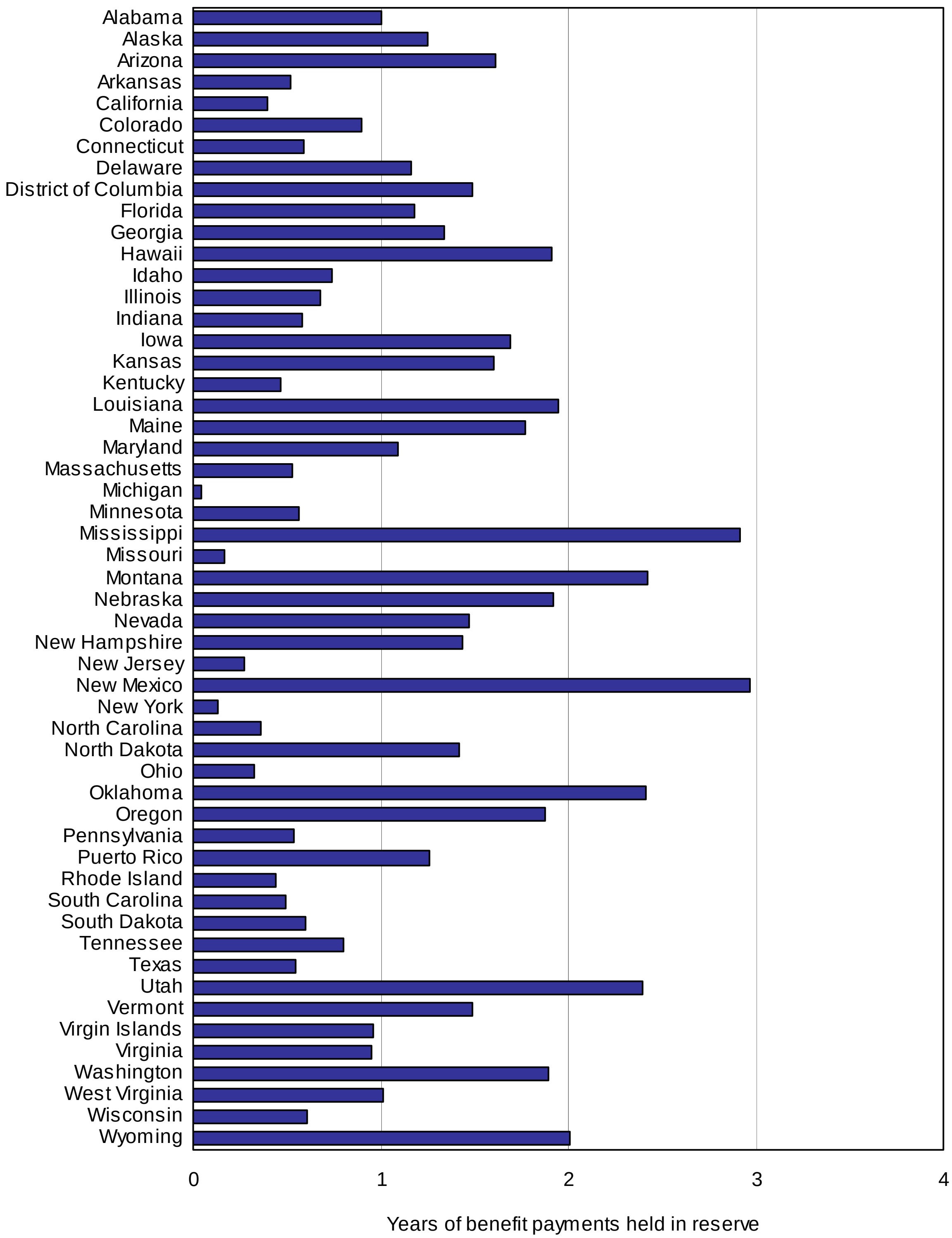
Source: Data for the present value calculations are from the Department of Labor.

Unemployment Trust Fund Solvency

Each State's accumulated UTF net assets or reserve balance should provide a defined level of benefit payments over a defined period. To be minimally solvent, a State's reserve balance should provide for 1 year's projected benefit payment needs based on the highest levels of benefit payments experienced by the State over the last 20 years. A ratio of 1.0 or greater prior to a recession indicates a State is minimally solvent. States below this level are vulnerable to exhausting their funds in a recession. States exhausting their reserve balance must borrow funds from the Federal Unemployment Account (FUA) to make benefit payments. During periods of high-sustained unemployment, balances in the FUA may be depleted. In these circumstances, FUA is authorized to borrow from the Treasury General Fund.

Chart 16 presents the State by State results of this analysis as of September 30, 2007. As the chart illustrates, 25 State funds were below the minimal solvency ratio on September 30, 2007.

Chart 16—Unemployment Trust Fund Solvency as of September 30, 2007



Deferred Maintenance

Deferred maintenance is the estimated cost to bring Government-owned property to an acceptable condition, resulting from not performing maintenance on a timely basis. Deferred maintenance excludes the cost of expanding the capacity of assets or upgrading them to serve needs different from those originally intended. The consequences of not performing regular maintenance could include increased safety hazards, poor service to the public, higher costs in the future, and inefficient operations. Estimated deferred maintenance costs are not accrued in the Statements of Net Cost or recognized as a liability on the balance sheets.

The amounts disclosed for deferred maintenance are allowed to be measured using the following three methods:

- Condition assessment surveys are periodic inspections of the Government-owned property to determine the current condition and estimated cost to bring the property to an acceptable condition.
- Life-cycle cost forecast is an acquisition or procurement technique that considers operation, maintenance, and other costs in addition to the acquisition cost of assets.
- Management analysis method is founded on inflation-adjusted reductions in maintenance funding since the base year.

The amounts disclosed on the table below have all been measured using the condition assessment survey method. The standards for acceptable operating condition and the changes in these standards and changes in asset condition vary widely between the Federal entities.

Some deferred maintenance has been deemed critical. Such amounts and conditions are defined by the individual agencies with responsibility for the safekeeping of these assets. Low and high estimates are based on the materiality of the estimated cost of returning the asset to the acceptable condition versus the total value of the corresponding asset.

Deferred Maintenance as of September 30

	Deferred Maintenance Cost Range					
	Low Estimate		High Estimate		Critical Maintenance	
(In billions of dollars)	2007	2006	2007	2006	2007	2006
Asset Category:						
Buildings, structures and facilities	89.9	25.3	97.2	32.1	12.5	11.7
Furniture, fixtures and equipment	0.2	0.4	0.3	0.4	0.2	0.1
Other general property, plant, and equipment	6.4	1.6	6.4	1.6	0.2	0.1
Heritage assets	3.9	1.7	5.3	2.9	0.2	-
Total deferred maintenance	100.4	29.0	109.2	37.0	13.1	11.9

Please refer to the individual financial statements of DOD, USDA, DOE, VA, DOI, and NASA for detailed significant information on deferred maintenance, including the standards used for acceptable operating condition and changes in asset condition. These agencies comprise 80 percent of the Government's total reported net property, plant, and equipment of $691.1 billion as of September 30, 2007. There is a vast difference in amounts reported from fiscal year 2006 to fiscal year 2007 because this year, DOD changed its methodology for reporting deferred maintenance. In prior years, the amount was based upon the annual deferred sustainment (maintenance). This year, the amount is based upon the cumulative deferred amount for facility restoration and modernization and thus is significantly larger than previous years. While restoration and modernization is not precisely equivalent to deferred maintenance, the values are generally representative of the magnitude of the deferred maintenance requirements.

Unexpended Budget Balances

Unexpended budget balances consist of the unobligated and obligated, but unliquidated, budget balances.

Unobligated budget balances, including amounts for trust funds, are the cumulative amount of budget balances that are not obligated and that remain available for obligation. In 1-year accounts, the unobligated balance is not available for new obligations after the end of the fiscal year. In multiyear accounts, the unobligated balance may be carried forward and remains available for obligation for the period specified. In no-year accounts, the unobligated balance is carried forward until specifically rescinded by law or until the purposes for which it was provided have been accomplished. The total unobligated budget balances for fiscal years 2006 and 2005 are $463.3 billion and $458.0 billion, respectively.

Obligated budget balances are the cumulative budget balances that have been obligated but not liquidated. The obligated balance can be carried forward for a maximum of 5 years after the appropriation has expired. The total obligated budget balances for fiscal years 2006 and 2005 are $977.6 billion and $911.3 billion, respectively.

The President’s Budget with fiscal year 2007 actuals is expected to be published in February 2008. The President’s fiscal year 2008 Budget (issued on February 5, 2007), includes the estimates of the unobligated and obligated amounts for fiscal year 2007. However, these estimated amounts are expected to differ from the actual amount due to compilation differences, which include correction of errors or reclassifications due to nonbudgetary or expired amounts, and other changes upon completion of final OMB review, and are therefore not reported.

Tax Burden

The Internal Revenue Code provides for progressive tax rates, whereby higher incomes are generally subject to higher tax rates. The following tables present the latest available information on income tax and related income, deductions, and credit for individuals by income level and for corporations by size of assets.

Individual Income Tax Liability for Tax Year 2005

Adjusted Gross Income (AGI)	Number of Taxable Returns (In thousands of dollars)	AGI (In millions of dollars)	Total Income Tax (In millions of dollars)	Average AGI per Return (In whole dollars)	Average Income Tax per Return (In whole dollars)	Income Tax as a Percentage of AGI
Under $15,000	36,889	197,723	3,239	5,360	88	1.6%
$15,000 under $30,000	29,739	655,562	23,308	22,044	784	3.6%
$30,000 under $50,000	24,596	961,071	60,187	39,075	2,447	6.3%
$50,000 under $100,000	28,867	2,033,408	179,382	70,441	6,214	8.8%
$100,000 under $200,000 ..	10,831	1,434,585	190,599	132,452	17,598	13.3%
$200,000 or more	3,541	2,081,299	471,549	587,772	133,168	22.7%
Total	134,463	7,363,648	928,264			

Corporation Income Tax Liability for Tax Year 2004

Total Assets (In thousands of dollars)	Income Subject to Tax (In millions of dollars)	Total Income Tax after Credits (In millions of dollars)	Percentage of Income Tax after Credits to Taxable Income
Zero assets	15,385	4,076	26.5%
$1 under $500	8,436	1,536	18.2%
$500 under $1,000	4,081	960	23.5%
$1,000 under $5,000	12,215	3,519	28.8%
$5,000 under $10,000	7,562	2,446	32.3%
$10,000 under $25,000	10,694	3,511	32.8%
$25,000 under $50,000	10,076	3,282	32.6%
$50,000 under $100,000	12,037	3,918	32.5%
$100,000 under $250,000	23,779	7,529	31.7%
$250,000 or more	753,124	193,658	25.7%
Total	857,389	224,435	

Tax Gap

The tax gap is the aggregate amount of tax (i.e., excluding interest and penalties) that is imposed by the tax laws for any given tax year but is not paid voluntarily and timely. The Internal Revenue Service (IRS) currently projects that the annual Federal gross tax gap is estimated at $345.0 billion. This estimate is based on the results of the National Research Program (NRP). The NRP was a study conducted to measure the compliance rate of the individual filers based on examination of a statistical sample of their filed returns for tax year 2001. The tax gap arises from three types of noncompliance: not filing timely tax returns (the nonfiling gap), underreporting the correct amount of tax on timely-filed returns (the underreporting gap), and not paying on time the full amount reported on timely-filed returns (the underpayment gap). Of these three components, only the underpayment gap is observed; the nonfiling gap and the underreporting gap must be estimated. Each instance of noncompliance by a taxpayer contributes to the tax gap, whether or not the IRS detects it, and whether or not the taxpayer is even aware of the noncompliance. The tax gap does not include underpayments by corporate taxpayers or include taxes that should have been paid on income from the illegal sector of the economy.

Underreporting of income tax, employment taxes, and other taxes represents 82 percent of the tax gap. The single largest subcomponent of underreporting involves individuals understating their income, taking improper deductions, overstating business expenses, and erroneously claiming credits. Individual underreporting represents about half of the total tax gap. Individual income tax also accounts for about half of all tax liabilities.

The collection gap is the cumulative amount of assessed tax, penalties, and interest that the IRS expects to remain uncollectible. In essence, it represents the difference between the total balance of unpaid assessments and the net taxes receivable reported on the IRS' balance sheet. The tax gap and the collection gap are related and overlapping concepts, but they have significant differences. The collection gap is a cumulative balance sheet concept for a particular point in time, while the tax gap is like an income statement item for a single year. Moreover, the tax gap estimates include all noncompliance, while the collection gap includes only amounts that have been assessed (a small portion of all noncompliance).

Other Claims for Refunds

Management has estimated amounts that may be paid out as other claims for tax refunds. This estimate represents an amount (principal and interest) that may be paid for claims pending judicial review by the Federal courts or, internally, by appeals. The total estimated payout (including principal and interest) for claims pending judicial review by the Federal courts is $8.8 billion and $14.8 billion for fiscal years 2007 and 2006, respectively. For those under appeal, the estimated payout is $5.9 billion and $7.1 billion for fiscal years 2007 and 2006, respectively. There are also unasserted claims for refunds of certain excise taxes. Although these refund claims have been deemed to be probable, they do not meet the criteria in SFFAS No. 5 for reporting the amounts in the balance sheets or for disclosure in the Notes to the Financial Statements. However, they meet the criteria in SFFAS No. 7 for inclusion as supplemental information. To the extent judgments against the Government for these claims prompt other similarly situated taxpayers to file similar refund claims, these amounts could become significantly greater.

Risk Assumed

Risk assumed information is important for all Federal insurance and guarantee programs, except those relating to social insurance, life insurance and loan guarantee programs. Risk assumed is generally measured by the present value of unpaid expected losses net of associated premiums based on the risk inherent in the insurance or guarantee coverage in force. In addition to the liability for unpaid insurance claims included in Note 14—Insurance Program Liabilities, for events that have already occurred, the Federal Government is also required to report as supplementary information risk assumed amounts and the periodic changes in those amounts.

The assessments of losses expected based on the risk assumed are based on actuarial or financial methods applicable to the economic, legal and policy environment in force at the time the assessments are made. Management has estimated the loss amounts based on the risk assumed as well as the periodic changes for the following insurance programs.

Please refer to the individual financial statements of the Pension Benefit Guaranty Corporation, the Department of Homeland Security, and the National Credit Union Administration for other significant detailed information.

Risk Assumed Information as of September 30

(In billions of dollars)	2007	2006
Present Value of unpaid expected losses, net of associated premiums:		
Pension Benefit Guaranty Corporation	65.7	73.4
Department of Homeland Security	0.6	-
National Credit Union Administration	0.1	0.1
Total	66.4	73.5
Periodic changes in risk assumed amounts:		
Pension Benefit Guaranty Corporation	(7.6)	(35.1)
Total	(7.6)	(35.1)

Unmatched Transactions and Balances

(In millions of dollars)	Fiscal Year 2007	Fiscal Year 2006
Change in Intra-Governmental Unmatched Balances		
Debt/Investments	2,137.0	1,231.4
Interest Payable/Receivable	(73.6)	77.7
Loans Payable/Receivable	5,602.4	(1,178.0)
Benefit Program Contributions Payable/Receivable	53.3	(128.8)
Accounts Payable/Receivable	(2,093.7)	10,271.5
Advances from/to Others & Deferred Credits/Prepayments	(209.1)	(855.5)
Transfers Payable/Receivable	(523.3)	(379.8)
	4,893.0	9,038.5
Unmatched Intra-Governmental Transactions		
Federal Securities Interest Revenue/Expense–Investment Exchange	(830.0)	2,206.2
Borrowings Interest Revenue/Expense–Exchange	(1,058.1)	397.0
Borrowings Gains/Losses	(6.8)	(16.5)
Nonexpenditure Transfers–In/Out	6,600.1	1,409.5
Expenditure Transfers–In/Out	(855.8)	(615.0)
Transfers–In/Out Without Reimbursement	5,508.6	7,386.2
Imputed Financing Source/Cost	(8.9)	(7.6)
Benefit Program Revenue/Cost	1,961.7	(950.1)
	11,310.8	9,809.7
General Fund Transactions		
Fund Balance with Treasury	(18,149.1)	(39,241.6)
Appropriations of Unavailable Special or Trust Fund Receipts-Transfer Out	2,781.4	1,407.6
Appropriations of Unavailable Special or Trust Fund Receipts-Transfer In	(1,585.4)	(8,357.6)
Other General Fund Transactions	(13,101.4)	25,661.7
	(30,054.5)	(20,529.9)
Net Intra-Agency Reporting Errors*	7,171.3	(9,309.0)
Unmatched Transactions and Balances, Net	(6,679.4)	(10,990.7)

*Includes reporting errors for DHS (5,371.0) million in fiscal year 2006

( )Parentheses indicate a decrease to Net Position.

The Statement of Operations and Changes in Net Position includes an amount for unmatched transactions and balances that result from the consolidation of Federal reporting entities. Transactions between Federal entities must be eliminated in consolidation to calculate the financial position of the U.S. Government. Many of the amounts included in the table represent intra-governmental activity and balances that differed between Federal agency trading partners and often totaled significantly more than the net amounts shown. In addition, included in the "General Fund Transactions" section are certain intra-governmental accounts, primarily related to unreconciled transactions with the General Fund, totaling hundreds of billions of dollars. The table also reflects other consolidating adjustments and other adjustments that contributed to the unmatched transactions and balances amount.

Unmatched transactions and balances between Federal entities impact not only in the period in which differences originate but also in the periods where differences are reconciled. As a result, it would not be proper to conclude that increases or decreases in the unmatched amounts shown in the table above reflect improvements or deteriorations in the Government's ability to reconcile intra-governmental transactions. The Federal community considers the identification and accurate reporting of intra-governmental activity a priority.

United States Government Stewardship Information (Unaudited) for the Years Ended September 30, 2007, and September 30, 2006

Stewardship Investments

Stewardship investments focus on Government programs aimed at providing long-term benefits by improving the Nation's productivity and enhancing economic growth. These investments can be provided through direct Federal spending or grants to State and local governments for certain education and training programs, research and development, and federally financed but not federally-owned property, such as bridges and roads. When incurred, these investments are included as expenses in determining the net cost of operations. Stewardship investments for the current year and for the immediately preceding 4 years are shown below in Table 11. The amounts reported in fiscal year 2007 for investments in prior years (fiscal years 2006-2003) are restated due to agencies continuously reviewing, correcting, and updating this data.

Table 11
Stewardship Investments
for the Years Ended September 30

(In billions of dollars)	Fiscal Year 2007	Restated Fiscal Year 2006	Restated Fiscal Year 2005	Restated Fiscal Year 2004	Restated Fiscal Year 2003
Investments in non-federal physical property	56.1	54.4	51.9	54.8	49.1
Investments in human capital	76.1	107.4	88.1	76.6	71.0
Research and development:					
Investments in basic research	25.0	24.2	24.1	22.5	21.2
Investments in applied research	17.1	18.4	18.3	18.0	16.7
Investments in development	18.6	23.8	16.6	15.1	14.1
Total investments	192.9	228.2	199.0	187.0	172.1

Non-Federal Physical Property

The Government makes grants and provides funds for the purchase, construction, and/or major renovation of State and local government physical properties. Cost for non-federal physical property programs are included as expenses in the Statements of Net Cost and are reported as investments in Table 11. They are measured on the same accrual basis of accounting used in the *Financial Report* statements.

DOT, HUD, and the Environmental Protection Agency (EPA) had $46.7 billion (83 percent), $3.6 billion (7 percent), and $3.2 billion (6 percent), respectively, of the total non-federal physical property investments in fiscal year 2007 as shown in Table 11. These same agencies also had similar investment amounts (and percentage contributions) in each of the preceding 4 years.

Within DOT, the Federal Highway Administration invested $33.7 billion during fiscal year 2007, primarily via reimbursement from the Highway Trust Fund, of states' construction costs related to interstate and national highways. The States' contribution is 10 percent for the Interstate System and 20 percent for most other programs. These highway programs have not typically resulted in significant transfers of property to State or local governments.

The significant programs administered by HUD relate to grants for property renovation and public housing programs. The significant programs administered by the EPA relate to grants for the nation's drinking water and clean water infrastructure. Neither of these programs typically transfers property to State or local governments.

Human Capital

The Government runs several programs that invest in human capital. Those investments go toward increasing and maintaining a healthy economy by educating and training the general public. Costs do not include training expenses for Federal workers.

Education, DOL, and VA had $61.8 billion (81 percent), $5.9 billion (8 percent), and $3.5 billion (5 percent), respectively, of the total human capital investments in fiscal year 2007 as shown in Table 11. These same agencies also had similar investment amounts (and percentage contributions) in each of the preceding 4 years, with the exception of Education in fiscal year 2007, where there was a decrease in FFEL and Direct Loan subsidy re-estimates and subsidy transfers due to decreased loan consolidation activity during the year.

Education administers a wide variety of programs related to general public education and training programs that are intended to increase or maintain national economic productive capacity. Within Education, approximately 32 percent of the annual investment in fiscal year 2007 relates to Federal student aid, either in the form of direct or guaranteed loans or grants to eligible undergraduate and graduate students. The remaining investments primarily relate to grants for Elementary, Secondary, and Special Education programs as well as for various departmental initiatives (e.g., charter schools, foreign language assistance, etc.).

The significant human capital programs administered by DOL relate to grants for job training and employment programs. The significant human capital programs administered by VA also relate to grants for job training and rehabilitation programs for veterans.

Research and Development

Federal investments in research and development (R&D) comprise those expenses for basic research, applied research, and development that are intended to increase or maintain national economic productive capacity or yield other future benefits.

- Investments in basic research are for systematic studies to gain knowledge or understanding of the fundamental aspects of phenomena and of observable facts without specific applications toward processes or products in mind.
- Investments in applied research are for systematic studies to gain knowledge or understanding necessary for determining the means by which a recognized and specific need may be met.
- Investments in development are the systematic use of the knowledge and understanding gained from research for the production of useful materials, devices, systems, or methods, including the design and development of prototypes and processes.

With regard to basic and applied research, HHS had $15.9 billion (64 percent) and $11.0 billion (65 percent), of the total basic and applied research investments, respectively, in fiscal year 2007 as shown in Table 11. HHS also had similar R&D investment amounts (and percentage contributions) in each of the preceding 4 years.

Within HHS, the National Institutes of Health (NIH) conducts almost all (97 percent) of the department's basic and applied research. The NIH Research Program includes all aspects of the medical research continuum, including basic and disease-oriented research, observational and population-based research, behavioral research, and clinical research, including research to understand both health and disease states, to move laboratory findings into medical applications, to assess new treatments or compare different treatment approaches; and health services research.

The NIH regards the expeditious transfer of the results of its medical research for further development and commercialization of products of immediate benefit to improved health as an important mandate.

With regard to development, NASA and DOD had $8.9 billion (50 percent) and $7.3 billion (41 percent), respectively, of total development investments in fiscal year 2007, as shown in Table 11. DOD changed its methodology for reporting yearly investments in research and development during fiscal year 2007 which affected the current and prior 4 years. As a result, the total amount of investments in development (Table 11) have been restated. Development is comprised of five stages: advanced technology development, advanced component development and prototypes, system development and demonstration, management support, and operational systems development. NASA development programs include activities to extend our knowledge of Earth, its space environment, and the universe, and to invest in new aeronautics and advanced space transportation technologies that support the development and application of technologies critical to the economic, scientific, and technical competiveness of the United States. Some outcomes and future outcomes of this development are:

- The Constellation Systems program to develop, demonstrate, and deploy the capabilities to transport crew and cargo for missions to the lunar surface and safely return the crew to Earth,
- Robotic spacecraft that use electrical power for propulsion, data acquisition, and communication to accurately place themselves in orbit around the surfaces of bodies about which we may know relatively little,
- The Fundamental Aeronautics Program conducts development technology to enable revolutionary capabilities for the future of aviation. NASA will develop advanced tools and capabilities that will enable whole new classes of aircraft that not only meet the noise and emissions requirements of the future but that also provide fast, efficient, and economical flight,
- The MARS Exploration program has been developed to conduct a rigorous, incremental, discovery-driven exploration of MARS to determine the planet's physical, dynamic, and geological characteristics, investigate the Martian climate in the context of understanding habitability, and investigate whether MARS ever had the potential to develop and harbor any kind of life,
- The development and demonstration of space-based measurements, providing information about the Earth-Sun systems not available by other means.

Major outcomes of DOD development are:

- Hardware and software components, or complete weapon systems, ready for operational and developmental testing and field use, and
- Weapon systems finalized for complete operational and developmental testing.

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Appendix: Significant Government Entities Included and Excluded from the Financial Statements

This appendix provides the reader a clear understanding of which organizations and agencies are encompassed in the reporting entity for this publication. The reporting entity is a specifically defined group of agencies, principally cabinet departments and other agencies of the executive branch, as stated in the law and accounting guidance.

The determination as to which organizations and agencies will be included in the reporting entity is governed by Federal laws and is also based on guidance issued by the Federal Accounting Standards Advisory Board in their Statement of Federal Financial Accounting Concept (SFFAC) No. 2, Entity and Display, which provides criteria for determining what should be included in the reporting entity for a consolidated Governmentwide report. The Board is now considering more specific guidance on the reporting entity for this report.

There are a total of 148 organizations and agencies included in the Financial Report of the United States Government. The lists below describe three groups of entity types that comprise the reporting entity for the Financial Report.

Significant Entities Included in these Statements:

Twenty-Four CFO Act Agencies Required to Submit Data

Department of Agriculture
www.usda.gov
Department of Commerce
www.doc.gov
Department of Defense
www.defenselink.mil
Department of Education
www.ed.gov
Department of Energy
www.doe.gov
Department of Health and Human Services
www.hhs.gov
Department of Homeland Security
www.dhs.gov
Department of Housing and Urban Development
www.hud.gov
Department of the Interior
www.doi.gov
Department of Justice
www.usdoj.gov
Department of Labor
www.dol.gov
Department of State
www.state.gov
Department of Transportation
www.dot.gov
Department of the Treasury
www.ustreas.gov
Department of Veterans Affairs
www.va.gov
Environmental Protection Agency
www.epa.gov
General Services Administration
www.gsa.gov
National Aeronautics and Space Administration
www.nasa.gov
National Science Foundation
www.nsf.gov
Office of Personnel Management
www.opm.gov
Small Business Administration
www.sba.gov
Social Security Administration
www.ssa.gov
U.S. Agency for International Development
www.usaid.gov
U.S. Nuclear Regulatory Commission
www.nrc.gov

Eleven Additional Significant Entities Required to Submit Data

Export-Import Bank of the United States
www.exim.gov
Farm Credit System Insurance Corporation
www.fcsic.gov
Federal Communications Commission
www.fcc.gov
Federal Deposit Insurance Corporation
www.fdic.gov
National Credit Union Administration
www.ncua.gov
Pension Benefit Guaranty Corporation
www.pbgc.gov
Railroad Retirement Board
www.rrb.gov
Securities and Exchange Commission
www.sec.gov
Smithsonian Institution
www.si.edu
Tennessee Valley Authority
www.tva.gov
U.S. Postal Service
www.usps.gov

Other Entities Included in these Statements:

One Hundred Thirteen Additional Entities Included in these Statements

Abraham Lincoln Bicentennial Commission
Advisory Council on Historic Preservation
African Development Foundation
American Battle Monuments Commission
America's Education Goals Panel
Antitrust Modernization Commission
Appalachian Regional Commission
Appalachian Regional Development Fund
Architect of the Capitol
Architectural and Transportation Barriers Compliance Board
Armed Forces Retirement Home
Barry Goldwater Scholarship and Excellence in Education Foundation
Botanic Garden
Broadcasting Board of Governors
Central Intelligence Agency
Chemical Safety Hazard Investigation Board
Christopher Columbus Fellowship Foundation
Commission for the Preservation of America's Heritage Abroad
Commission of Fine Arts
Commission on Affordable Housing and Health Facility Needs for Seniors in the 21st Century
Commission on Civil Rights
Commission on International Religious Freedom
Commission on Ocean Policy
Commission on Online Child Protection
Commission on Review of Overseas Military Facility Structure-United States
Commission on Security & Cooperation–Europe
Committee for Purchase from People who are Blind or Severely Disabled
Commodity Futures Trading Commission
Community Management Staff
Congressional Budget Office
Congressional-Executive Commission on the People's Republic of China
Consumer Product Safety Commission
Corporation for National & Community Service
Court of Appeals for Veterans Claims
Court Services and Offender Supervision Agency for DC
DC Courts
DC Courts–Defender Services
Defense Nuclear Facilities Safety Board
Delta Regional Authority
Denali Commission
Dwight D. Eisenhower Memorial Commission
Eisenhower Exchange Fellowship Program
Election Assistance Commission
Environmental Dispute Resolution Fund
Equal Employment Opportunity Commission
Executive Office of the President
Farm Credit Administration
Federal Election Commission
Federal Financial Institutions Examination Council Appraisal Subcommittee
Federal Housing Finance Board
Federal Labor Relations Authority
Federal Maritime Commission
Federal Mediation and Conciliation Service
Federal Mine Safety and Health Review Commission
Federal Trade Commission
Government Accountability Office
Government Printing Office

Harry S. Truman Scholarship Trust Fund
Institute of Museum Services
Interagency Council on the Homeless
Inter-American Foundation
International Trade Commission
James Madison Memorial Fellowship Foundation
Japan-United States Friendship Commission
John C. Stennis Center
John F. Kennedy Center for the Performing Arts
Judiciary Office Building Development
Library of Congress
Marine Mammal Commission
Medicare Payment Advisory Commission
Merit Systems Protection Board
Military Sales Program
Millennium Challenge Corporation
Morris K. Udall Scholarship Foundation
National Archives and Records Administration
National Capital Planning Commission
National Commission on Libraries and Information Science
National Commission on Terrorist Attacks upon the United States
National Council on Disability
National Endowment for the Arts
National Endowment for the Humanities
National Gallery of Art
National Labor Relations Board
National Mediation Board
National Railroad Retirement Investment Trust
National Transportation Safety Board
National Veterans Business Development Corporation
Neighborhood Reinvestment Corporation
Nuclear Waste Technical Review Board
Occupational Safety & Health Review Commission
Office of Compliance
Office of Government Ethics
Office of Navajo & Hopi Indian Relocation
Office of Special Counsel
Office of the Federal Coordination for Alaska Natural Gas Transportation Projects
Open World Leadership Center Funds
Overseas Private Investment Corporation
Panama Canal Commission
Peace Corps
Presidio Trust
Public Defender Service
Selective Service System
Senate Preservation Fund
St. Lawrence Seaway Development Corporation
State Justice Institute
U.S. Capital Preservation Commission
U.S. China Security Review Commission
U.S. Holocaust Memorial Museum
U.S. Institute of Peace
U.S. Trade and Development Agency
Vietnam Education Foundation
White House Commission on the National Moment of Remembrance
Woodrow Wilson International Center for Scholars

Legislative and Judicial Branches

There are no legal or other requirements for the legislative branch or judicial branch to prepare audited financial statements or to provide accrual-based accounting data for inclusion in the Governmentwide financial statements. Therefore, these consolidated statements do not include accrual-based accounting data for the U.S. Courts or the Congress. Some Congressional agencies voluntarily prepare and submit such information (examples: Government Accountability Office, Government Printing Office, and Library of Congress). The President's Budget includes cash-based, outlay data for the legislative and judicial branches and, to a limited extent, this outlay data is also a part of the information contained in this report.

Entities Excluded from these Statements are:

These specific entities are not considered part of the Governmentwide reporting entity based on the individual assessment of the entities with respect to the indicative criteria stated in SFFAC No. 2, Entity and Display:

Army and Air Force Exchange Service
Board of Governors of the Federal Reserve System
(Including the Federal Reserve Banks)
Federal Home Loan Banks
Federal Retirement Thrift Investment Board
(Including the Thrift Savings Fund)
Federal National Mortgage Association (Fannie Mae)

Financing Corporation
Federal Home Loan Mortgage Corporation
(Freddie Mac)
Marine Corps Exchange
Navy Exchange Service Command
Resolution Funding Corporation
Student Loan Marketing Association (SLMA or Sallie Mae)

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Accountability * Integrity * Reliability

Comptroller General
of the United States

United States Government Accountability Office
Washington, DC 20548

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

The Secretary of the Treasury, in coordination with the Director of the Office of Management and Budget, is required annually to submit financial statements for the U.S. government to the President and the Congress. GAO is required to audit these statements.[1] This is our report on the accompanying U.S. government's consolidated financial statements for the fiscal years ended September 30, 2007 and 2006, and our associated reports on internal control and compliance with significant laws and regulations. As used in this report, accrual basis financial statements refer to all of the consolidated financial statements and notes, except for those related to the Statement of Social Insurance.[2]

The federal government is responsible for (1) preparing annual consolidated financial statements in conformity with U.S. generally accepted accounting principles (GAAP); (2) establishing, maintaining, and assessing internal control to provide reasonable assurance that the control objectives of the Federal Managers' Financial Integrity Act (FMFIA)[3] are met; and (3) complying with significant laws and regulations. Also, the 24 Chief Financial Officers (CFO) Act agencies are responsible for implementing and maintaining financial management systems that substantially comply with Federal Financial Management Improvement Act of 1996 (FFMIA)[4] requirements. Our objective was to

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[1] The Government Management Reform Act of 1994 has required such reporting, covering the executive branch of government, beginning with financial statements prepared for fiscal year 1997. 31 U.S.C. 331(e). The federal government has elected to include certain financial information on the legislative and judicial branches in the consolidated financial statements as well.

[2] The accrual basis consolidated financial statements for the fiscal years ended September 30, 2007 and 2006 consist of the (1) Statements of Net Cost, (2) Statements of Operations and Changes in Net Position, (3) Reconciliations of Net Operating Cost and Unified Budget Deficit, (4) Statements of Changes in Cash Balance from Unified Budget and Other Activities, and (5) Balance Sheets, including the related notes to these financial statements. Most revenues are recorded on a modified cash basis. The 2007 and 2006 Statements of Social Insurance, including the related notes, are also included in the consolidated financial statements. The Statements of Social Insurance do not interrelate to the accrual basis consolidated financial statements.

[3] 31 U.S.C. 3512 (c), (d) (commonly referred to as FMFIA). This act requires executive agency heads to evaluate and report annually to the President and the Congress on the adequacy of their internal control and accounting systems and on actions to correct significant problems.

[4] 31 U.S.C. 3512 note (Federal Financial Management Improvement Act).

audit the consolidated financial statements for the fiscal years ended September 30, 2007 and 2006. Appendix I discusses the scope and methodology of our work.

A significant number of material weaknesses[5] related to financial systems, fundamental recordkeeping and financial reporting, and incomplete documentation continued to (1) hamper the federal government's ability to reliably report a significant portion of its assets, liabilities, costs, and other related information; (2) affect the federal government's ability to reliably measure the full cost as well as the financial and nonfinancial performance of certain programs and activities; (3) impair the federal government's ability to adequately safeguard significant assets and properly record various transactions; and (4) hinder the federal government from having reliable financial information to operate in an economical, efficient, and effective manner. We found the following:

- Certain material weaknesses in financial reporting and other limitations on the scope of our work[6] resulted in conditions that continued to prevent us from expressing an opinion on the accompanying accrual basis consolidated financial statements for the fiscal years ended September 30, 2007 and 2006.[7]

- The 2007 Statement of Social Insurance[8] is presented fairly, in all material respects, in conformity with GAAP; we disclaim an opinion on the 2006 Statement of Social Insurance.[9]

- 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.

[5] A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected. A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.

[6] 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.

[7] We previously reported that certain material weaknesses prevented us from expressing an opinion on the consolidated financial statements of the U.S. government for fiscal years 1997 through 2006.

[8] The valuation date is January 1 for all social insurance programs except the Black Lung program, for which the valuation date is September 30.

[9] 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 this report.

Significant Matter of Emphasis—The Nation's Long-Term Fiscal Challenge

Before discussing our disclaimer of opinion on the accrual basis consolidated financial statements and unqualified opinion on the Statement of Social Insurance, the following key items deserve emphasis in order to put the information contained in the financial statements and the Management's Discussion and Analysis section of the *2007 Financial Report of the United States Government* (*2007 Financial Report*) into context. Despite continued improvement in both the reported annual net operating cost and cash-based budget deficit, the U.S. government's total reported liabilities, net social insurance commitments, and other fiscal exposures continue to grow and now total approximately $53 trillion—up more than $2 trillion during fiscal year 2007 and more than $32 trillion from about $20 trillion in fiscal year 2000. The fiscal and cash flow implications of our large and growing Social Security and Medicare commitments will be felt as the large "baby boom" generation leaves the work force and collects benefits. In fact, the first boomers already have filed for early retirement benefits. The budget and economic implications of the baby boom generation's retirement will only intensify as the baby boomers age. Given these and other factors, it seems clear that our nation is on an imprudent and unsustainable long-term fiscal path that is getting worse with the passage of time. The issues raised by this long-term fiscal challenge are issues of significance that affect every American. Leadership and the efforts of many people will be needed to put our nation on a more prudent and sustainable longer-term fiscal path.

DISCLAIMER OF OPINION ON THE ACCRUAL BASIS CONSOLIDATED FINANCIAL STATEMENTS

Because of the federal government's inability to demonstrate the reliability of significant portions of the U.S. government's accompanying accrual basis consolidated financial statements for fiscal years 2007 and 2006, principally resulting from certain material weaknesses, and other limitations on the scope of our work, described in this report, we are unable to, and we do not, express an opinion on such financial statements.

As a result of these limitations, readers are cautioned that amounts reported in the accrual basis consolidated financial statements and related notes may not be reliable. These material weaknesses and other scope limitations also affect the reliability of certain information contained in the accompanying Management's Discussion and Analysis and other financial management information—including information used to manage the government day to day and budget information reported by federal agencies—that is taken from the same data sources as the accrual basis consolidated financial statements.

We have not audited and do not express an opinion on the Management's Discussion and Analysis, Stewardship Information, Supplemental Information, or other information included in the accompanying fiscal year *2007 Financial Report*.

Limitations on the Scope of Our Work

For fiscal years 2007 and 2006, there were limitations on the scope of our work in addition to the material weaknesses that contributed to our disclaimer of opinion on the accrual basis consolidated financial statements. First, the Department of the Treasury (Treasury) and the Office of Management and Budget (OMB) depend on certain federal agencies' representations to provide their representations to us regarding the U.S. government's consolidated financial statements. Treasury and OMB were unable to provide us with adequate representations regarding the U.S. government's accrual basis consolidated financial statements primarily because of insufficient representations provided to them by one CFO Act agency for fiscal year 2007, and two CFO Act agencies for fiscal year 2006.[10] Second, Treasury was unable to provide the final accrual basis consolidated financial statements and certain supporting documentation in time for us to complete all of our planned auditing procedures related to the compilation of these financial statements.

Material Weaknesses Contributing to Our Disclaimer of Opinion on the Accrual Basis Consolidated Financial Statements

The federal government did not maintain adequate systems or have sufficient, reliable evidence to support certain material information reported in the accompanying accrual basis consolidated financial statements, as briefly described below. The underlying material weaknesses in internal control, which generally have existed for years, contributed to our disclaimer of opinion on the accrual basis consolidated financial statements. Appendix II describes the material weaknesses in more detail and highlights the primary effects of these material weaknesses on the accompanying accrual basis consolidated financial statements and on the management of federal government operations. The material weaknesses that contributed to our disclaimer of opinion on the accrual basis consolidated financial statements were the federal government's inability to:

- satisfactorily determine that property, plant, and equipment and inventories and related property, primarily held by the Department of Defense (DOD), were properly reported in the consolidated financial statements;

- implement effective credit reform estimation and related financial reporting processes at certain federal credit agencies;

[10] The agencies are the Department of Defense, for fiscal years 2007 and 2006, and the Department of Homeland Security for fiscal year 2006.

- reasonably estimate or adequately support amounts reported for certain liabilities, such as environmental and disposal liabilities, or determine whether commitments and contingencies were complete and properly reported;
- support significant portions of the total net cost of operations, most notably related to DOD, and adequately reconcile disbursement activity at certain agencies;
- adequately account for and reconcile intragovernmental activity and balances between federal agencies;
- ensure that the federal government's consolidated financial statements were (1) consistent with the underlying audited agency financial statements, (2) properly balanced, and (3) in conformity with GAAP; and
- identify and either resolve or explain material differences that exist between certain components of the budget deficit reported in Treasury's records, used to prepare the Reconciliation of Net Operating Cost and Unified Budget Deficit and Statement of Changes in Cash Balance from Unified Budget and Other Activities, and related amounts reported in federal agencies' financial statements and underlying financial information and records.

Due to the material weaknesses and the additional limitations on the scope of our work discussed above, there may also be additional issues that could affect the accrual basis consolidated financial statements that have not been identified.

UNQUALIFIED OPINION ON THE 2007 STATEMENT OF SOCIAL INSURANCE

In our opinion, the 2007 Statement of Social Insurance presents fairly, in all material respects, the financial condition of the U.S. government's social insurance programs, in conformity with GAAP. We disclaim an opinion on the 2006 Statement of Social Insurance[11] and have not audited and do not express an opinion on the Statements of Social Insurance for 2005, 2004, and 2003, and other information related to such statements, that is included in the accompanying fiscal year *2007 Financial Report*.

As discussed in Note 22 to the consolidated financial statements, the Statement of Social Insurance presents the actuarial present value of the federal government's estimated future revenue to be received from or on behalf of participants and estimated future expenditures to be paid to or on behalf of participants, based on benefit formulas in current law and using a projection period sufficient to illustrate the long-term

[11] Beginning in fiscal year 2006, the Statement of Social Insurance became a principal financial statement and was audited as part of the applicable federal agencies' financial statements. We disclaimed an opinion on the fiscal year 2006 consolidated financial statements, including the Statement of Social Insurance. For fiscal year 2007, we designed our audit to provide an opinion on the 2007 consolidated Statement of Social Insurance.

sustainability of the social insurance programs.[12] In preparing the Statement of Social Insurance, management considers and selects assumptions and data that it believes provide a reasonable basis for the assertions in the statement. However, because of the large number of factors that affect the Statement of Social Insurance and the fact that such assumptions are inherently subject to substantial uncertainty (arising from the likelihood of future changes in general economic, regulatory, and market conditions, as well as other more specific future events, significant uncertainties, and contingencies), there will be differences between the estimates in the Statement of Social Insurance and the actual results, and those differences may be material. The Supplemental Information section of the *2007 Financial Report* includes unaudited information concerning the effects of changes in various assumptions on the present value of future estimated expenditures in excess of future revenue. As discussed in that section, Medicare projections are very sensitive to changes in the health care cost growth assumption.

In addition to the inherent uncertainty that underlies the expenditure projections prepared for all parts of Medicare, the Supplementary Medical Insurance (SMI) Part D projections have an added uncertainty in that they were prepared using very little program experience upon which to base the estimates, and the SMI Part B projections assume significant reductions in physician payments, as required under current law, which may or may not occur. The Congress has overridden scheduled reductions in physician payments calculated for each of the last 5 years, including for 2007.[13] No legislation has been enacted to override scheduled reductions in payments for 2008.[14] It is not possible to anticipate what other actions the Congress might take, either in the near or long-term, to alter the scheduled reductions in physician payments. If scheduled reductions continue to be overridden in the future, actual SMI Part B expenditures could be materially more than the amounts presented in the 2007 Statement of Social Insurance.

The scheduled future benefits reported in the Statement of Social Insurance are based on benefit formulas in current law. However, consistent with the respective annual Trustees Reports, the Social Security and Medicare programs are not sustainable under current financing arrangements. Also, the law concerning these programs can be changed at any time by the Congress. In fact, payment of Social Security and Medicare Hospital Insurance (Part A) benefits are limited by law to the balances in the respective trust funds. Consequently, future scheduled benefits are limited to future revenues plus existing trust fund assets. As discussed in Supplemental Information, the Social Security and Medicare Part A trust funds are projected to be exhausted in 2041 and 2019, respectively, at which time they will be unable to pay the full amount of scheduled future benefits. For Social Security, projected future revenues would be sufficient to pay 75 percent of scheduled benefits in 2041, the year of trust fund exhaustion, and decreasing to 70 percent of scheduled benefits in 2081. Similarly, for Medicare Part A, projected

[12] The projection period used for the Social Security, Medicare, and Railroad Retirement social insurance programs is 75 years. For the Black Lung program, the projections are through 2040, when the program is scheduled to terminate.
[13] Pub. L. No. 109-432, div. B, title I, § 101(a), 120 Stat. 2922, 2975 (Dec. 20, 2006).
[14] As of December 10, 2007, the House of Representatives had passed a bill, H.R. 3162, that would modify the method of calculating physician fee schedules, but the Senate had not passed any such legislation.

future revenues would be sufficient to pay 79 percent of scheduled benefits in 2019, the year of trust fund exhaustion, and decreasing to 29 percent of scheduled benefits in 2081.

Management's Discussion and Analysis and Supplemental Information included in the accompanying fiscal year *2007 Financial Report* contains information directly related to the Statements of Social Insurance. We did not audit and do not express an opinion on this information. However, we compared the information that directly related to the Statements of Social Insurance for consistency with the Statements of Social Insurance and discussed the methods of measurement and presentation of such information with Treasury officials. Based on this limited work, we found no material inconsistencies with the Statements of Social Insurance or GAAP.

ADVERSE OPINION ON INTERNAL CONTROL

Because of the effects of the material weaknesses discussed in this report, in our opinion, the federal government did not maintain effective internal control as of September 30, 2007, to meet the following objectives: (1) transactions are properly recorded, processed, and summarized to permit the preparation of the financial statements and stewardship information in conformity with GAAP, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition; and (2) transactions are executed in accordance with laws governing the use of budget authority and with other significant laws and regulations that could have a direct and material effect on the financial statements and stewardship information. Consequently, the federal government's internal control did not provide reasonable assurance that misstatements, losses, or noncompliance material in relation to the financial statements or to stewardship information would be prevented or detected on a timely basis. Our adverse opinion on internal control over financial reporting and compliance is based upon the criteria established under FMFIA.

In addition to the material weaknesses that contributed to our disclaimer of opinion on the accrual basis consolidated financial statements, which were discussed above, we found the following three other material weaknesses in internal control as of September 30, 2007. These weaknesses are discussed in more detail in appendix III, including the primary effects of the material weaknesses on the accompanying accrual basis consolidated financial statements and on the management of federal government operations. These other material weaknesses were the federal government's inability to:

- determine the full extent to which improper payments occur;
- identify and resolve information security control weaknesses and manage information security risks on an ongoing basis; and
- effectively manage its tax collection activities.

Further, we found the following significant deficiencies[15] in internal control as of September 30, 2007, which are discussed in more detail in appendix IV. These significant deficiencies involve the following areas:

- preparing the Statement of Social Insurance for certain programs, and

- monitoring and oversight regarding certain federal grants and entities that offer Medicare health plan options.

Individual federal agency financial statement audit reports identify additional control deficiencies, which were reported by agency auditors as either material weaknesses or significant deficiencies at the individual agency level. We do not deem these additional deficiencies to be material weaknesses or significant deficiencies at the governmentwide level. Also, due to the issues noted throughout this report, additional material weaknesses and significant deficiencies may exist that have not been reported.

COMPLIANCE WITH SIGNIFICANT LAWS AND REGULATIONS

Our work to test compliance with selected provisions of significant laws and regulations related to financial reporting was limited by the material weaknesses and scope limitations discussed in this report. U.S. generally accepted government auditing standards and OMB guidance require auditors to report on the agency's compliance with significant laws and regulations. Certain individual agency audit reports contain instances of noncompliance. None of these instances were deemed to be reportable noncompliances with regard to the accompanying consolidated financial statements.

We caution that other noncompliance may have occurred and not been detected. Further, the results of our limited procedures may not be sufficient for other purposes. Our objective was not to, and we do not, express an opinion on compliance with significant laws and regulations.

[15] In fiscal year 2006 and in prior years, we reported that individual federal agency financial statement audit reports identified reportable conditions in internal control, some of which were reported by agency auditors as being material weaknesses at the individual agency level, but did not represent material weaknesses at the governmentwide level. Reportable conditions involved matters coming to the auditor's attention that, in the auditor's judgment, should be communicated because they represent significant deficiencies in the design or operation of internal control, and could adversely affect an agency's ability to meet key control objectives. In May 2006, the American Institute of Certified Public Accountants issued Statement on Auditing Standards (SAS) 112, and subsequently made conforming changes to the Statements on Standards for Attestation Engagements (AT) 501. AT 501 eliminated the term reportable condition and it is no longer used. AT 501 also established standards related to a new definition for the terms "material weakness" and "significant deficiency," as defined in footnote 5, and the auditor's responsibilities for identifying, evaluating, and communicating matters related to an entity's internal control over financial reporting. Under these new standards, the auditor is required to communicate control deficiencies that are considered to be material weaknesses or significant deficiencies in internal controls.

AGENCY FINANCIAL MANAGEMENT SYSTEMS

To achieve the financial management improvements envisioned by the CFO Act, FFMIA, and the President's Management Agenda, federal agencies need to modernize their financial management systems to generate reliable, useful, and timely financial and performance information throughout the year and at year-end. As discussed throughout this report, serious financial management weaknesses have contributed significantly to our inability to determine the reliability of the accrual basis consolidated financial statements. The size and complexity of the federal government and the long-standing nature of its financial management systems weaknesses continue to present a formidable management challenge in providing accountability to the nation's taxpayers.

FFMIA requires auditors, as part of the 24 CFO Act agencies' financial statement audits, to report whether agencies' financial management systems substantially comply with (1) federal financial management systems requirements, (2) applicable federal accounting standards, and (3) the federal government's Standard General Ledger at the transaction level. For fiscal years 2007 and 2006, auditors for 13 and 17 of the 24 CFO Act agencies, respectively, reported that the agencies' financial management systems did not substantially comply with one or more of these three FFMIA requirements. Although this represents an improvement, the majority of federal agencies' financial management systems are still unable to routinely produce reliable, useful, and timely financial information. Consequently, the federal government's capacity to manage with timely and objective data is limited, thereby hampering its ability to effectively administer and oversee its major programs.

OMB CIRCULAR NO. A-123, *Management's Responsibilities for Internal Control*

In December 2004, OMB revised OMB Circular No. A-123, *Management's Responsibility for Internal Control*, which became effective for fiscal year 2006. In fiscal year 2006, agencies began to implement the more rigorous requirements of the revised OMB Circular No. A-123, which include management identification, assessment, testing, correction, and documentation of internal controls over financial reporting for each account or group of accounts, as well as an annual assurance statement from the agency head as to whether internal control over financial reporting is effective.

OMB recognized that due to the complexity of some agencies, implementation of these new requirements may span more than 1 year. Accordingly, certain agencies have adopted multi-year implementation plans. According to OMB's *Federal Financial Management Report for 2007*, 16 of the 24 CFO Act agencies have performed assessments required by OMB Circular No. A-123 for all key processes, while the remaining 8 CFO Act agencies are phasing in implementation of the requirements by testing a portion of the key processes and providing plans for testing the remaining processes within 3 years. Also, according to that report, to achieve its strategic goal of improving effectiveness of internal control over financial reporting, OMB has developed priority actions that include updating guidance, as necessary, based on lessons learned from agencies' implementation of the circular. It will be important that OMB continue to monitor and oversee federal agencies' implementation of these new requirements.

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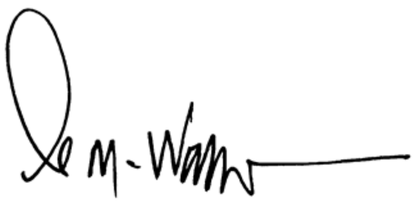
We provided a draft of this report to Treasury and OMB officials, who provided technical comments, which have been incorporated as appropriate. Treasury and OMB officials expressed their continuing commitment to address the problems this report outlines.



David M. Walker
Comptroller General
of the United States

December 10, 2007

APPENDIX I

Objectives, Scope, and Methodology

The Government Management Reform Act of 1994 expanded the requirements of the Chief Financial Officers (CFO) Act of 1990 by making the inspectors general of 24 major federal agencies[16] responsible for annual audits of agencywide financial statements prepared by these agencies and GAO responsible for the audit of the U.S. government's consolidated financial statements. The Accountability of Tax Dollars (ATD) Act of 2002[17] requires most other executive branch agencies to prepare and have audited annual financial statements. The Office of Management and Budget (OMB) and the Department of the Treasury (Treasury) have identified 35 agencies[18] that are significant to the U.S. government's consolidated financial statements. Our work was performed in coordination and cooperation with the inspectors general and independent public accountants for these 35 agencies to achieve our joint audit objectives. Our audit approach regarding the accrual basis consolidated financial statements focused primarily on determining the current status of the material weaknesses that contributed to our disclaimer of opinion on the accrual basis consolidated financial statements and the other material weaknesses affecting internal control that we had previously reported in our report on the consolidated financial statements for fiscal year 2006.[19] Our work included separately auditing the financial statements of the following significant federal agencies and federal agency components:

- We audited and expressed an unqualified opinion on the Internal Revenue Service's (IRS) fiscal years 2007 and 2006 financial statements. In fiscal years 2007 and 2006, IRS collected about \$2.7 trillion and \$2.5 trillion, respectively, in tax payments and paid about \$292 billion and \$277 billion, respectively, in refunds to taxpayers.[20] For fiscal year 2007, we continued to report material internal control weaknesses that resulted in ineffective internal control. We also reported a significant deficiency. Our tests of IRS's compliance with selected provisions of significant laws and regulations disclosed one area of noncompliance. We also found that IRS's financial management systems did not substantially comply with the three requirements of the Federal Financial Management Improvement Act of 1996.

[16] 31 U.S.C. 901(b), 3521(e). The 1994 act authorized the Office of Management and Budget to designate agency components that also would receive a financial statement audit. 31 U.S.C. 3515(c); see footnote 1.
[17] Pub. L. No. 107-289, 116 Stat. 2049 (Nov. 7, 2002); see 31 U.S.C. 3515.
[18] See *Treasury Financial Manual*, volume I, part 2, chapter 4700, for a listing of the 35 agencies.
[19] For our report on the U.S. government's consolidated financial statements for fiscal year 2006, see U. S. Department of the Treasury, *Fiscal Year 2006 Financial Report of the United States Government* (Washington, D.C.: Dec. 2006), pp. 149-168, which can be found on GAO's Internet site at www.gao.gov.
[20] GAO, *Financial Audit: IRS's Fiscal Years 2007 and 2006 Financial Statements*, GAO-08-166 (Washington, D.C.: Nov. 9, 2007).

- We audited and expressed an unqualified opinion on the Schedules of Federal Debt managed by Treasury's Bureau of the Public Debt (BPD) for the fiscal years ended September 30, 2007 and 2006.[21] For these 2 fiscal years, the schedules reported (1) approximately $5.0 trillion (2007) and $4.8 trillion (2006) of federal debt held by the public;[22] (2) about $3.9 trillion (2007) and $3.7 trillion (2006) of intragovernmental debt holdings;[23] and (3) about $239 billion (2007) and $222 billion (2006) of interest on federal debt held by the public. We reported that as of September 30, 2007, BPD had effective internal control over financial reporting and compliance with laws and regulations relevant to the Schedule of Federal Debt. Further, we reported that there was no reportable BPD noncompliance in fiscal year 2007 with a selected provision of law we tested.

- We audited and expressed unqualified opinions on the fiscal years 2007 and 2006 financial statements of the United States Securities and Exchange Commission (SEC).[24] For fiscal year 2007, we reported that SEC did not have effective internal control over financial reporting because of a material weakness. We also reported three significant deficiencies. Although certain compliance controls should be improved, SEC maintained effective internal control over compliance with significant laws and regulations. Further, we reported that there was no reportable noncompliance with selected provisions of laws and regulations we tested.

- We audited and expressed unqualified opinions on the December 31, 2006 and 2005, financial statements of the funds administered by the Federal Deposit Insurance Corporation (FDIC), including the Deposit Insurance Fund (DIF)[25] and the FSLIC Resolution Fund.[26] We reported that as of December 31, 2006, FDIC had effective internal control over financial reporting and compliance with significant laws and regulations. In addition, we performed certain procedures and tests of internal control over certain material balances of the funds administered by FDIC as of September 30, 2007.

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[21] GAO, *Financial Audit: Bureau of the Public Debt's Fiscal Years 2007 and 2006 Schedules of Federal Debt*, GAO-08-168 (Washington, D.C.: Nov. 7, 2007).
[22] The public holding federal debt is comprised of individuals, corporations, state and local governments, the Federal Reserve Banks, and foreign governments and central banks.
[23] Intragovernmental debt holdings represent federal debt issued by Treasury and held by certain federal government accounts such as the Social Security and Medicare trust funds.
[24] GAO, *Financial Audit: Securities and Exchange Commission's Financial Statements for Fiscal Years 2007 and 2006*, GAO-08-167 (Washington, D.C.: Nov. 16, 2007).
[25] On February 8, 2006, the President signed into law the Federal Deposit Insurance Reform Act of 2005. Among its provisions, the act called for the merger of the Bank Insurance Fund (BIF) and Savings Association Insurance Fund (SAIF) into a single deposit insurance fund. In accordance with the act, FDIC merged BIF and SAIF into the newly established DIF on March 31, 2006. The financial results of the newly formed DIF were retrospectively applied as though they had been combined at the beginning of the reporting year as well as for prior periods presented for comparative purposes.
[26] GAO, *Financial Audit: Federal Deposit Insurance Corporation Funds' 2006 and 2005 Financial Statements*, GAO-07-371 (Washington, D.C.: Feb. 13, 2007).

In addition, we considered the CFO Act agencies' and certain other federal agencies' fiscal years 2007 and 2006 financial statements and the related auditors' reports prepared by the inspectors general or contracted independent public accountants. Financial statements and audit reports for these agencies provide information about the operations of each of these entities. We did not audit, and we do not express an opinion on, any of these individual federal agency financial statements.

We considered the Department of Defense's (DOD) assertion that DOD management prepared and submitted pursuant to the provisions of the National Defense Authorization Act for Fiscal Year 2002.[27] In accordance with section 1008 of this act, DOD reported that certain major deficiencies related to (1) noncompliant systems, (2) financial processes, and (3) business processes continued to impact the department's ability to prepare reliable financial statements. In addition, DOD refers to its ongoing efforts to address related material weaknesses reported by the DOD Inspector General. In the DOD Inspector General's fiscal year 2007 report on internal control over financial reporting, the Inspector General cited material weaknesses in several areas including (1) property, plant, and equipment; (2) inventory and operating material and supplies; (3) environmental liabilities; and (4) intragovernmental eliminations.

Because of the significance of the amounts included in the Statement of Social Insurance related to the Social Security Administration (SSA) and the Department of Health and Human Services (HHS), our audit approach regarding the Statement of Social Insurance focused primarily on these two agencies. For each federal agency preparing a Statement of Social Insurance,[28] we considered the agencies' fiscal year 2007 and 2006 financial statements and the related auditors' reports prepared by the inspectors general or contracted independent public accountants. We performed sufficient audit work, including internal control and substantive audit procedures, reperformance procedures, and review of the other auditors' Statement of Social Insurance-related audit work, to support our opinion on the 2007 Statement of Social Insurance.

We performed sufficient audit work to provide this report on the consolidated financial statements, internal control, and compliance with selected provisions of significant laws and regulations. We considered the limitations on the scope of our work regarding the accrual basis consolidated financial statements in forming our conclusions. Our work was performed in accordance with U.S. generally accepted government auditing standards.

[27] Pub. L. No. 107-107, §1008, 115 Stat. 1012, 1204 (Dec. 28, 2001).
[28] These agencies include SSA, HHS, the Railroad Retirement Board, and the Department of Labor.

APPENDIX II

Material Weaknesses Contributing to Our Disclaimer of Opinion on the Accrual Basis Consolidated Financial Statements

The continuing material weaknesses discussed below contributed to our disclaimer of opinion on the federal government's accrual basis consolidated financial statements. The federal government did not maintain adequate systems or have sufficient, reliable evidence to support information reported in the accompanying accrual basis consolidated financial statements, as described below.

Property, Plant, and Equipment and Inventories and Related Property

The federal government could not satisfactorily determine that property, plant, and equipment (PP&E) and inventories and related property were properly reported in the consolidated financial statements. Most of the PP&E and inventories and related property are the responsibility of DOD. As in past years, DOD did not maintain adequate systems or have sufficient records to provide reliable information on these assets. Other agencies, most notably the National Aeronautics and Space Administration, reported continued weaknesses in internal control procedures and processes related to PP&E.

Without reliable asset information, the federal government does not fully know the assets it owns and their location and condition and cannot effectively (1) safeguard assets from physical deterioration, theft, or loss; (2) account for acquisitions and disposals of such assets; (3) ensure that the assets are available for use when needed; (4) prevent unnecessary storage and maintenance costs or purchase of assets already on hand; and (5) determine the full costs of programs that use these assets.

Loans Receivable and Loan Guarantee Liabilities

Federal agencies that account for the majority of the reported balances for direct loans and loan guarantee liabilities continue to have internal control weaknesses related to their credit reform estimation and related financial reporting processes. While progress in addressing these long-standing weaknesses was reported by certain federal credit agencies, certain deficiencies in the Department of Agriculture's credit reform processes contributed to its auditor being unable to obtain sufficient, appropriate evidence to support related accounts. As such, for fiscal year 2007, we have added this area to the list of material weaknesses contributing to our disclaimer of opinion on the accrual basis consolidated financial statements.

These issues and the complexities associated with estimating the costs of lending activities significantly increase the risk that material misstatements in agency and governmentwide financial statements could occur and go undetected. Moreover, these weaknesses continue to adversely affect the federal government's ability to support annual budget requests for federal lending programs, make future budgetary decisions, manage program costs, and measure the performance of lending activities.

Liabilities and Commitments and Contingencies

The federal government could not reasonably estimate or adequately support amounts reported for certain liabilities. For example, DOD was not able to estimate with assurance key components of its environmental and disposal liabilities. In the past, DOD could not support a significant amount of its estimated military postretirement health benefits liabilities included in federal employee and veteran benefits payable. These unsupported amounts related to the cost of direct health care provided by DOD-managed military treatment facilities. This year, the auditor's report on the financial statements that include the estimated military postretirement health benefits liabilities had not been issued as of the date of this report. Further, the federal government could not determine whether commitments and contingencies, including those related to treaties and other international agreements entered into to further the U.S. government's interests, were complete and properly reported.

Problems in accounting for liabilities affect the determination of the full cost of the federal government's current operations and the extent of its liabilities. Also, weaknesses in internal control supporting the process for estimating environmental and disposal liabilities could result in improperly stated liabilities as well as affect the federal government's ability to determine priorities for cleanup and disposal activities and to appropriately consider future budgetary resources needed to carry out these activities. In addition, if disclosures of commitments and contingencies are incomplete or incorrect, reliable information is not available about the extent of the federal government's obligations.

Cost of Government Operations and Disbursement Activity

The previously discussed material weaknesses in reporting assets and liabilities, material weaknesses in financial statement preparation, as discussed below, and the lack of adequate disbursement reconciliations at certain federal agencies affect reported net costs. As a result, the federal government was unable to support significant portions of the total net cost of operations, most notably related to DOD.

With respect to disbursements, DOD and certain other federal agencies reported continued weaknesses in reconciling disbursement activity. For fiscal years 2007 and 2006, there was unreconciled disbursement activity, including unreconciled differences between federal agencies' and Treasury's records of disbursements and unsupported federal agency adjustments, totaling billions of dollars, which could also affect the balance sheet.

Unreliable cost information affects the federal government's ability to control and reduce costs, assess performance, evaluate programs, and set fees to recover costs where required. If disbursements are improperly recorded, this could result in misstatements in the financial statements and in certain data provided by federal agencies for inclusion in *The Budget of the United States Government* (hereafter referred to as "the President's Budget") concerning obligations and outlays.

Accounting for and Reconciliation of Intragovernmental Activity and Balances

Federal agencies are unable to adequately account for and reconcile intragovernmental activity and balances. OMB and Treasury require the chief financial officers (CFO) of 35 executive departments and agencies to reconcile, on a quarterly basis, selected intragovernmental activity and balances with their trading partners. In addition, these agencies are required to report to Treasury, the agency's inspector general, and GAO on the extent and results of intragovernmental activity and balances reconciliation efforts as of the end of the fiscal year.

A substantial number of the agencies did not adequately perform the required reconciliations for fiscal years 2007 and 2006. For these fiscal years, based on trading partner information provided to Treasury via agencies' closing packages, Treasury produced a "Material Difference Report" for each agency showing amounts for certain intragovernmental activity and balances that significantly differed from those of its corresponding trading partners as of the end of the fiscal year. Based on our analysis of the "Material Difference Reports" for fiscal year 2007, we noted that a significant number of CFOs were unable to adequately explain the differences with their trading partners or did not provide adequate documentation to support responses on the CFO Representations. For both fiscal years 2007 and 2006, amounts reported by federal agency trading partners for certain intragovernmental accounts were not in agreement by significant amounts. In addition, a significant number of CFOs cited differing accounting methodologies, accounting errors, and timing differences for their material differences with their trading partners. Some CFOs simply indicated that they were unable to explain the differences with their trading partners with no indication when the differences will be resolved. As a result of the above, the federal government's ability to determine the impact of these differences on the amounts reported in the accrual basis consolidated financial statements is significantly impaired.

In 2006, OMB issued Memorandum No. M-07-03, *Business Rules for Intragovernmental Transactions* (Nov. 13, 2006), and Treasury issued the Treasury Financial Manual Bulletin No. 2007-03, *Intragovernmental Business Rules* (Nov. 15, 2006). This guidance added criteria for resolving intragovernmental disputes and major differences between trading partners for certain intragovernmental transactions and called for the establishment of an Intragovernmental Dispute Resolution Committee. OMB is currently working with the Chief Financial Officers Council to create the Intragovernmental Dispute Resolution Committee.[29] Treasury is also taking steps to help resolve material differences in intragovernmental activity and balances. For example, Treasury is requiring federal agencies to provide a plan of action on how the agency is addressing certain of its unresolved material differences. Resolving the intragovernmental transactions problem remains a difficult challenge and will require a strong commitment

[29] The U.S. Chief Financial Officers Council is an organization of the CFOs and Deputy CFOs of the largest federal agencies and senior officials of OMB and Treasury who work collaboratively to improve financial management in the U.S. Government.

by federal agencies to fully implement the required business rules and continued strong leadership by OMB and Treasury.

Preparation of Consolidated Financial Statements

While further progress was demonstrated in fiscal year 2007, the federal government continued to have inadequate systems, controls, and procedures to ensure that the consolidated financial statements are consistent with the underlying audited agency financial statements, properly balanced, and in conformity with U.S. generally accepted accounting principles (GAAP). In addition, as discussed in our scope limitation section of this report, Treasury could not provide the final fiscal year 2007 accrual basis consolidated financial statements and adequate supporting documentation in time for us to complete all of our planned auditing procedures. During our fiscal year 2007 audit, we found the following:[30]

- Treasury has showed progress by demonstrating that amounts in the Statement of Social Insurance were consistent with the underlying federal agencies' audited financial statements and that the Balance Sheet and the Statement of Net Cost were consistent with federal agencies' financial statements prior to eliminating intragovernmental activity and balances. However, Treasury's process for compiling the consolidated financial statements did not ensure that the information in the remaining three principal financial statements and notes were fully consistent with the underlying information in federal agencies' audited financial statements and other financial data.

- At the federal agency level, for fiscal year 2007, auditors for many of the CFO Act agencies reported material weaknesses or other significant deficiencies regarding agencies' financial reporting processes which, in turn, could affect the preparation of the consolidated financial statements. For example, auditors for several agencies reported that a significant number of adjustments were required to prepare the agencies' financial statements. These and other auditors are also required to separately audit financial information sent by the federal agencies to Treasury via a closing package. In connection with preparing the consolidated financial statements, Treasury had to create adjustments to correct significant errors found in agencies' audited closing package information.

[30] Most of the issues we identified in fiscal year 2007 existed in fiscal year 2006, and many have existed for a number of years. In July 2007, we reported the issues we identified to Treasury and OMB and provided recommendations for corrective action in GAO, *Financial Audit: Significant Internal Control Weaknesses Remain in the Preparation of the Consolidated Financial Statements of the U.S. Government*, GAO-07-805 (Washington, D.C.: July 23, 2007).

- To make the fiscal years 2007 and 2006 consolidated financial statements balance, Treasury recorded net decreases of $6.7 billion and $11 billion, respectively, to net operating cost on the Statement of Operations and Changes in Net Position, which it labeled "Other - Unmatched transactions and balances."[31] An additional net $2.5 billion and $10.4 billion of unmatched transactions were recorded in the Statement of Net Cost for fiscal years 2007 and 2006, respectively. Treasury is unable to fully identify and quantify all components of these unreconciled activities.

- The federal government could not demonstrate that it had fully identified and reported all items needed to reconcile the operating results, which for fiscal year 2007 showed a net operating cost of $275.5 billion, to the budget results, which for the same period showed a unified budget deficit of $162.8 billion.

- Treasury's elimination of certain intragovernmental activity and balances continues to be impaired by the federal agencies' problems in handling their intragovernmental transactions. As previously discussed, amounts reported for federal agency trading partners for certain intragovernmental accounts were not in agreement by significant amounts. This resulted in the need for intragovernmental elimination entries by Treasury that recorded the net differences between trading partners as "Other – Unmatched transactions and balances," in order to force the Statements of Operations and Changes in Net Position into balance. In addition, differences in other intragovernmental accounts, primarily related to transactions with the General Fund, have not been reconciled, still remain unresolved, and total hundreds of billions of dollars. Therefore, the federal government continues to be unable to determine the impact of unreconciled intragovernmental activity and balances on the accrual basis consolidated financial statements.

- We have consistently reported that certain financial information required by GAAP was not disclosed in the consolidated financial statements. In 2006, the Federal Accounting Standards Advisory Board issued a new standard that eliminated or lessened the disclosure requirements for the consolidated financial statements related to certain information that Treasury had not been reporting.[32] While Treasury made progress in addressing some of the remaining omitted information, there continue to be disclosures required by GAAP that are excluded from the consolidated financial statements. Also, certain material weaknesses noted in this report, for example, commitments and contingencies related to treaties and other international agreements, preclude Treasury from determining if a disclosure is required by GAAP in the consolidated financial statements and us

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[31] Although Treasury was unable to determine how much of the unmatched transactions and balances, if any, relate to net operating cost, it reported this amount as a component of net operating cost in the accompanying consolidated financial statements.

[32] SFFAS No. 32, *Consolidated Financial Report of the United States Government Requirements: Implementing Statement of Federal Financial Accounting Concepts 4 "Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government"* (Washington, D.C.: Sept. 28, 2006).

from determining if the omitted information is material. Further, Treasury's ability to report information in accordance with GAAP will also remain impaired until federal agencies, such as DOD, can provide Treasury with complete and reliable information required to be reported in the consolidated financial statements.

- Other internal control weaknesses existed in Treasury’s process for preparing the consolidated financial statements, involving inadequate or ineffective (1) documentation of certain policies and procedures; (2) management reviews of adjustments and key iterations of the financial statements, notes, and management discussion and analysis provided to GAO for audit; (3) supporting documentation for certain adjustments made to the consolidated financial statements; (4) processes for monitoring the preparation of the consolidated financial statements; and (5) spreadsheet controls.

- The consolidated financial statements include financial information for the executive, legislative, and judicial branches, to the extent that federal agencies within those branches have provided Treasury such information. However, as we have reported in past years, there continue to be undetermined amounts of assets, liabilities, costs, and revenues that are not included, and the federal government did not provide evidence or disclose in the consolidated financial statements that the excluded financial information was immaterial.

- As in previous years, Treasury did not have adequate systems and personnel to address the magnitude of the fiscal year 2007 financial reporting challenges it faced, such as weaknesses in Treasury’s process for preparing the consolidated financial statements noted above. We found that personnel at Treasury’s Financial Management Service had excessive workloads that required an extraordinary amount of effort and dedication to compile the consolidated financial statements; however, there were not enough personnel with specialized financial reporting experience to help ensure reliable financial reporting by the reporting date. In addition, the federal government does not perform quarterly compilations at the governmentwide level, which leads to almost all of the compilation effort being performed during a condensed time period at the end of the year.

During fiscal year 2007, Treasury, in coordination with OMB, continued to develop and implement corrective action plans and milestones for short-term and long-range solutions for certain internal control weaknesses we have reported regarding the process for preparing the consolidated financial statements. Resolving some of these internal control weaknesses will be a difficult challenge and will require a strong commitment from Treasury and OMB as they execute and implement their corrective action plans.

Components of the Budget Deficit

Both the Reconciliation of Net Operating Cost and Unified Budget Deficit and Statement of Changes in Cash Balance from Unified Budget and Other Activities report a budget deficit for fiscal years 2007 and 2006 of $162.8 billion and $247.7 billion, respectively.[33] The budget deficit is calculated by subtracting actual budget outlays (outlays) from actual budget receipts (receipts).

For several years, we have been reporting material unreconciled differences between the total net outlays reported in selected federal agencies' Statement of Budgetary Resources (SBR) and Treasury's central accounting records used to compute the budget deficit[34] reported in the consolidated financial statements. OMB and Treasury have continued to work with federal agencies to reduce these material unreconciled differences. However, billions of dollars of differences still exist in this and other components of the deficit because the federal government does not have effective processes and procedures for identifying, resolving, and explaining material differences in the components of the deficit between Treasury's central accounting records and information reported in agency financial statements and underlying agency financial information and records. Until these differences are timely reconciled by the federal government, their effect on the U.S. government's consolidated financial statements will be unknown.

In fiscal year 2007, we again noted that several agencies' auditors reported internal control weaknesses (1) affecting the agencies' SBRs, and (2) relating to monitoring, accounting, and reporting of budgetary transactions. These weaknesses could affect the reporting and calculation of the net outlay amounts in the agencies' SBRs. In addition, such weaknesses also affect the agencies' ability to report reliable budgetary information to Treasury and OMB and may affect the unified budget outlays reported by Treasury in its *Combined Statement of Receipts, Outlays, and Balances*,[35] and certain amounts reported in the President's Budget.

[33] The budget deficit, receipts, and outlays amounts are reported in Treasury's Monthly Treasury Statement and the President's Budget.

[34] See GAO's audit report on its audit of the federal government's fiscal year 2006 financial statements that was incorporated in the *2006 Financial Report of the U.S. Government* published by Treasury. Also, see GAO, *Financial Audit: Process for Preparing the Consolidated Financial Statements of the U.S. Government Needs Improvement*, GAO-04-45 (Washington, D.C.: Oct. 30, 2003).

[35] Treasury's *Combined Statement of Receipts, Outlays, and Balances* presents budget results and cash related assets and liabilities of the federal government with supporting details. Treasury represents this report as the recognized official publication of receipts and outlays of the federal government based on agency reporting.

APPENDIX III

Other Material Weaknesses

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. In addition to the material weaknesses discussed in appendix II that contributed to our disclaimer of opinion on the accrual basis consolidated financial statements, we found the following three other material weaknesses in internal control.

Improper Payments

Although showing progress under OMB's continuing leadership, agencies' fiscal year 2007 reporting under the Improper Payments Information Act of 2002 (IPIA)[36] does not reflect the full scope of improper payments. For fiscal year 2007, federal agencies' estimates of improper payments, based on available information, totaled about $55 billion.[37] The increase from the prior year estimate of $41 billion[38] was primarily attributable to a component of the Medicaid program reporting improper payments for the first time totaling about $13 billion for fiscal year 2007, which we view as a positive step to improve transparency over the full magnitude of improper payments.

Major challenges remain in meeting the goals of the act and ultimately better ensuring the integrity of payments.[39] For fiscal year 2007, four agency auditors reported noncompliance issues with IPIA related to agencies' risk assessments, sampling methodologies, implementing corrective action plans, and recovering improper payments. We also identified issues with agencies' risk assessments such as not completing risk assessments of all programs and activities or not conducting annual reviews of any programs and activities. OMB's current guidance allows for annual risk assessments to be conducted less often than annually (generally every 3 years) for programs where baselines are already established, are in the process of being measured, or are scheduled to be measured by an established date. For fiscal year 2007, we noted that 4 agencies were implementing a 3-year cycle for conducting risk assessments. Furthermore, select agencies have not reported improper payment estimates for 14 risk-susceptible federal programs with total program outlays of about $170 billion for fiscal year 2007. Lastly,

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[36] Pub. L. No. 107-300, 116 Stat. 2350 (Nov. 26, 2002). The IPIA requires federal agencies to review all programs and activities, identify those that may be susceptible to significant improper payments, estimate and report the annual amount of improper payments for those programs, and implement actions to cost-effectively reduce improper payments.

[37] The $55 billion includes 19 newly reported programs with improper payment estimates totaling about $16 billion. Of the 19 programs, 5 reported zero improper payment estimates for fiscal year 2007.

[38] In their fiscal year 2007 Performance and Accountability Reports (PAR), selected federal agencies updated their fiscal year 2006 improper payment estimates to reflect changes since issuance of their fiscal year 2006 PARs. These updates decreased the governmentwide improper payment estimate for fiscal year 2006 from $42 billion to $41 billion.

[39] GAO, *Improper Payments: Agencies' Efforts to Address Improper Payment and Recovery Auditing Requirements Continue,* GAO-07-635T (Washington, D.C.: Mar. 29, 2007).

we found that major management challenges and internal control weaknesses continue to plague agency operations and programs susceptible to significant improper payments. For example, in the Department of Education's fiscal year *2007 Performance and Accountability Report*, the Office of Inspector General reported that its recent investigations continue to uncover problems, including inadequate attention to improper payments and failure to identify and take corrective action to detect and prevent fraudulent activities by grantees.

Information Security

Although progress has been made, serious and widespread information security control weaknesses continue to place federal assets at risk of inadvertent or deliberate misuse, financial information at risk of unauthorized modification or destruction, sensitive information at risk of inappropriate disclosure, and critical operations at risk of disruption. GAO has reported information security as a high-risk area across government since February 1997. During fiscal year 2007, federal agencies did not consistently implement effective controls to prevent, limit, or detect unauthorized access to computing resources. Specifically, agencies did not always (1) identify and authenticate users to prevent unauthorized access; (2) enforce the principle of least privilege to ensure that authorized access was necessary and appropriate; (3) apply encryption to protect sensitive data on networks and portable devices; (4) log, audit, and monitor security-relevant events; and (5) restrict physical access to information assets. In addition, agencies did not consistently configure network devices and services to prevent unauthorized access and ensure system integrity, such as patching key servers and workstations in a timely manner; assign incompatible duties to different individuals or groups so that one individual does not control all aspects of a process or transaction; and maintain or test continuity of operations plans for key information systems. Such information security control weaknesses unnecessarily increase the risk that the reliability and availability of data that are recorded in or transmitted by federal financial management systems could be compromised. A primary reason for these weaknesses is that federal agencies have not yet fully institutionalized comprehensive security management programs, which are critical to identifying information security control weaknesses, resolving information security problems, and managing information security risks on an ongoing basis. The administration has taken important actions to improve information security, such as issuing extensive guidance on information security and requiring agencies to perform specific actions to protect certain personally identifiable information. However, until agencies effectively and fully implement agencywide information security programs, federal data and systems, including financial information, will remain at risk.

Tax Collection Activities

During fiscal year 2007, material internal control weaknesses and systems deficiencies continued to affect the federal government's ability to effectively manage its tax collection activities, an issue that has been reported in our financial statement audit reports for the past 10 years. Due to errors and delays in recording taxpayer information, payments, and other activities, taxpayers were not always credited for payments made on their taxes owed, which could result in undue taxpayer burden. In addition, the federal government did not always follow up on potential unreported or underreported taxes and did not always pursue collection efforts against taxpayers owing taxes to the federal government. Moreover, the federal government did not have cost benefit information, related cost-based performance measures, or a systematic process for ensuring it is using its resources to maximize its ability to collect what is owed and minimize the disbursements of improper tax refunds. As a result, the federal government is vulnerable to loss of tax revenue and exposed to potentially billions of dollars in losses due to inappropriate refund disbursements.

APPENDIX IV

Significant Deficiencies

In addition to the material weaknesses discussed in appendices II and III, we found the following significant deficiencies in internal control.

Preparation of the Statement of Social Insurance

Deficiencies were identified in certain controls over spreadsheets used by HHS to prepare its Statement of Social Insurance. This federal agency contributes the majority of the amounts reported on the consolidated Statement of Social Insurance. Such control deficiencies could result in misstatements to the Statement of Social Insurance.

Monitoring and Oversight

Federal Grants

The federal government annually awards grants totaling hundreds of billions of dollars. Control deficiencies were identified at several federal agencies regarding the monitoring and oversight of grants. For example, the auditor for one federal agency that awards and manages significant amounts of grants reported issues with obtaining documentation to evidence the agency's ongoing monitoring of open grants. These control deficiencies could adversely affect the federal government's ability to ensure that grant funds are being spent in accordance with applicable program laws and regulations.

Medicare Advantage Organizations

Under the Medicare Advantage program, HHS approves private companies to offer health plan options to Medicare enrollees that include all Medicare-covered services. Control deficiencies were identified at HHS regarding oversight of these Medicare Advantage Organizations (MAOs). These involved (1) the MAO review selection methodology, (2) documentation to support monitoring reviews, (3) review and approval of MAOs' corrective action plans, and (4) information in HHS' tracking system used to monitor the status of MAO oversight. These control deficiencies could adversely affect the federal government's ability to ensure that MAOs are in compliance with regulations established within applicable Medicare law.

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