



DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

**A Message from the Secretary of the Treasury**

Since the start of the recession in December 2007, the United States has confronted the greatest economic challenges in generations: the worst financial crisis since the Great Depression; the steepest GDP contraction in over 50 years; double-digit unemployment; rising home foreclosure rates; and the loss of \$17.5 trillion of household wealth.

The strategy that the Federal Government adopted has been effective in restoring economic growth. Largely because of the Recovery Act and financial stabilization policies, GDP went from contracting at an annual rate of 6 percent at the beginning of 2009 to growing by nearly 6 percent at the end of the year. Confidence in our financial markets and institutions has been largely restored. Borrowing costs for many American businesses and consumers have fallen significantly. Job losses are moderating. And the housing market has shown signs of stabilizing, which together with higher equity prices, has helped household wealth to recover by \$5 trillion.

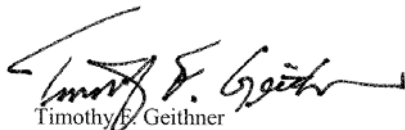
Those are real signs of progress. But they are not enough. Too many Americans are still out of work. Going forward, the Department of the Treasury and other Government agencies are committed to reinforcing recovery, strengthening our economic foundation, creating the conditions for the private sector to grow so that businesses can create new jobs, and putting America on a fiscally sustainable path.

The 2009 Financial Report of the U.S. Government, issued by the U.S. Department of the Treasury, is a comprehensive financial report that discusses the Government's current financial position. As shown in this Report, the Government's net operating cost for fiscal year 2009 was approximately \$1.3 trillion – a \$245 billion increase from an already record-high \$1.0 trillion in fiscal year 2008. This increase was largely due to increased costs for mandatory spending programs, such as Unemployment Insurance, Social Security, Medicaid, and Medicare benefits; continued investment in the economic recovery effort; and more than a \$400 billion decrease in tax revenue due to the economic downturn. These circumstances similarly impacted the budget deficit, which went from \$455 billion in Fiscal Year 2008 to \$1.4 trillion in Fiscal Year 2009.

With the economy facing a deep recession, unprecedented Government intervention was essential to stabilize the economy. These actions have inevitably contributed to the large budget deficits documented in this report, but have had a substantial beneficial impact in improving economic growth and performance, and preventing an even deeper recession. Notable economic recovery efforts included the Emergency Economic Stabilization Act of 2008 and the American Recovery and Reinvestment Act of 2009, which provided tax cuts for 95 percent of American working families and small businesses, as well as direct support for the unemployed and new infrastructure investments.

These efforts have provided hundreds of billions of dollars of economic stimulus and provided necessary support so that the financial sector could resume functioning in its role as an intermediary that channel savings into productive private sector investments. As we emerge from the recession, Government intervention continues to be necessary in the near term to support recovery. This Report provides insights into how taxpayer dollars are being used to support recovery programs being implemented across the Government.

While job creation and economic recovery remains the priority, the Government cannot borrow without limit. The Administration is committed to creating the conditions necessary for robust, long-term economic growth. This includes supporting innovation, setting up and enforcing basic rules of the market place, improving education and infrastructure, and strengthening the social safety net. In addition, our long term prosperity requires us to put the Government on a fiscally sustainable path. Once we have strong growth in place, we must begin the process of bringing down our deficits to sustainable levels. Failure to put the U.S. Government budget on a sustainable path would weaken recovery, leading to higher interest rates for families that want to buy a home or for businesses seeking to start or expand, and limit the Government's ability to respond in future crises.



Timothy F. Geithner

# Contents

<b>A Message from the Secretary of the Treasury</b>	
<b>A Citizen's Guide</b> .....	i
<b>Management's Discussion and Analysis</b> .....	1
<b>Statement of the Acting Comptroller General of the United States</b> .....	31
<b>Financial Statements</b>	
Introduction .....	39
Statements of Net Cost .....	45
Statements of Operations and Changes in Net Position.....	46
Reconciliations of Net Operating Cost and Unified Budget Deficit.....	47
Statements of Changes in Cash Balance from Unified Budget and Other Activities .....	48
Balance Sheets.....	49
Statements of Social Insurance.....	50
<b>Notes to the Financial Statements</b>	
Note 1. Summary of Significant Accounting Policies.....	53
Note 2. Cash and Other Monetary Assets.....	62
Note 3. Accounts and Taxes Receivable, Net.....	64
Note 4. Loans Receivable, Mortgage Backed Securities, and Loan Guarantee Liabilities, Net.....	65
Note 5. TARP Direct Loans and Equity Investments, Net.....	69
Note 6. Beneficial Interest in Trust .....	74
Note 7. Inventories and Related Property, Net.....	75
Note 8. Property, Plant, and Equipment, Net .....	77
Note 9. Securities and Investments.....	78
Note 10. Derivatives.....	80
Note 11. Investments in Government Sponsored Enterprises and Other Financial and Housing Market Stabilization .....	81
Note 12. Other Assets.....	85
Note 13. Accounts Payable.....	86
Note 14. Federal Debt Securities Held by the Public and Accrued Interest .....	87
Note 15. Federal Employee and Veteran Benefits Payable .....	90
Note 16. Environmental and Disposal Liabilities.....	96
Note 17. Benefits Due and Payable .....	98
Note 18. Insurance and Guarantee Program Liabilities .....	99
Note 19. Other Liabilities .....	100
Note 20. Collections and Refunds of Federal Revenue .....	102
Note 21. Prior Period Adjustments.....	105
Note 22. Contingencies .....	106
Note 23. Commitments.....	110
Note 24. Earmarked Funds .....	113
Note 25. Fiduciary Activities.....	123
Note 26. Social Insurance.....	124
Note 27. Stewardship Land and Heritage Assets.....	132
Note 28. Subsequent Events .....	133

**Supplemental Information (Unaudited)**

Social Insurance .....	137
Social Security and Medicare .....	137
Railroad Retirement, Black Lung, and Unemployment Insurance .....	159
Deferred Maintenance .....	170
Unexpended Budget Balances .....	171
Tax Burden .....	171
Tax Gap .....	172
Other Claims for Refunds.....	173
Tax Assessments .....	173
Risk Assumed.....	173
Unmatched Transactions and Balances .....	175

**Stewardship Information (Unaudited)**

Stewardship Investments .....	177
Non-Federal Physical Property.....	178
Human Capital.....	178
Research and Development .....	178

**Appendixes**

A. Significant Government Entities.....	181
B. Material Weaknesses Reported by Auditors and Federal Managers' Financial Integrity Act (FMFIA) Tables .....	185
C. Government Corporations Required to Submit Audited Financial Statements to OMB .....	193
D. Accountability of Tax Dollars Act Agencies Required to Submit Audited Financial Statements to OMB .....	195
E. Selected Components of CFO Act Agencies Required to Submit Audited Financial Statements to OMB .....	199
F. Compliance with the Federal Financial Management Improvement Act of 1996.....	201
G. Debt Collection Deficiencies and Corrective Actions .....	203
H. Acronyms .....	205

<b>Government Accountability Office Auditor's Report .....</b>	<b>209</b>
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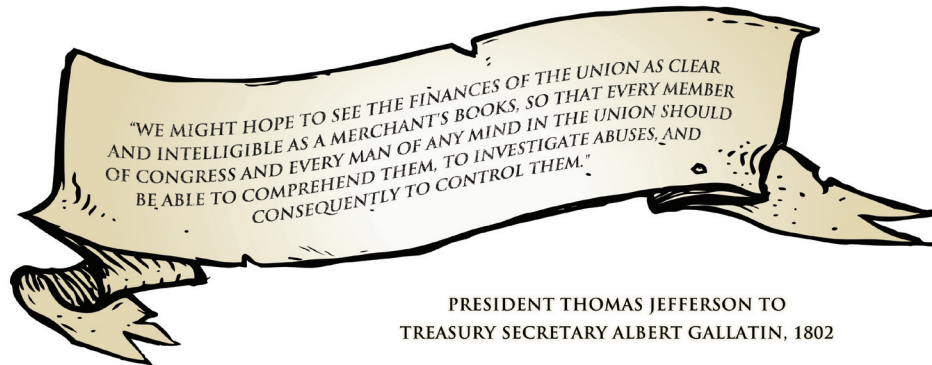
# List of Social Insurance Charts

Chart 1	OASDI Beneficiaries per 100 Covered Workers, 1970-2083.....	140
Chart 2	OASDI Income (Excluding Interest) and Expenditures, 1970-2083 .....	141
Chart 3	OASDI Income (Excluding Interest) and Expenditures as a Percent of Taxable Payroll, 1970-2083 .....	142
Chart 4	OASDI Income (Excluding Interest) and Expenditures as a Percent of GDP, 1970-2083.....	143
Chart 5	Total Medicare (HI and SMI) Expenditures and Noninterest Income as a Percent of GDP, 1970-2083.....	146
Chart 6	Medicare Part A Income (Excluding Interest) and Expenditures, 1970-2083 .....	147
Chart 7	Medicare Part A Income (Excluding Interest) and Expenditures as a Percent of Taxable Payroll, 1970-2083 .....	148
Chart 8	Medicare Part A Income (Excluding Interest) and Expenditures as a Percent of GDP, 1970-2083.....	149
Chart 9	Medicare Part B and Part D Premium and State Transfer Income and Expenditures, 1970-2083.....	150
Chart 10	Medicare Part B and Part D Premium and State Transfer Income and Expenditures as a Percent of GDP, 1970-2083.....	151
Chart 11	Estimated Railroad Retirement Income (Excluding Interest and Financial Interchange Income) and Expenditures, 2009-2083 .....	158
Chart 12	Estimated Railroad Retirement Income (Excluding Interest and Financial Interchange Income) and Expenditures as a Percent of Tier II Taxable Payroll, 2009-2083 .....	159
Chart 13	Estimated Black Lung Income and Expenditures (Excluding Interest), 2010-2040.....	163
Chart 14	Estimated Unemployment Trust Fund Cash Flow Using Expected Economic Conditions, 2010-2019 .....	165
Chart 15	Unemployment Trust Fund Solvency as of September 30, 2009.....	167

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# *The Federal Government's Financial Health*

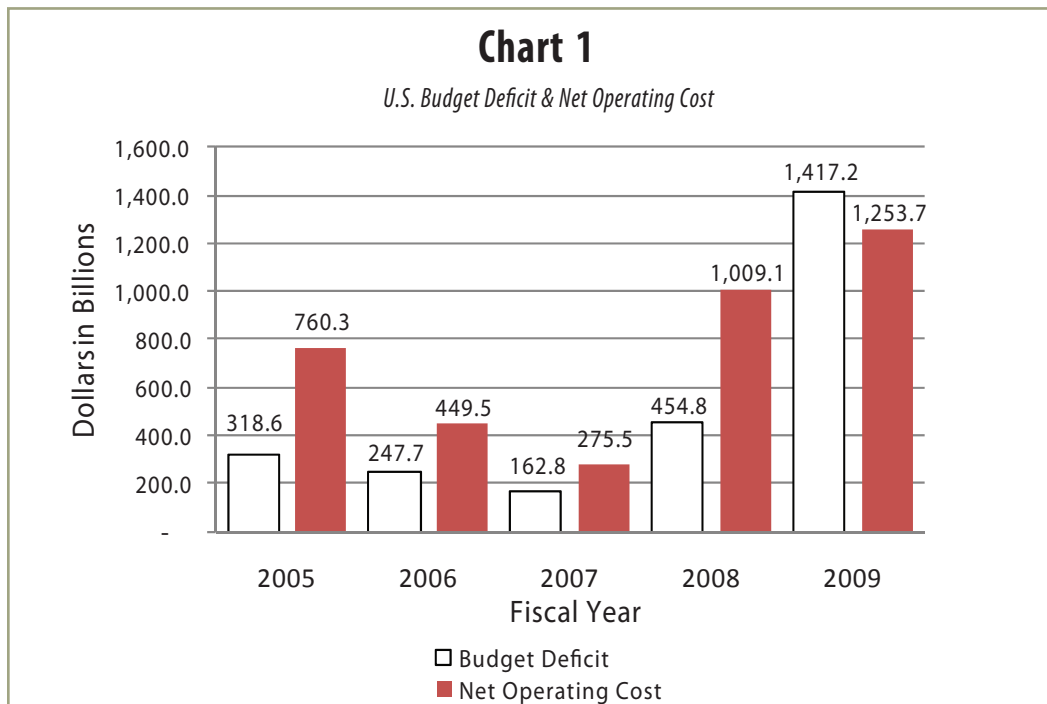
## A Citizen's Guide to the Financial Report of the United States Government



### OVERVIEW

Because of the severe economic downturn, instability in financial markets, and the policy measures taken to help the economy recover, Fiscal Year (FY) 2009 brought substantial changes to the financial position and condition of the U.S. Government. The budget deficit increased from \$455 billion in FY 2008 to \$1.4 trillion in FY 2009, while net operating cost increased from just over \$1 trillion in FY 2008 to approximately \$1.3 trillion. *See 'Where We Are Now', p. 3.*

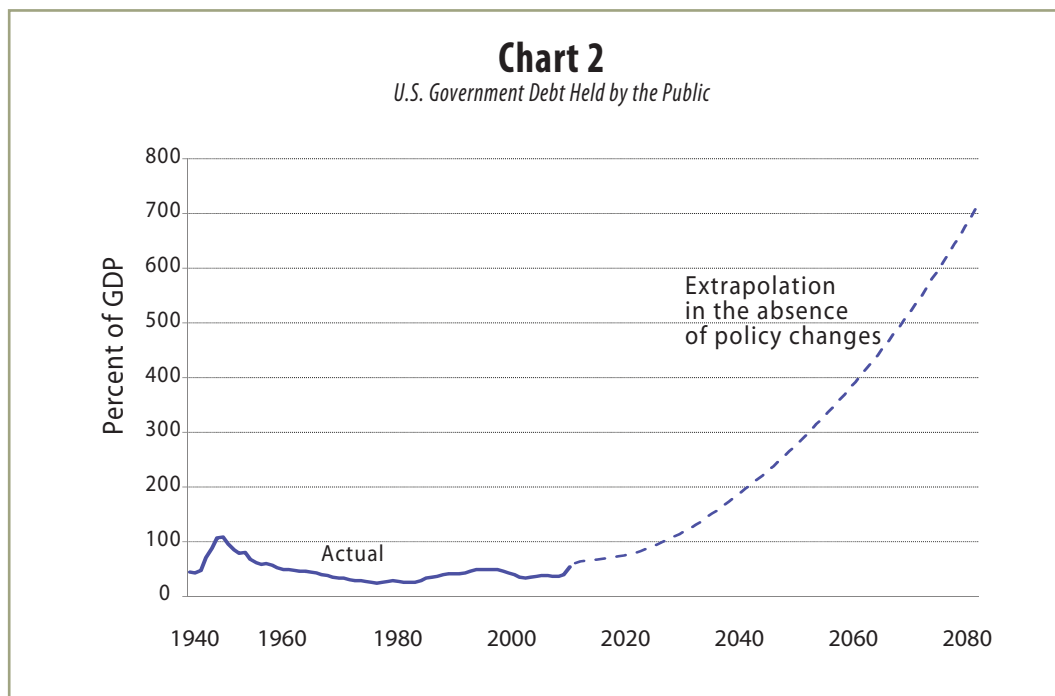
This Citizen's Guide (Guide) discusses both the primarily cash-based U.S. Budget Deficit and the primarily accrual-based net operating cost, included in the Financial Report of the U.S. Government (see Chart 1). The differences in these two measures of financial health are discussed in more detail in this Guide.



Some Government programs act as “automatic stabilizers,” helping to support the economy during a downturn by increasing spending and reducing tax collections. This support is “automatic” because increased spending on programs like unemployment benefits, Social Security, and Medicaid and a reduction in tax receipts happens even without any legislative changes in policies. The automatic stabilizers caused deficits and net operating costs to surge during FY 2009.

New policies were enacted that also contributed to the change in the Government’s financial position. These new policies included the Housing and Economic Recovery Act of 2008 (HERA), the Emergency Economic Stabilization Act of 2008 (EESA), and the American Recovery and Reinvestment Act of 2009 (Recovery Act or ARRA). Implementation of these and other initiatives represents unprecedented efforts to stabilize the financial markets, jump-start the nation’s economy, create or save millions of jobs, and put a down payment on addressing long-neglected challenges so the country can thrive in the 21st century. **See ‘The Economic Recovery Effort’, p. 6.**

In light of the high unemployment rate and the devastating effects that unemployment has on American families, the Government’s immediate focus is on encouraging private sector job creation. But the Government must simultaneously address the medium- and long-term fiscal imbalance resulting from past budget deficits, the impact of the economic downturn, and demands on the nation’s social programs, notably Medicare, Medicaid, and Social Security. As currently structured, the Government’s fiscal path cannot be sustained indefinitely, and would, over time, dramatically increase the Government’s budget deficit and debt (see Chart 2). **See ‘Where We Are Headed’ p. 10.**



This Guide highlights important information contained in the *2009 Financial Report of the United States Government*. The Secretary of the Treasury, Director of the Office of Management and Budget (OMB), and Acting Comptroller General of the United States believe that the information discussed in this Guide is important to all Americans.



## WHERE WE ARE NOW

### THE ECONOMY

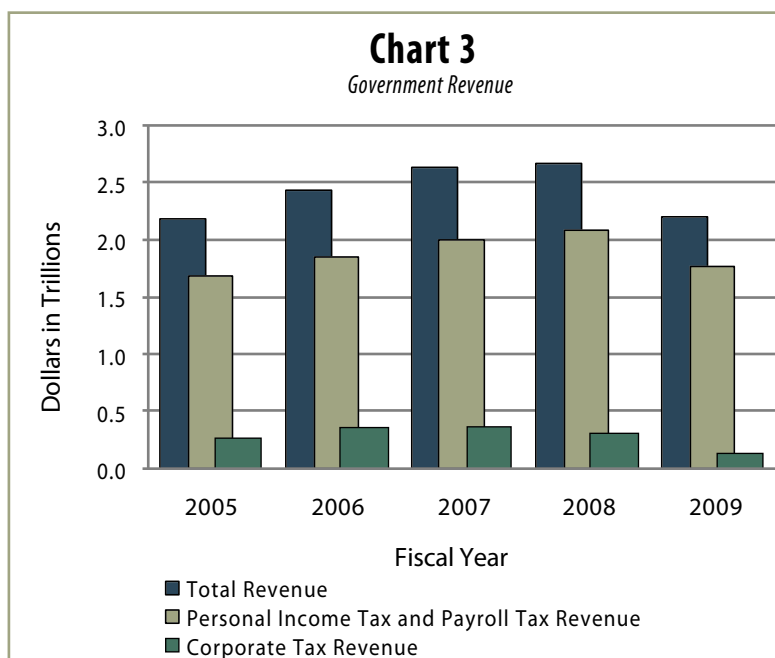
The economic recession, which began during FY 2008, intensified in the first half of FY 2009. GDP fell at a 5.4 percent rate during the first quarter of the fiscal year and at a 6.4 percent rate in the second quarter. Unemployment increased from 6.2 percent in September 2008 to 9.8 percent in September 2009. While the economy began to grow again during the last quarter of the fiscal year, employment continued to fall. By the end of FY 2009, 8 million jobs had been lost since the beginning of the recession. Overall consumer-price inflation was negative over the course of the fiscal year, reflecting declines in energy prices from record levels in the previous fiscal year, as well as slack in the economy and, to a lesser extent, slower food price inflation. The core inflation rate (which excludes food and energy) remained positive, but also moderated.

As the economy weakened, Federal tax receipts fell, and spending increased, causing the FY 2009 budget deficit to jump to \$1,417 billion – roughly triple the FY 2008 budget deficit of \$455 billion. Most of the deficit increase was due to the economic downturn and the automatic stabilizer features of the U.S. fiscal system, not to policy changes. The economy did, however, receive significant support during the fiscal year from a wide range of actions taken to combat the financial crisis and from the American Recovery and Reinvestment Act of 2009, which reduced taxes for businesses and working families, provided emergency relief for the unemployed and others who have borne the brunt of the recession, and made investments to create jobs, spur economic activity, and lay the foundation for future sustained growth.

### WHAT CAME IN AND WHAT WENT OUT

What came in? Total Government revenues (calculated using a modified cash basis) decreased \$463 billion to about \$2.2 trillion during FY 2009, due in great part to the effects of the recession and tax changes associated with the 2009 stimulus package. As shown in Chart 3, individual income tax revenue (which decreased by almost 15 percent) and corporate tax revenue (which decreased by more than 50 percent) account for the majority (nearly 90 percent) of total revenues.

What went out? While Government budget spending increased during FY 2009, the Government's net cost, which takes into account not only current spending but also changes in liabilities, decreased by approximately \$206 billion to about \$3.4 trillion. Cost increases of \$94 billion at the Department of Health



and Human Services (HHS) for medical benefits and \$73 billion at the Social Security Administration (SSA), due in part to the first wave of ‘baby boomers’ reaching retirement age as well as to recession-induced increases in benefit claims, were more than offset by a \$488 billion decrease in costs at the Department of Veterans’ Affairs (VA) stemming from VA’s re-estimation of veterans’ benefits liabilities. According to VA, the 2009 decrease in the actuarial liability was primarily caused by a large decrease in the cost of living adjustment (COLA) assumptions in the past year. The decrease was due in part to: (1) the decrease in inflation expectations that occurred during 2009 and (2) a change in methodology which aligned the assumption for future COLA rates with the assumption for future discount rates. VA’s estimate decrease in FY 2009 followed a substantial increase in the veteran’s benefit liability during FY 2008. Comparing a \$339 billion liability increase in FY 2008 to the FY 2009 liability decrease of \$149 billion results in a combined decrease in net cost due to VA reestimates of \$488 billion. The reason the VA’s estimates fluctuate so much from year to year is that VA assumes that current period interest and inflation rates will persist into the future. Thus, when current rates change, projections of the future change as well. Starting with next year’s financial statement, the VA plans to switch to a methodology more similar to that used in the Social Security and Medicare Trustees’ Reports – in which projections of future economic variables reflect average historical rates rather than simply the current period values.

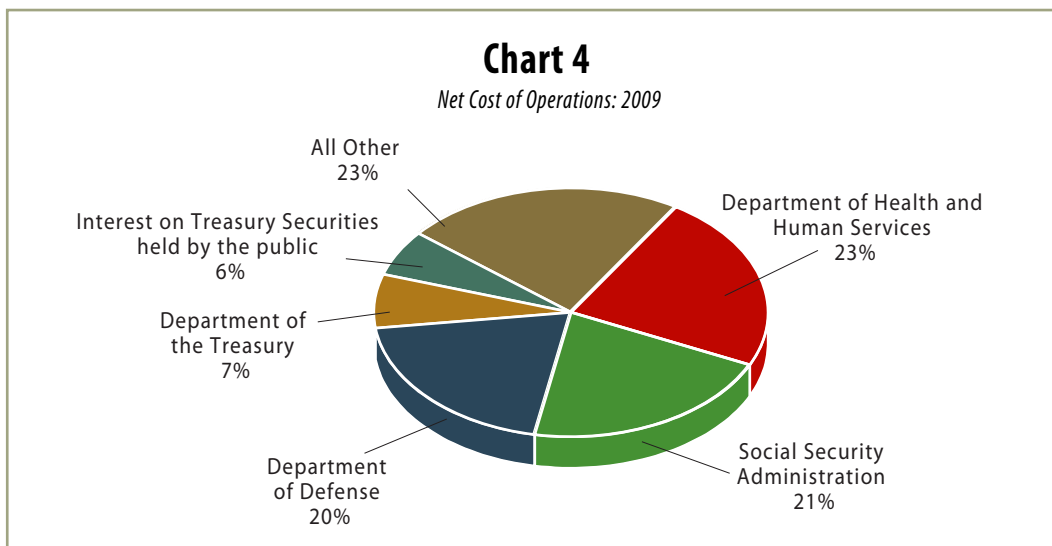


Chart 4 shows that the largest contributors to the Government’s net cost include the Departments of Health and Human Services (HHS) and Defense (DoD), the Social Security Administration (SSA), and the interest paid on debt held by the public (i.e., publicly-held debt). To derive net cost, the Government nets its costs against revenues earned from Government programs (e.g., Medicare premiums, National Park entry fees, and postal service fees). To arrive at the Government’s “bottom line” net operating cost, the Government subtracts taxes and other revenues from net costs. Thus, despite the decrease in net costs, the substantial FY 2009 decline in tax revenues resulted in a total net operating cost increase of nearly \$250 billion to reach a bottom line of about \$1.3 trillion.

**COST VS. DEFICIT: WHAT’S THE DIFFERENCE?**

The *Budget of the United States Government* (President’s Budget) is the Government’s primary financial planning and control tool. It describes how the Government spent and

plans to spend the public's money, comparing *receipts*, or cash paid to the Government, with *outlays*, or payments to individuals, businesses or other parties. Outlays are measured primarily on a cash basis. The ***Financial Report of the United States Government*** (Financial Report) reports on the accrual-based cost of operations, sources used to finance the Government's costs, how much the Government owns and owes, and the outlook for fiscal sustainability. It compares the Government's *revenues*, or amounts that the Government has collected and expects to collect, but has not necessarily received, with its *costs* (recognized when owed, but not necessarily paid) to derive net operating cost. Together, the President's Budget and the Financial Report present a complementary perspective on the nation's financial health and provide a valuable management tool for the country's leaders.

<b>Table 1: Budget Deficit vs. Net Operating Cost</b>		
Dollars in Billions	2009	2008
<b>Net Operating Cost</b>	<b>\$(1,253.7)</b>	<b>\$(1,009.1)</b>
Change in:		
Liabilities for Veteran's Compensation	\$(149.2)	\$339.0
Liabilities for Military and Civilian Employee Benefits	\$114.0	\$210.8
TARP Downward Reestimate	\$(110.0)	\$-
Other	\$(18.2)	\$4.5
<b>Budget Deficit</b>	<b>\$(1,417.1)</b>	<b>\$(454.8)</b>

The Government's net operating cost typically exceeds the deficit due largely to the inclusion of cost accruals for benefits earned by government employees that will be paid in the future. However, in FY 2009, the Government's budget deficit was approximately \$1.4 trillion (budget-basis reporting), \$163 billion greater than net operating cost (from the Financial Report) of about \$1.3 trillion. As mentioned earlier, the VA substantially reduced its estimates of its veterans' benefit liabilities and costs. In addition, there was a \$110 billion downward re-estimate of the cost of the Troubled Asset Relief Program (TARP), which was recorded as a reduction in net operating cost for FY 2009, but will not be reflected in the budget deficit until FY 2010. Table 1 shows factors that caused the budget deficit to uncharacteristically exceed net operating cost in FY 2009.

## THE DEBT

Historically, the Government has incurred debt when it borrows from the public to finance budget deficits. The economic recovery efforts of the past year precipitated a need to dramatically increase the amount of funds borrowed from the public. However, part of this increase has financed investments that the Government expects to ultimately recover in whole or in part. The Government's debt held by the public totaled approximately \$7.6 trillion at the end of FY 2009, and was held by the public in the form of Treasury securities, such as bills, notes, and bonds, and accrued interest payable. The "public" consists of individuals, corporations, state and local governments, Federal Reserve Banks, and foreign governments.

In addition to debt held by the public, the Government has outstanding nearly \$4.4 trillion of intragovernmental debt, which arises when one part of the Government borrows from

another. It represents debt held by Government funds, including the Social Security (\$2.5 trillion) and Medicare (\$372 billion) trust funds. These Government funds are typically required to invest any excess annual receipts in Federal debt securities. Because these amounts are both liabilities of the Treasury and assets of the Government trust funds, they are eliminated in the consolidation process for the Governmentwide financial statements. When those securities are redeemed, e.g., to pay future Social Security benefits – the Government will need to obtain the resources necessary to reimburse the trust funds.

The sum of debt held by the public and intragovernmental debt equals gross Federal debt, which (with some adjustments) is subject to a statutory ceiling (i.e., the debt limit). Congress raised the debt limit twice during FY 2009 – from \$10.6 trillion to \$11.3 trillion in October 2008 with the passage of the EESA, and again to \$12.1 trillion in February 2009 with the passage of the ARRA. In December 2009, the limit was raised to \$12.4 trillion and in February 2010, it was raised again to \$14.3 trillion.

If overall budget deficits continue, however, the Government will have to borrow more from the public in order to finance program needs and pay interest on debt held by the public. Instances where the debt held by the public increases faster than the economy for extended periods can pose additional challenges. The remainder of this Guide examines these and other indicators of the challenges the Government will face in maintaining long-term fiscal sustainability.

## **THE ECONOMIC RECOVERY EFFORT**

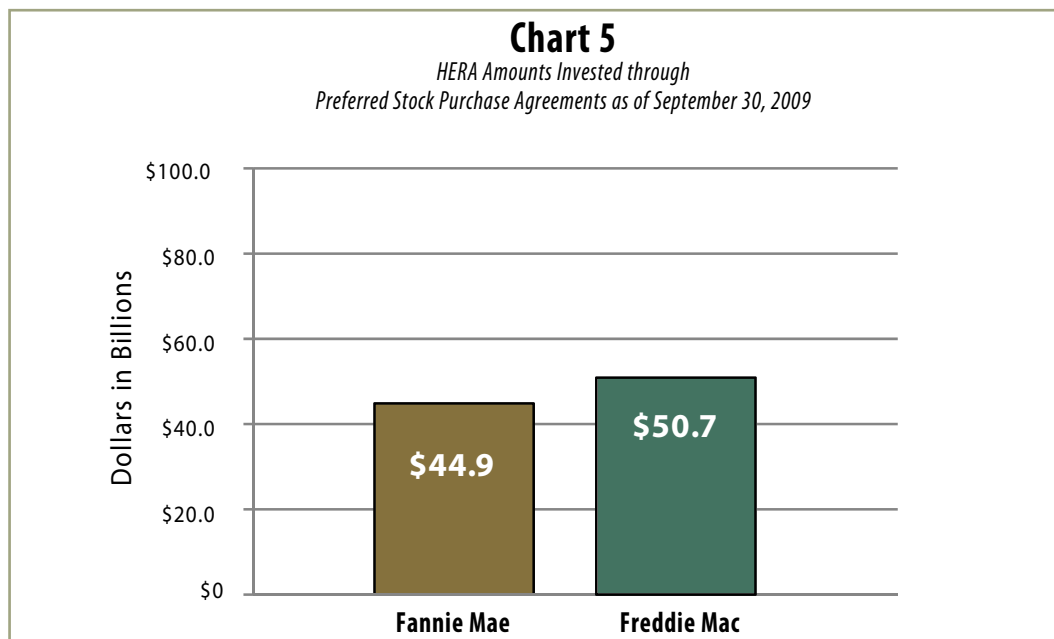
The severity of the recent financial crisis reflected long-term structural changes that had made the financial system significantly more fragile. Financial intermediation and risk taking grew rapidly in the relatively stable economic environment that preceded the crisis, while rising asset prices hid weak underwriting standards and masked growing leverage throughout the system. Further, risk management systems did not evolve at the pace of financial innovation, which was being driven in part by rapid improvements in information technology. Securitization expanded, allowing for more credit to rely on securities markets. This financial innovation made the system both more interconnected and opaque. The regulatory system was ill-prepared to handle the rapid growth of complex financial activity. In addition, unregulated markets and structures provided an increasing share of short-term credit to fund long-term assets. Such gaps and weaknesses in the supervision and regulation of financial firms presented challenges to the government's ability to monitor, prevent, or address risks as they built up in the financial system.

Starting in 2007, unanticipated mortgage-related losses weakened the balance sheets of major institutions, thereby reducing their capacity to provide credit and liquidity support to the economy and the rest of the financial system. Given the interconnections throughout the system, problems at individual institutions severely compromised confidence in the system as a whole, both in the United States and abroad. These pressures became acute as FY 2009 approached, as evidenced by the need to put Fannie Mae and Freddie Mac into conservatorship, the failure of Lehman Brothers, and significant problems at American International Group (AIG). In response, the Treasury Department, the Federal Reserve, the Federal Deposit Insurance Corporation (FDIC), and other U.S. government bodies took decisive action to help stabilize financial markets and the nation's economy, and to pull the financial system back from the brink of systemic collapse.

***Housing and Economic Recovery Act (HERA)***

In July 2008, HERA was enacted. HERA established a new regulatory agency, the Federal Housing Finance Agency (FHFA), with enhanced regulatory authority over the housing Government-Sponsored Enterprises (GSEs). It also authorized the Treasury Department to provide financial support for the housing GSEs. Under HERA, the Treasury, in conjunction with the FHFA's decision to place Fannie Mae and Freddie Mac into conservatorship, agreed to: (1) provide initial capital of up to \$100 billion each to Fannie Mae and Freddie Mac through a Senior Preferred Stock Purchase Agreement (SPSPA), should it be needed; (2) establish a GSE credit facility; and (3) purchase GSE-guaranteed mortgage-backed securities (MBS) to help support the availability of mortgage credit by temporarily providing additional capital to the mortgage market. On December 31, 2009, both the short-term credit facility and MBS purchase programs terminated.

The SPSPAs provide that the Government will make funding advances to the GSEs if, at the end of any quarter, the FHFA determines that the liabilities of either GSE individually exceed its respective assets. As shown in Chart 5, as of September 30, 2009, actual payments to the GSEs totaled a combined \$95.6 billion. In addition, as of September 30, 2009, Treasury accrued \$91.9 billion dollars as a liability for liquidity commitments. In May 2009, Treasury's financial liquidity commitment under the SPSPAs was increased from an initial amount of \$100 billion per GSE to \$200 billion per GSE to provide additional security for financial markets. In December 2009, Treasury amended the SPSPAs to replace the existing fixed \$200 billion per GSE cap with a formulaic cap for the next three years that will adjust upwards quarterly by the cumulative amount of any losses realized by either Fannie Mae or Freddie Mac and downwards by the cumulative amount of any gains, but not below \$200 billion per GSE. The SPSPAs, together with the placement of the GSEs into conservatorship by the FHFA, helped prevent the deteriorating condition of the GSEs from causing a systemic disruption to the housing market and the financial system. This initiative has ensured that Fannie Mae and Freddie Mac can continue to fulfill their critical role in the mortgage market by providing liquidity and stabilizing the market. The success of this initiative and others has contributed to lower mortgage rates during the past fiscal year.

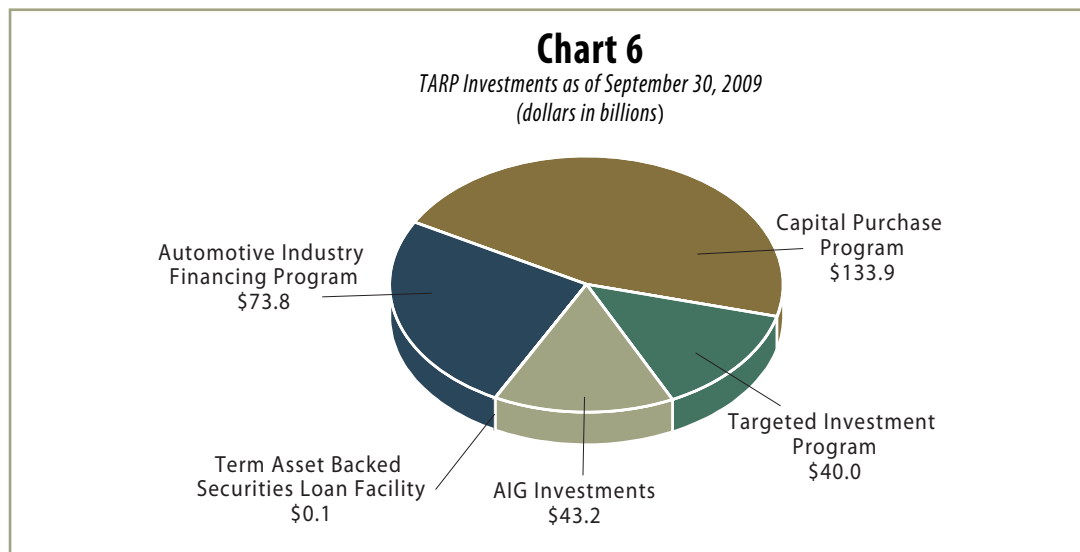


Under the MBS Purchase program, Treasury held about \$184.5 billion in GSE MBS during FY 2009 and received back \$27 billion in principal and interest on GSE MBS it had purchased.<sup>1</sup> This activity, combined with purchases by the Federal Reserve, have helped bring down mortgage rates to historically low levels and provide liquidity and stability to housing markets throughout the financial crisis. Additionally, the HOPE for Homeowners Program was established under HERA to help borrowers faced with foreclosure refinance through the Federal Housing Administration (FHA).

***Emergency Economic Stabilization Act (EESA), the Troubled Asset Relief Program (TARP) and the Office of Financial Stability***

In the early days of the financial crisis, the Government's policy response was led by the Federal Reserve,<sup>2</sup> and, to a lesser extent, the FDIC. Before September 2008, the Federal Reserve was providing sorely needed liquidity to many financial institutions, which allowed them to meet near-term obligations. The FDIC was insuring deposits, which helped quell bank runs, and it was resolving troubled depository institutions, such as IndyMac. But when stress in the system dramatically intensified in the wake of the Lehman failure, investor confidence collapsed. In response, the Emergency Economic Stabilization Act of 2008 (EESA) was enacted.

One of the purposes of EESA, through the creation of the TARP, is to provide the Secretary of the Treasury with the authorities and facilities necessary to help restore liquidity and stability to the U.S. financial system. In addition, the Secretary is directed to ensure that such authorities are used in a manner that protects home values, college funds, retirement accounts, and life savings; preserves homeownership; promotes jobs and economic growth; maximizes overall returns to taxpayers; and provides public accountability. It also provided specific authority to take certain actions to prevent avoidable foreclosures. Finally, it established the Office of Financial Stability in the Department of the Treasury (Treasury-OFS) to oversee and manage the many recovery initiatives and programs.



1 In the first three months of FY 2010, through December 31, 2009, Treasury purchased an additional \$29.9 billion in MBS securities, and received back an additional \$9 billion in principal and interest. No further purchases were to be made after December 31, 2009.

2 The Federal Reserve is an independent organization and not considered a part of the Federal reporting entity. As such, their financial results are not consolidated into the Government's financial statements.

The EESA provided authority for the TARP to purchase or guarantee up to \$700 billion of troubled assets.<sup>3</sup> Treasury-OFS used this authority to help strengthen the U.S. financial system, restore health and liquidity to credit markets to facilitate borrowing by consumers and businesses, and prevent avoidable foreclosures in the housing market. While the TARP should be evaluated primarily based on its impact on stabilizing the financial system, an important factor in the analysis is cost. While EESA provided up to \$700 billion in authority, the TARP has not cost taxpayers \$700 billion. Treasury-OFS used the authority to make investments to help stabilize the financial system and expects that much of the funding will be repaid. While some of the TARP investments are likely to result in a cost, others are estimated to produce net income.

As of September 30, 2009, approximately \$317 billion of the \$700 billion in purchase and guarantee authority remained available. During FY 2009, Treasury-OFS disbursed \$364 billion, most of it in the form of investments. A total of \$73 billion of those TARP funds have already been repaid during FY 2009, resulting in a total of \$291 billion in investments outstanding as of September 30, 2009 (see Chart 6). In addition, for FY 2009, reported net cost of operations for TARP was approximately \$41.6 billion, including administrative expenses, and, for the period ended September 30, 2009, investments generated \$12.7 billion in cash received by the Treasury through interest, dividends, and the proceeds from the sale of warrants.

It is important to note that much of the discussion in this Guide regarding TARP activity is as of fiscal year-end 2009 (i.e., through September 30, 2009). Additional information pertaining to material 'subsequent events' is provided in summary fashion in this Guide and in greater detail in the notes to the financial statements. For example, subsequent to September 30, 2009, certain TARP participants have repaid approximately \$90 billion to the Treasury, and the Asset Guarantee Program was terminated.

The ultimate return on the outstanding TARP investments will depend on how the economy and financial markets evolve. Improvement in the economic and financial outlook since the spring of 2009 reflects a broad and aggressive policy response that included the financial stability policies implemented under TARP, efforts to bolster confidence in the housing and mortgage markets under HERA, other financial stability policies implemented by the FDIC and the Board of Governors of the Federal Reserve, accommodative monetary policy, and the American Recovery and Reinvestment Act of 2009.

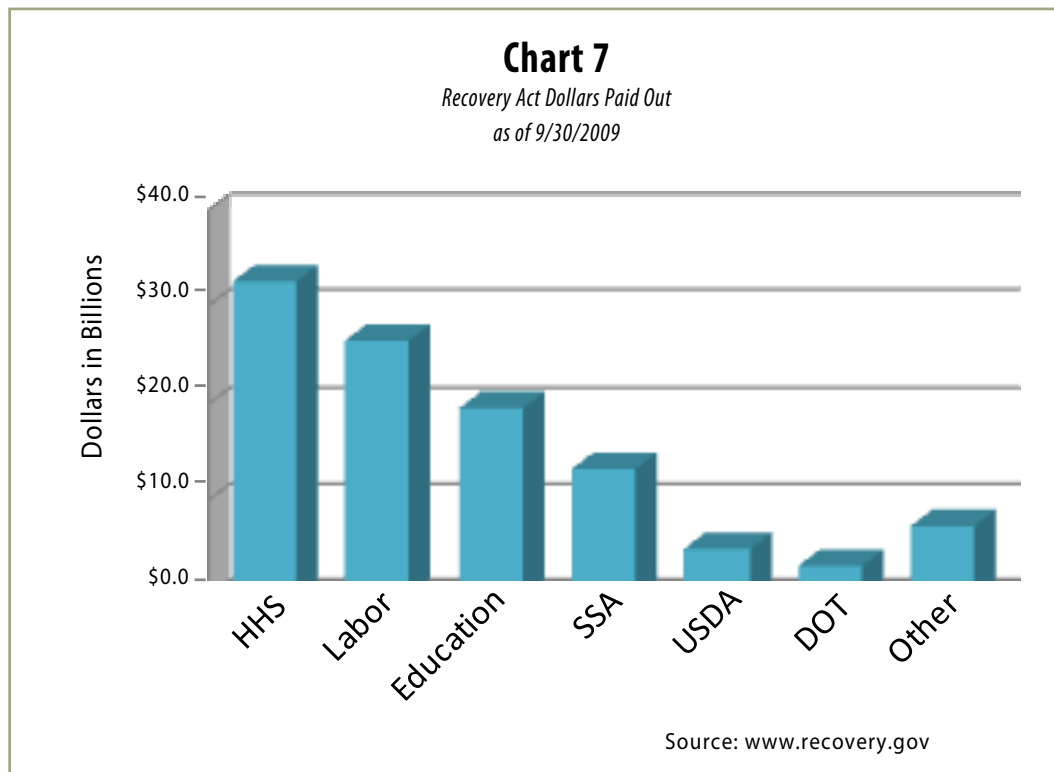
### ***American Recovery and Reinvestment Act (ARRA)***

The American Recovery and Reinvestment Act of 2009 (Recovery Act or ARRA) was passed by Congress and signed into law by President Obama on February 17, 2009. The purpose of the original \$787 billion Recovery package is to jump-start the economy and to create and save jobs. Approximately one-third of ARRA is dedicated to tax cuts for businesses and working families. Another third goes toward emergency relief for those who have borne the brunt of the recession. The final third of the Recovery Act is devoted to making investments to create jobs, spur economic activity, and lay the foundation for future sustained growth. ARRA provides for unprecedented levels of transparency and accountability so that the public will be able to know how, when, and where tax dollars are spent.

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<sup>3</sup> The Helping Families Save Their Homes Act of 2009, Pub. L. No. 111-22, Div. A, amended the EESA and reduced the maximum allowable amount of outstanding troubled assets under the act by almost \$1.3 billion, from \$700 billion to \$698.7 billion.

The website, [Recovery.gov](http://www.recovery.gov), is the centerpiece of the President's commitment to transparency and accountability. [Recovery.gov](http://www.recovery.gov) features information on how the Act is working, tools to help hold the government accountable, and up-to-date data on the expenditure of funds. It is the main vehicle to provide the public with the ability to monitor the progress of ARRA payments. Chart 7 summarizes amounts paid out by Federal agencies as of September 30, 2009. It is important to note that amounts spent by the Federal, State, and Local Government agencies, as well as by the private sector are continually changing. Readers may find the most up-to-date information on where and how these funds are being used at [www.recovery.gov](http://www.recovery.gov).<sup>4</sup>



## WHERE WE ARE HEADED

For years it has been apparent that rising health care costs and population aging would eventually present a serious fiscal challenge. With the baby-boom generation now beginning to retire, that challenge is upon us. Total spending on Medicare, Medicaid, and Social Security is expected to rise by approximately 3 percent of GDP between 2008 and 2020. In combination with the fiscal imbalance resulting from past budget deficits and the impact of the economic downturn, the Government is on a trajectory that will result in deficits of 5 percent of GDP even after the economy recovers. The President has established a bipartisan fiscal commission to recommend policies to stabilize the debt-to-GDP ratio at an acceptable level once the economy recovers and address the growth of entitlement spending and the gap between the estimated revenues and expenditures of the Federal Government.

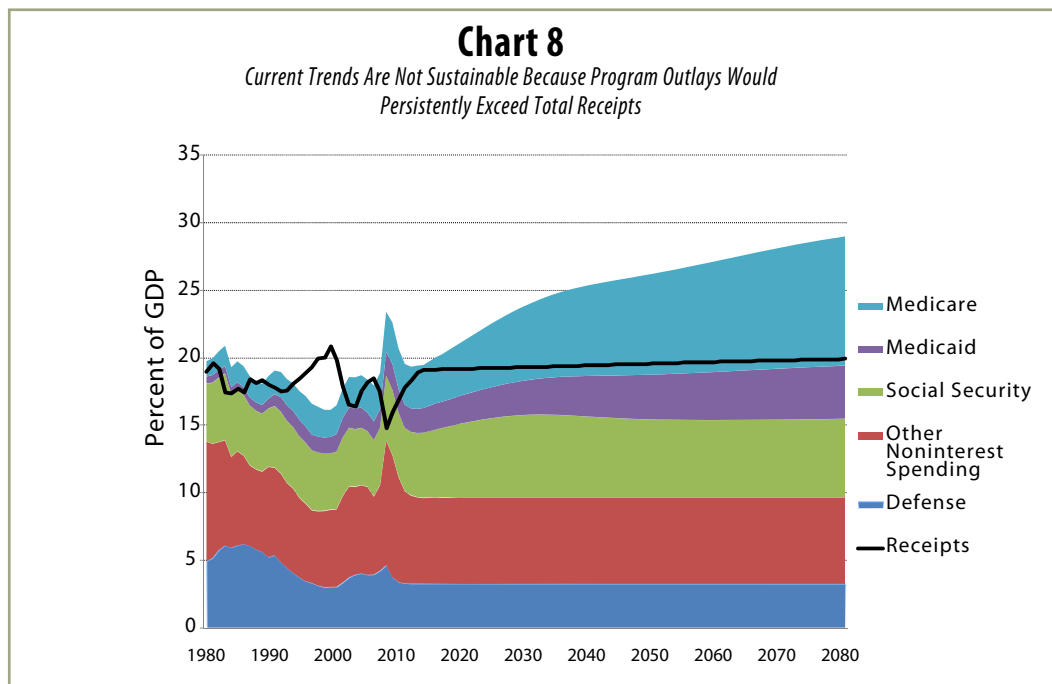
<sup>4</sup> Amounts in Chart 7 reflect reported activity as of September 30, 2009. These amounts are not reflected explicitly in agency financial statements and are not audited separately as part of the annual agency or consolidated financial statement audits. For more information, see the Recovery Act website at [www.recovery.gov](http://www.recovery.gov).



## CHALLENGES AHEAD: DEFICITS AND INTEREST

Spending under current law for Medicare, Medicaid, and Social Security is expected to grow much faster than GDP over the next 75 years as health care costs rise and the population ages. Revenues, on the other hand, are expected to grow only modestly faster than GDP. Together, these two trends imply that without policy changes, the difference between spending and revenues—the budget deficit—will grow larger as a share of GDP.

Chart 8 shows historical and estimated receipts, program spending, and primary deficits expressed as shares of GDP from 1980 to 2083. Program spending grew rapidly in 2008 and 2009 due to the financial crisis and the recession and the policies necessary to combat both, and is expected to fall in the next few years as the economy recovers. Starting in 2014, however, rising health care costs and, to a lesser extent, the aging population, are expected to cause program spending as a share of GDP to rise continuously from 19 percent in 2014 to 25 percent in 2040 and 29 percent in 2080. This reflects the expectation that health care spending per person will continue to grow faster than will the economy as a whole and also reflects the movement of the 78 million 'baby boomers' (those born between 1946 and 1964) from work to retirement.<sup>5</sup>



The revenue share of GDP was depressed in 2008 and especially 2009 by the recession and tax changes enacted as part of the 2009 stimulus package. As the economy recovers, the revenue share of GDP is expected to return to more normal levels and then grow slightly as increases in real incomes cause larger shares of income to fall into the upper income tax brackets.<sup>6</sup> This estimate assumes that legislation will continue to be enacted that prevents the share of income subject to the Alternative Minimum Tax from rising.

5 The Medicare Trustees' Report shows that, under current law, the Hospital Insurance Trust Fund will not have sufficient funds to pay scheduled benefits beginning in 2017. At that point, trust fund income would still be able to cover only 81 percent of scheduled benefits, but this share would fall to about 29 percent in 2083. The Social Security Trust Funds similarly face a long-run shortfall. Under current law, the OASDI Trust Funds will be exhausted in 2037, though revenues would still be sufficient to pay 76 percent of scheduled benefits in 2037 and 74 percent in 2083.

6 The increase in estimated revenues due to real income rising is somewhat offset by a decline in revenue as the share of compensation allocated to employer-sponsored health insurance costs, which are tax-exempt, increases over time.

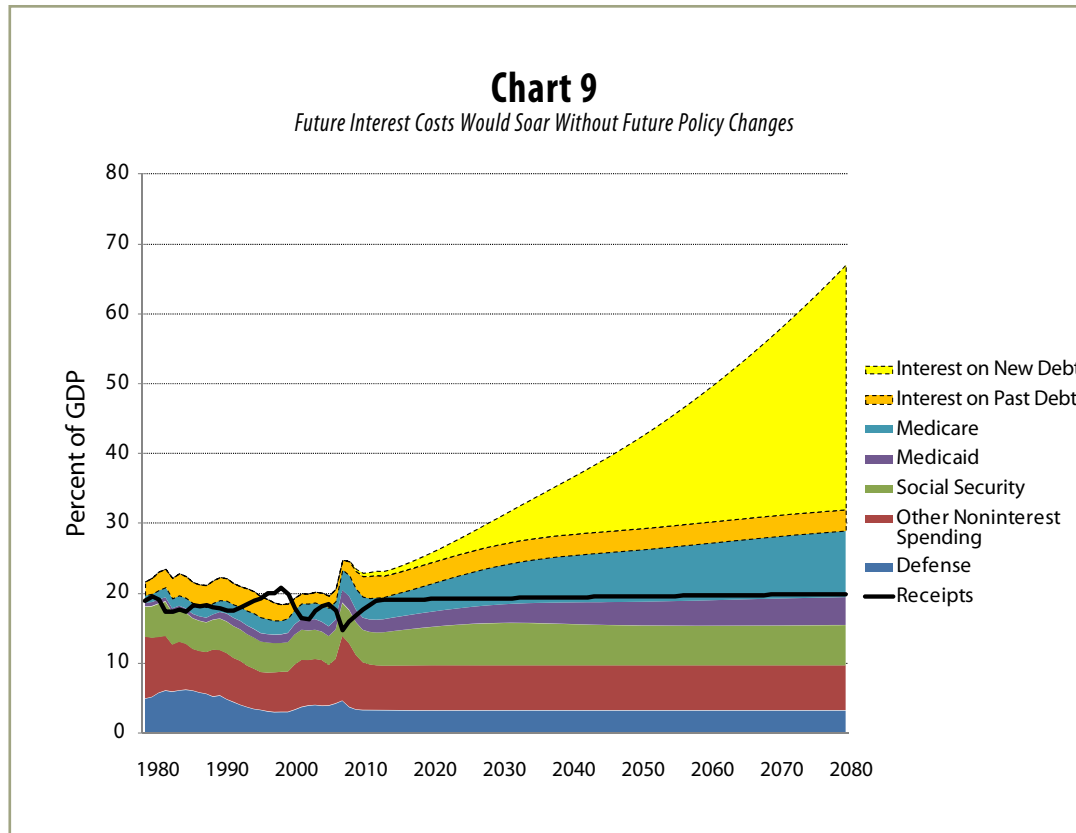


Chart 8 also illustrates the difference between estimated program spending (spending on mandatory and discretionary programs, excluding interest on debt held by the public) and estimated Government receipts. This difference, known as the primary deficit, is a useful concept because interest spending results from past primary deficits and interest payments on the resulting debt, and can be controlled only by controlling the level of future primary deficits. To stabilize the debt held by the public-to-GDP (debt-to-GDP) ratio at the projected level of debt-to-GDP when the economy recovers would require roughly a sustained primary balance – a balanced budget excluding interest payments. As such, the chart is also useful for assessing the magnitude of revenue increases or spending reductions that would be necessary to produce fiscal stability.<sup>7</sup> If policy changes are delayed, the magnitude of the policy changes that would be needed to stabilize the debt-to-GDP ratio would be greater.

Looking forward, in the absence of policy changes, large and growing primary deficits will increase debt held by the public and interest on that debt. Chart 9 shows that net interest expressed as a share of GDP is estimated to rise from 1.3 percent in 2009 to 10 percent in 2040 and to 35 percent in 2080. Because interest expenses grow, the total deficit and debt held by the public grow much more rapidly than does the primary deficit. Chart 2 at the opening of this Guide showed an extrapolation of increases in the outyears in publicly-held debt as a share of GDP if current policies remain unchanged. These estimates illustrate that current policies are not sustainable.

<sup>7</sup> The conditions for a stable debt-to-GDP ratio also depend on the relationship between interest rates and GDP growth rates.

## LOOKING AHEAD

During the past two years, the nation has confronted extraordinary challenges: a severe recession here and around the world; a catastrophic loss of trust and confidence in our financial system; unprecedented foreclosure rates; small businesses struggling to stay afloat; and millions of Americans worried about losing their jobs and savings. The current economic challenges that the United States faces require bold and comprehensive action, and Treasury and other Government agencies have responded with an array of programs and initiatives. However, even as the Government continues its current efforts to foster economic stability, it cannot lose sight of the long-term fiscal challenges associated with its social insurance programs. The nation must change course and bring social insurance expenses and resources in balance before the deficit and debt reach unprecedented heights. Delays will only increase the magnitude of the reforms needed and will place more of the burden on future generations. While there is still more work to be done and both near- and long-term challenges remain, the Federal Government has already accomplished a great deal during this fiscal year and will continue to work at an unprecedented pace to restore balance, growth, and confidence in our nation's economy.

## FIND OUT MORE

You will find more detail on the issues discussed in this Guide in the *2009 Financial Report of the United States Government*, issued by the U.S. Department of the Treasury. The Report provides a comprehensive view of both the Government's current financial position and prospects for moving forward. It further discusses the steps the Federal Government has taken to restore stability in the U.S. financial system and the fiscal challenges of the future. The issues discussed in the Citizens' Guide and the *Financial Report* affect, and should be of interest to, every citizen. The *Financial Report's* comprehensive reporting is intended to inform and support the decision-making needs of lawmakers and the public and to help keep the United States on solid financial ground.

You are encouraged to explore the information it contains and to ask questions about how the Government manages taxpayers' money. The *2009 Financial Report of the United States Government* and other information about the nation's finances are available at:

- U.S. Department of the Treasury's Financial Management Service, <http://www.fms.treas.gov/fr/index.html>;
- OMB's Office of Federal Financial Management, <http://www.whitehouse.gov/omb/financial/index.html>; and
- GAO, <http://www.gao.gov/financial/fy2009financialreport.html>.

This Citizen's Guide highlights information in the 2009 Financial Report. The Government Accountability Office's (GAO) complete audit report on the U.S. Government's consolidated financial statements can be found beginning on page 209 of the Financial Report. For FY 2009 and 2008, GAO issued an unqualified or 'clean' opinion on the Statement of Social Insurance. However, certain material financial reporting control weaknesses and other limitations on the scope of its work prevented GAO from expressing an opinion on the remaining financial statements in the Financial Report.

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# MANAGEMENT'S DISCUSSION AND ANALYSIS

## Introduction

The fiscal year (FY) 2009 *Financial Report of the United States Government (Report)* provides the President, Congress, and the American people with a comprehensive view of the Federal Government's finances, i.e., its financial position and condition, its revenues and costs, assets and liabilities, and other obligations and commitments. The Report also discusses important financial issues and significant conditions that may affect future operations. This year's Report gives particular emphasis to two key issues: the Government's ongoing efforts to jump-start the economy and create jobs, and the need to achieve fiscal sustainability over the medium and long term.

Pursuant to 31 U.S.C. § 331(e)(1), the Department of the Treasury must submit the Report, which is subject to audit by the Government Accountability Office (GAO), to the President and Congress no later than six months after the September 30 fiscal year end. To encourage timely and relevant reporting, the Office of Management and Budget (OMB) accelerated both agency and governmentwide reporting deadlines to 45 days and 75 days after year end, respectively. However, for FY 2009, some agencies that were significantly impacted by the substantial reporting requirements of both the Emergency Economic Stabilization Act of 2008 (EESA) and the American Recovery and Reinvestment Act of 2009 (ARRA) were granted reporting deadline extensions, which consequently affected the timing of this Report.

The Report is prepared from the audited financial statements of specifically designated Federal agencies, including the Cabinet departments and many smaller, independent agencies (see organizational chart on the next page). GAO issued, as it has for the past twelve years, a 'disclaimer' of opinion on the accrual-based consolidated financial statements for the fiscal years ended September 30, 2009 and 2008. This means that sufficient information was not available for the auditors to determine whether the reported financial results were reliable. In FY 2009, 28 of the 35 most significant agencies earned unqualified opinions on their financial statement audits.<sup>1</sup> In addition, the Government earned an unqualified audit opinion on a Report component - the Statement of Social Insurance (SOSI) - for the third year in a row, indicating the auditor's opinion that the SOSI fairly presents the financial condition of the programs covered in that statement.

The FY 2009 *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;
- Principal financial statements and the related footnotes to the financial statements;
- Supplemental and Stewardship Information; and
- GAO's Audit Report.

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

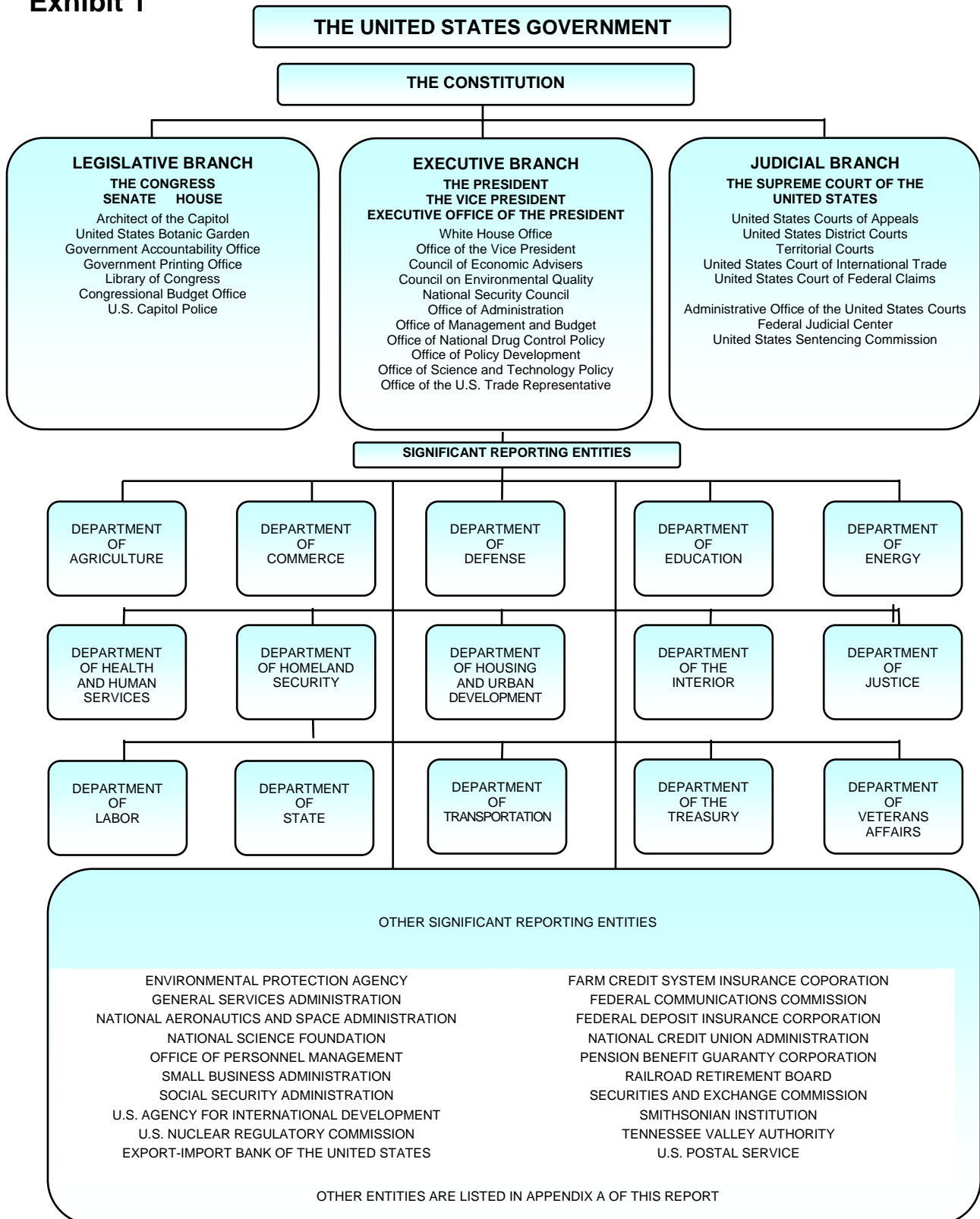
## Mission & Organization

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.

<sup>1</sup> Among the 35 significant entities are the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), and the Farm Credit System Insurance Corporation (FCSIC), which operate on a calendar year basis (December 31 year end). These entities' 2009 audits are not yet complete.

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

**Exhibit 1**



## The Government's Financial Position and Condition

A complete assessment of the Government's financial or fiscal condition requires analysis of historical results, projections of future revenues and expenditures, and an assessment of the Government's long-term fiscal sustainability. 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 estimated expenditures for future scheduled benefits for Social Security, Medicare, and other social insurance programs over a 75-year period to a subset of the revenues that support these programs (e.g., the payroll taxes and revenue from taxation of benefits that support Social Security and Medicare Part A, but not the general revenues that support Medicare Parts B and D). Expected expenditures for other major programs (including defense, Medicaid, and education), future tax revenues, and the net cost of the Government's recent efforts to stabilize the economy will also affect the Government's future fiscal condition. The sustainability of social insurance and other major programs is discussed below in the section "The Long-Term Fiscal Outlook: Where We Are Headed".

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

Dollars in Billions	2009	2008
Gross Cost	\$ (3,735.6)	\$ (3,891.6)
Less: Earned Revenue	\$ 300.9	\$ 250.9
<b>Net Cost of Operations</b>	<b>\$ (3,434.7)</b>	<b>\$ (3,640.7)</b>
<b>Less: Taxes and Other Revenue:</b>	<b>\$ 2,198.4</b>	<b>\$ 2,661.4</b>
<b>Net Operating Cost<sup>1</sup></b>	<b>\$ (1,236.3)</b>	<b>\$ (979.3)</b>
<b>Assets<sup>2</sup>:</b>		
Cash & Other Monetary Assets	\$ 393.2	\$ 424.5
Loans Receivable and Mortgage-Backed Securities, Net	\$ 538.9	\$ 253.8
TARP Direct Loans & Equity Investments, Net	\$ 239.7	\$ -
Property, Plant & Equipment, Net	\$ 784.1	\$ 737.7
Other Assets	\$ 712.0	\$ 558.7
<b>Total Assets</b>	<b>\$ 2,667.9</b>	<b>\$ 1,974.7</b>
<b>Liabilities<sup>2</sup>:</b>		
Federal Debt Held by the Public	\$ (7,582.7)	\$ (5,836.2)
Federal Employee & Veterans Benefits	\$ (5,283.7)	\$ (5,318.9)
Other Liabilities	\$ (1,257.4)	\$ (1,023.1)
<b>Total Liabilities</b>	<b>\$ (14,123.8)</b>	<b>\$ (12,178.2)</b>
<b>Net Position (Assets minus Liabilities)</b>	<b>\$ (11,455.9)</b>	<b>\$ (10,203.5)</b>
<b>Social Insurance Net Expenditures<sup>3</sup>:</b>		
Social Security (OASDI)	\$ (7,677)	\$ (6,555)
Medicare (Parts A, B, & D)	\$ (38,107)	\$ (36,312)
Other	\$ (94)	\$ (104)
<b>Total Social Insurance Net Expenditures</b>	<b>\$ (45,878)</b>	<b>\$ (42,970)</b>
<b>Social Insurance Net Expenditures as a % of Gross Domestic Product (GDP)<sup>4</sup></b>		
Social Security (OASDI)	-1.0%	-0.9%
Medicare (Parts A, B, & D)	-4.8%	-4.6%
Other	0.0%	0.0%
<b>Total Net Expenditures as % of GDP</b>	<b>-5.8%</b>	<b>-5.4%</b>

1 Source: Statement of Operations and Change in Net Position. Net Operating Cost includes adjustment for Unmatched Transactions and Balances

2 Source: Balance Sheet

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

4 Social Insurance values as reported in the Statement of Social Insurance. GDP values from the 2009 Social Security and Medicare Trust Fund Reports represent the present value of GDP over the 75 year projection period.

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

- The Government's net operating cost, which includes accruals for anticipated future costs, increased from about \$1.0 trillion in FY 2008 to approximately \$1.3 trillion in FY 2009. By comparison, Government primarily cash-based outlays of \$3.5 trillion, net of receipts of \$2.1 trillion (approximately 25 percent and 15 percent of GDP, respectively) yielded a unified budget deficit for FY 2009 of about \$1.4 trillion.
- The Government borrows from the public to finance the gap between cash-based outlays and receipts (the unified budget deficit) and to finance certain cash transactions that are not reflected in the deficit. The value, including interest, of publicly held debt was approximately \$7.6 trillion (53 percent of GDP) at the end of FY 2009.
- Social insurance programs and Medicaid continue to represent a large share of Government cash-based expenditures. As reported in the Statement of Social Insurance (SOSI), over the next 75 years, the present value of expenditures for OASDI, Medicare (parts A, B, and D), Railroad Retirement, and Black Lung<sup>2</sup>, are, absent policy changes, projected to exceed dedicated receipts for these programs by almost \$46 trillion (nearly 6% of GDP over the 75-year period). Medicare Parts B and D are financed by general revenues. By accounting convention, the general revenues are eliminated in the consolidation of the financial statements at the governmentwide level and as such are not included in this calculation even though the expenditures on the components are included.

## Fiscal Year 2009 Financial Statement Audit Results

Fiscal year 2009 was a difficult year for our nation's economy. In response, Congress passed several laws to help stimulate the economy and to help retain and create jobs, such as ARRA and EESA. Federal agencies were responsible for implementing new programs and expanding existing programs to carry out the goals of the stimulus package. In addition to managing the new or expanded programs, agencies were still held accountable to meet the OMB rigorous 45-day financial audit deadline. Twenty-two of the 24 CFO Act agencies met the 45-day deadline, with 19 agencies receiving clean audit opinions at that time.

This year, however, OMB granted one-month extensions to the Departments of State, Veterans Affairs, and the Treasury in accordance with OMB Memorandum M-10-04. The Memorandum allowed agencies to request a reporting extension due to the time and human resource constraints to implement economic recovery programs during the same time allotted to prepare and audit financial statements. The

**Table 2: Summary of FY 2009 Financial Statement Audit Results by Agency**

CFO Act Agencies	FY 2009 Audit Opinion
Department of Agriculture (USDA)	Unqualified
Department of Commerce (DOC)	Unqualified
Department of Defense (DOD)	Disclaimer
Department of Education (Education)	Unqualified
Department of Energy (DOE)	Unqualified
Department of Health and Human Services (HHS)	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

\* DHS' Balance Sheet and Statement of Custodial Activity were the only statements subject to audit.

\*\* The Department of State's overall disclaimer is attributable to the disclaimer of its Statement of Budgetary Resources. State received qualified audit opinions on its Balance Sheet, Statement of Net Cost, and Statement of Changes in Net Position.

<sup>2</sup> The Black Lung program is projected through 2040.



Department of Veterans Affairs, however, was able to meet the reporting deadline and did not use the extension granted by OMB. Because of the extensions granted and used by the Departments of State and the Treasury, the FY 2009 *Financial Report* was issued on February 26, 2010 instead of the initially planned issuance date of December 15, 2009. This is still ahead of the statutory deadline of March 31, 2010. As shown in Table 2, of the 24 major Federal agencies, 20 received clean opinions.

## The Governmentwide Reporting Entity

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

A number of entities and organizations are excluded due to the nature of their operations, including the Federal Reserve System (considered to be an independent central bank under the general oversight of Congress), all fiduciary funds, and government-sponsored enterprises, including the Federal Home Loan Banks, Fannie Mae, and Freddie Mac. The Government increased its investment in the recovery effort in FY

2009 under the EESA, which gave the Secretary of the Treasury temporary authority to purchase and guarantee assets in a wide range of financial institutions and markets. Following GAAP for Federal entities, the Government has not consolidated into its financial statements the assets, liabilities, or results of operations of any financial organization or commercial entity in which Treasury holds either a direct, indirect, or beneficial majority equity investment. Even though some of the equity investments are significant, these entities meet the criteria under paragraph 50 of the Statement of Federal Financial Accounting Concepts (SFFAC) No. 2, which directs that such investments should not be consolidated into the financial reports of the Federal Government, either in part or as a whole. A list of the significant agencies and entities contributing to this report is included in Appendix A.<sup>3</sup>

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 obligations for social insurance and maintain its economic reinvestment and recovery efforts. The information in this Report, when combined with the President's Budget, collectively provides a valuable tool for managing current operations and planning future initiatives.

### Limitations of the Financial Statements

The principal financial statements have been prepared to report the financial position and results of operations of the Federal Government, 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.

## Systems, Controls, & Legal Compliance

### Systems

As Federal agencies demonstrate success in obtaining and keeping an unqualified opinion on their audited financial statements, the Federal Government continues to face challenges in implementing financial systems that meet Federal requirements, but progress has been made. The number of agencies reporting compliance with the Federal Financial Management Improvement Act (FFMIA) continued to increase in FY 2009 from 15 to 17, and the number of auditors reporting compliance with FFMIA also increased from 10 to 14. The annual changes in compliances reported each year underscores the importance of current initiatives to standardize the financial management practices across the Federal Government.

This year, OMB updated Circular No. A-127, *Financial Management Systems*. The revised Circular is aimed at clarifying the definition of FFMIA substantial compliance so that auditors and agency heads interpret the

<sup>3</sup> Since programs are not administered at the governmentwide level, performance goals and measures for the federal Government, as a whole, are not reported here. The outcomes and results of those programs are addressed at the individual agency level and can be found in their individual reports.

guidance more consistently. The revised Circular also includes policies and standards for agencies to follow to improve management of financial systems.

## 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.

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

In addition to the FY 2009 agency financial statement audit results, the total number of repeat material weaknesses remained at 29. However, the total number of material weaknesses increased from 32 to 38, primarily due to an increase of findings related to Financial Management and Reporting. Deficiencies in controls over the financial statement preparation process contributed to this increase; as such, improvements are needed in various areas, including oversight, data integrity, reconciliations, policies and procedures, and training. Effective internal controls are a challenge not only at the agency level, but also at the government-wide level. GAO reported that at the governmentwide level, material weaknesses resulted in ineffective internal control over financial reporting. While progress is being made at many agencies and across the Government in identifying and resolving internal control deficiencies, continued diligence and commitment are needed.

## Legal Compliance

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

## The President's Budget and The Financial Report

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

Treasury generally prepares the financial statements in this Report on an 'accrual basis' of accounting as prescribed by U.S. generally accepted accounting principles (GAAP) for Federal entities.<sup>4</sup> These principles are tailored to the Government's unique characteristics and circumstances. For example, agencies prepare a uniquely structured 'Statement of Net Cost,' which is intended to present net Government resources used in its operations, instead of an 'Income Statement,' which private sector companies typically use to focus on profits or losses. Also

<sup>4</sup> Under GAAP, most U.S. Government revenues are recognized on a 'modified cash' basis, or when they become measurable. The Statement of Social Insurance presents the present value of the estimated future revenues and expenditures for scheduled benefits over the next 75 years for the Social Security, Medicare, Railroad Retirement programs; and through 2040 for the Black Lung program.

unique to Government is the preparation of separate statements to reconcile differences and articulate the relationship between the budget and financial accounting results (e.g., Statement of Reconciliation of Net Operating Cost and Unified Budget Deficit and the Statement of Changes in Cash Balance from Unified Budget Deficit and Other Activities).

President's Budget	Financial Report of the U.S. Government
<p style="text-align: center;"><u>Prepared primarily on a 'cash basis'</u></p> <ul style="list-style-type: none"> <li>• Initiative-based and prospective: focus on current and future initiatives planned and how resources will be used to fund them.</li> <li>• Receipts ('cash in'), taxes and other collections recorded when received.</li> <li>• Outlays ('cash out'), recorded when payment is made.</li> </ul>	<p style="text-align: center;"><u>Prepared on an 'accrual and modified cash basis'</u></p> <ul style="list-style-type: none"> <li>• Agency-based and retrospective – prior and present resources used to implement initiatives.</li> <li>• Revenue: Tax revenue (more than 90 percent of total revenue) recognized on modified cash basis (see Financial Statement Note 1.B). Remainder recognized when earned, but not necessarily received.</li> <li>• Costs: recognized when owed, but not necessarily paid.</li> </ul>

### Budget Deficit vs. Net Operating Cost

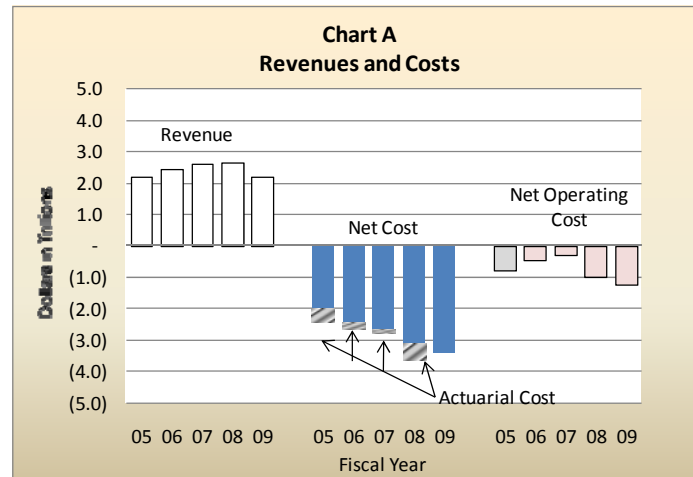
Because of the severe economic downturn and the policy measures taken to stabilize the financial markets and help the economy recover, the budget deficit rose substantially in FY 2009. The Government incurred a unified budget deficit of about \$1.4 trillion. Some government programs act as “automatic stabilizers,” helping to support the economy during a downturn by increasing spending and reducing tax collections. This support is “automatic” because increased spending on programs like unemployment benefits, Social Security, and Medicaid, and a reduction in tax receipts happen even without any legislative changes in policies. The automatic stabilizers caused the deficit to surge during FY2009. In addition, the results of actions related to legislation enacted to bolster the economy added further to the deficit.

Dollars in Billions	2009	2008
<b>Net Operating Cost</b>	\$ (1,253.7)	\$ (1,009.1)
Change in:		
Liabilities for Veteran's Compensation	\$ (149.2)	\$ 339.0
Liabilities for Military and Civilian Employee Benefits	\$ 114.0	\$ 210.8
TARP Downward Reestimate	\$ (110.0)	\$ -
Other	\$ (18.2)	\$ 4.5
<b>Budget Deficit</b>	<b>\$ (1,417.1)</b>	<b>\$ (454.8)</b>

As noted earlier, the Government's net operating cost (which increased from an already record high of about \$1.0 trillion in FY 2008 to approximately \$1.3 trillion in FY 2009) typically exceeds the deficit due largely to the inclusion of cost accruals for estimated future postemployment benefit liabilities. However, for FY 2009, as will be discussed later in this report, the Department of Veterans Affairs substantially reduced its estimates of long-term veterans' benefit liabilities and costs. These estimate changes accounted for the largest single difference between deficit and net operating cost. In addition, there was a \$110 billion downward re-estimate of the cost of the Troubled Asset Relief Program (TARP), which was recorded as a reduction in net operating cost for FY 2009, but will not be reflected in the budget deficit until FY 2010. Table 3 shows the factors that caused the budget deficit to uncharacteristically exceed net operating cost in FY 2009.

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

The Government's financial position and condition have traditionally been expressed through the Budget, focusing on surpluses 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, which for FY 2009 was a negative \$11.5 trillion, 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 Change in Net Position*, much like a corporation's income statement, shows the Government's 'bottom line' and its impact on net position (i.e., assets net of liabilities). The Government nets its costs against both: (1) earned revenues from Government programs (e.g., Medicare premiums, National Park entry fees, and postal service fees) to derive net cost; and (2) taxes and other revenue to arrive at the Government's 'bottom line' net operating cost.

Chart A and Table 4 show that the Government has incurred a total net operating cost (i.e., costs have exceeded its revenues) over the past several years, causing net position to decline. The Government's revenues last exceeded its costs in FYs 1999 and 2000. Chart A also shows that despite declines in net costs, including a substantial decrease in actuarial cost estimates (discussed later), during FY 2009, a \$463 billion decrease in taxes and other revenue resulted in an increase in net operating cost.

#### The Reconciliation of Net Operating Cost and Unified

*Budget Deficit Statement* shows how the Government's net operating cost from the primarily accrual-based financial statements relates to the more widely-known and primarily cash-based budget deficit. Most of this difference is attributable to accruals of actuarial costs associated with the estimated present value of the Federal Government's net postemployment liabilities. Chart A shows the effect of this 'actuarial' element on the Government's total net cost. These actuarial costs in recent years have also accounted for the majority of the annual change in the Government's total net cost. The Department of Veterans Affairs (VA) and other agencies use a number of assumptions, such as interest rates and life expectancy, to make annual actuarial projections of their long-term benefits liabilities and the related costs. As discussed below, changes in these assumptions can cause those projections, and consequently total costs, to fluctuate, sometimes significantly, from year to year.

**Table 4: Gross Cost, Revenues, and Net Cost**

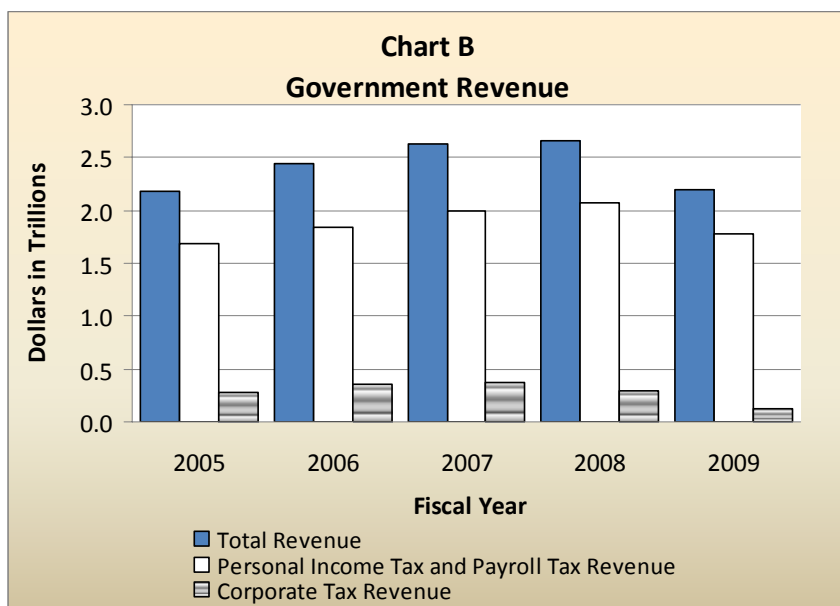
Dollars in Billions	2009	2008	Increase / (Decrease)	
			\$	%
<b>Gross Cost</b>				
HHS	\$ (866.4)	\$ (769.1)	\$ 97.3	12.7%
SSA	\$ (736.6)	\$ (663.9)	\$ 72.7	11.0%
DOD	\$ (718.4)	\$ (767.6)	\$ (49.2)	-6.4%
Treasury	\$ (254.6)	\$ (197.0)	\$ 57.6	29.2%
Interest on Treasury Securities Held by the Public	\$ (189.1)	\$ (241.6)	\$ (52.5)	-21.7%
Other Federal Agencies	\$ (970.5)	\$ (1,252.4)	\$ (281.9)	-22.5%
<b>Total Gross Cost</b>	<b>(\$3,735.6)</b>	<b>(\$3,891.6)</b>	<b>\$ (156.0)</b>	<b>-4.0%</b>
Less: Earned Revenue	\$ 300.9	\$ 250.9	\$ 50.0	20.0%
<b>Net Cost</b>	<b>(\$3,434.7)</b>	<b>(\$3,640.7)</b>	<b>\$ (206.0)</b>	<b>-5.7%</b>
Less: Taxes & Other Revenue	\$ 2,198.4	\$ 2,661.4	\$ (463.0)	-17.4%
<b>Net Operating Cost<sup>1</sup></b>	<b>(\$1,253.7)</b>	<b>(\$1,009.1)</b>	<b>\$ 244.6</b>	<b>24.2%</b>

<sup>1</sup> Net Operating Cost includes adjustment for Unmatched Transactions and Balances

**Revenue: “What Came In”**

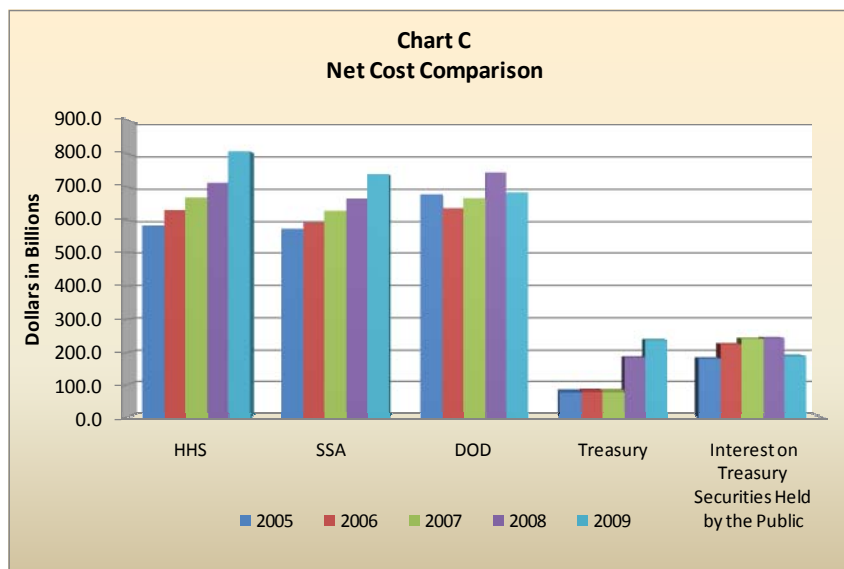
The *Statement of Net Cost* reports ‘earned’ revenue generated by Federal programs, including Medicare tax premiums paid by program participants and postal service fees. The *Statement of Operations and Changes in Net Position* shows the Government’s taxes and other revenues (i.e., revenues other than ‘earned’). As shown in Chart B, total Government revenues decreased \$463 billion to about \$2.2 trillion for FY 2009, due in great part to the effects of the recession.

Individual income tax revenue (which decreased by nearly 15 percent), and corporate tax revenue (which decreased by more than 50 percent) account for the majority (nearly 90 percent) of total revenues.



**Cost: “What Went Out”**

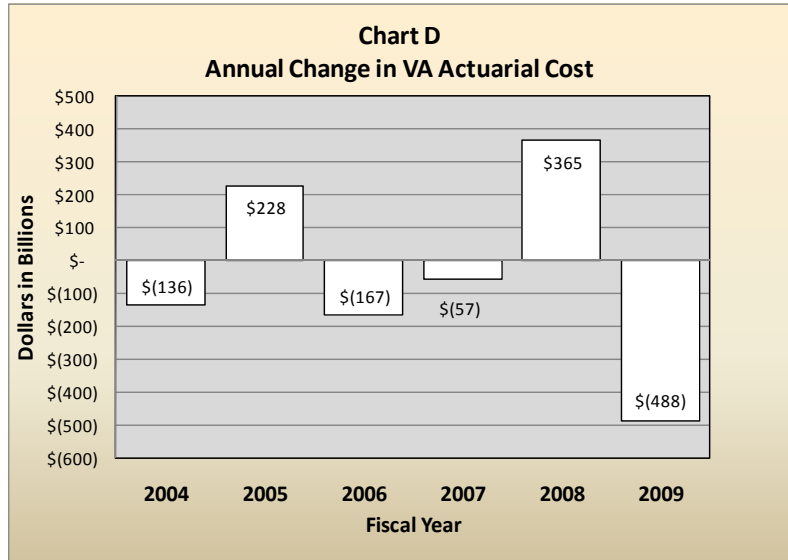
The *Statement of Net Cost* also shows how much it costs to operate the Federal Government, recognizing expenses when they happen, regardless of when payment is made (accrual basis). It shows the derivation of the Government’s net cost of operations or the difference between costs of goods produced and 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 FY 2009, the Government’s ‘bottom line’ net operating cost totaled about \$1.3 trillion (\$1,254 billion), an increase of nearly \$250 billion over a then record FY 2008 net operating cost of approximately \$1.0 trillion (see Table 4). Chart C shows the cost trends in the entities that contributed the most to the Government’s net cost in FY 2009. The Department of Health and Human Services (HHS), the Department of Defense (DoD), and the Social Security Administration (SSA) have consistently incurred the largest agency shares of the Government’s total net cost of operations in recent years, combining to comprise almost two-thirds of the Government’s FY 2009 total net cost. The bulk of HHS and SSA costs are attributable to major social insurance programs administered by these agencies, e.g., Social Security and Medicare. The *Statement of Social Insurance* (SOSI) and the related information in this report discuss the projected future revenues, expenditures, and future sustainability of these programs in greater detail. DoD costs relate primarily to operational activities, environmental cleanup, and military retirement and health benefits. In addition to interest costs on Federal debt held by the public, the Department of the Treasury was another significant contributor to the Government’s net cost in FY 2009. The majority of the increase

in Treasury costs is attributable to the economic recovery effort, including TARP and Government-Sponsored Enterprise (GSE) investments.

As indicated earlier, the nearly \$250 billion increase in net operating cost for FY 2009 was actually comprised of significant offsetting increases and decreases. In addition to the substantial decrease in revenues described earlier, net operating cost increased \$94 billion at the Department of Health and Human Services (HHS) for medical benefits and \$73 billion at the Social Security Administration (SSA) due to benefits payments made to the first wave of 'baby boomers' reaching retirement age and to the increase in disability and retirement benefit claims that occurs during a recession. However, these net cost increases were offset by a significant reduction in costs at the Department of Veterans Affairs (VA). VA's net cost decreased by \$488 billion, resulting in a net revenue total of \$43 billion for FY 2009.



This significant decrease in costs is attributable to VA's reestimation of its actuarial liability for and, consequently, anticipated cost of veterans' compensation benefits. According to VA, the 2009 decrease in the actuarial liability was primarily caused by a large decrease in the cost of living adjustment (COLA) assumption in the past year. The decrease was due in part to: (1) the decrease in inflation expectations that occurred during 2009 and (2) a change in methodology which aligned the assumption for future COLA rates with the assumption for future discount rates. Changes in these and other assumptions can cause wide fluctuations in an agency's cost and liability estimates and accruals (see Chart D for annual fluctuations in VA's actuarial costs). Table 5 shows the major components of this significant liability change, which, in addition to the COLA adjustment, include changes in discount rates and estimates of veteran eligibility. In the prior year, VA's net cost increased significantly because of an actuarial adjustment in the opposite direction. The liability decrease of \$149 billion in FY 2009, when compared to a \$339 billion increase in FY 2008, combine to cause a \$488 billion decrease in actuarial cost estimates for FY 2009.

**Table 5**  
**Components of VA Federal Employee & Veteran Benefit Liability Change - FY 2009**

Dollars in billions	\$
Change in COLA assumption	\$ (287)
Changes in original awards/new status	\$ 103
Changes in discount rates	\$ 62
Other sources	\$ (27)
<b>Total Change</b>	<b>\$ (149)</b>

The reason the VA's estimates fluctuate so much from year to year is that VA assumes that current period interest and inflation rates will persist into the future. Thus, when current rates change, projections of the future change as well. Starting with next year's financial statement, the VA plans to switch to a methodology more similar to that used in the Social Security and Medicare Trustees' Reports – in which projections of future economic variables reflect average historical rates rather than current period values.

## 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. In addition, as was the case with the *Statement of Operations and Changes in Net Position*, the *Balance Sheet* includes a separate presentation of the portion of net position earmarked for

specific funds and programs. Moreover, the Government's exposures are broader than the liabilities presented on the balance sheet, if such items as the Government's future social insurance exposures (namely, Medicare and Social Security), as well as other commitments and contingencies, are taken into account. These exposures are discussed in this section as well as in the supplemental disclosures of this Report.

Net Position Dollars in Billions	2009		2008		Increase (Decrease)	
	\$	%	\$	%	\$	%
<b>Assets</b>						
Cash & Other Monetary Assets	\$ 393.2		\$ 424.5		\$ (31.3)	-7.4%
Loans Receivable and Mortgage-Backed Securities, Net	\$ 538.9		\$ 253.8		\$ 285.1	112.3%
TARP Direct Loans & Equity Investments, Net	\$ 239.7		\$ -		\$ 239.7	n/a
Property, Plant & Equipment, Net	\$ 784.1		\$ 737.7		\$ 46.4	6.3%
Other Assets	\$ 712.0		\$ 558.7		\$ 153.3	27.4%
<b>Total Assets</b>	<b>\$ 2,667.9</b>		<b>\$ 1,974.7</b>		<b>\$ 693.2</b>	<b>35.1%</b>
<b>Less: Liabilities, comprised of:</b>						
Federal Debt Held by the Public	\$ (7,582.7)		\$ (5,836.2)		\$ 1,746.5	29.9%
Federal Employee & Veterans Benefits	\$ (5,283.7)		\$ (5,318.9)		\$ (35.2)	-0.7%
Other Liabilities	\$ (1,257.4)		\$ (1,023.1)		\$ 234.3	22.9%
<b>Total Liabilities</b>	<b>\$ (14,123.8)</b>		<b>\$ (12,178.2)</b>		<b>\$ 1,945.6</b>	<b>16.0%</b>
<b>Net Position</b> (Assets Minus Liabilities)	<b>\$ (11,455.9)</b>		<b>\$ (10,203.5)</b>		<b>\$ (1,252.4)</b>	<b>-12.3%</b>

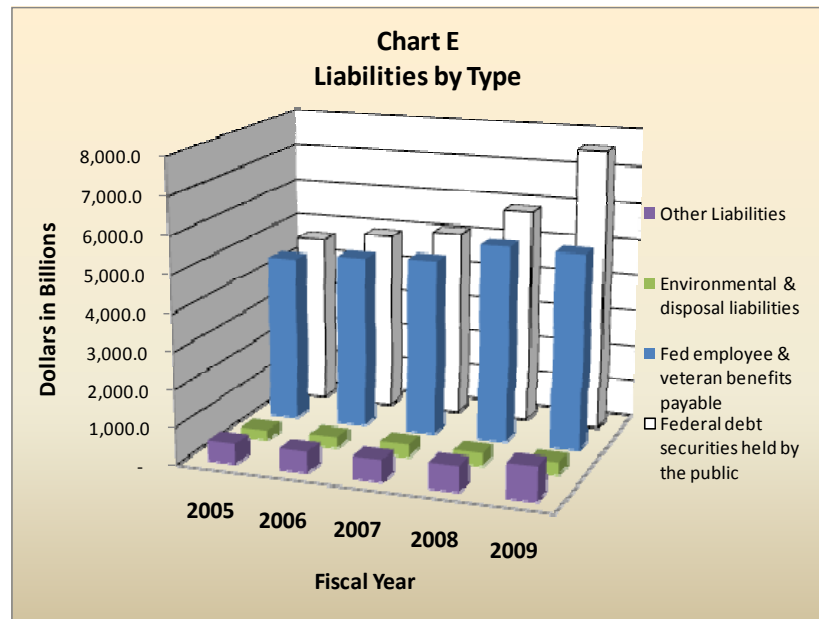
### Assets – "What We Own"

As of September 30, 2009, the Government held about \$2.7 trillion in assets, comprised mostly of net property, plant, and equipment (\$784 billion in FY 2009) and a combined total of \$778.6 billion in net loans receivable and investments, including nearly \$240 billion associated with the TARP efforts. During FY 2009, the Government's total assets increased by \$693.2 billion, due mostly to the \$525 billion increase in TARP and other loans receivable and investments. As part of the market stabilization effort, the Government implemented the Supplementary Financing Program (SFP) - a temporary program announced on September 17, 2008, by Treasury and the Federal Reserve to help manage the impact on the Federal Reserve's balance sheet of its initiatives aimed at addressing the ongoing crisis in financial markets. At its height, this program accounted for \$560 billion of the Government's cash balance. As of September 30, 2009, the total had been reduced to \$165 billion, as outstanding SFP bills matured and were not reinvested in the program. On September 16, 2009, Treasury announced its intention to reduce the balance to \$15 billion in the short run to preserve flexibility in the conduct of debt management policy. In addition to assets recorded on the balance sheet, the Government discloses that it also owns certain other stewardship assets such as land (e.g., national parks and forests) and heritage assets (e.g., national memorials and historic structures).

### Liabilities – "What We Owe"

Chart E shows the major components of liabilities, or what the Government owes, as of September 30, for fiscal years 2005 through 2009. As indicated in Table 6, the largest liabilities in recent years have been Federal debt held by the public and accrued interest, the balance of which increased to \$7.6 trillion in FY 2009. During the fiscal year, changes in economic conditions, as well as actions taken to address the downturn in the economy and instability in the financial markets, resulted in the need for an increase in borrowings from the public to finance federal spending.

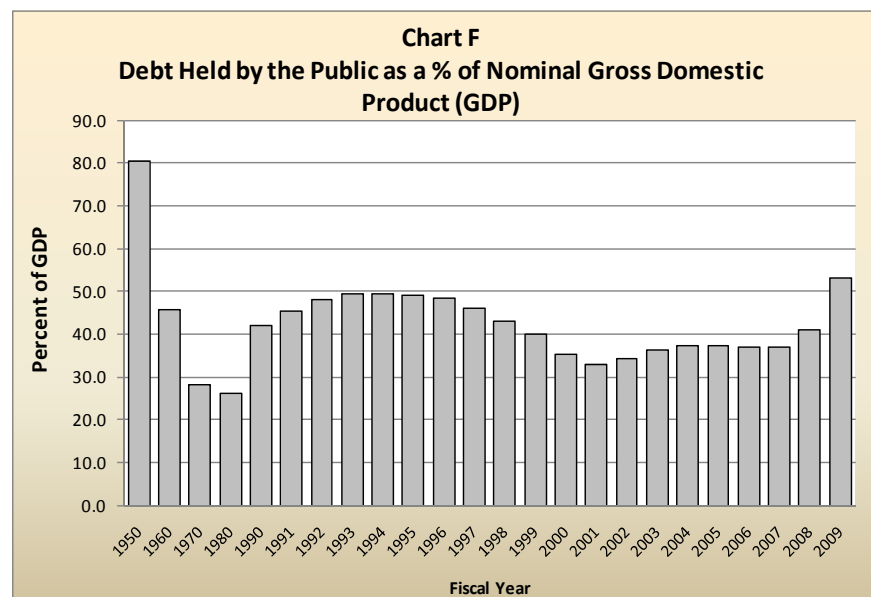
The other major component of the Government's liabilities is Federal employee postemployment and veteran benefits payable, which decreased during FY 2009, from \$5,318.9 billion to \$5,283.7 billion. As indicated earlier, this decrease was due largely to future benefit liability reestimates made by VA (\$149 billion decrease), offset by benefit liability increases for current military and civilian government employees. Civilian benefits payable accounts for more than a third of the Federal Employee and Veterans Benefits liability. The Office of Personnel Management (OPM) administers the largest civilian pension plan, covering nearly 2.6 million current employees and over 2.5 million annuitants.<sup>5</sup> The military pension plan covers over 2.3 million current military personnel (including active service, reserve, and National Guard) and approximately 2.2 million retirees and annuitants.<sup>6</sup>



Environmental and disposal liabilities stayed relatively constant at about \$342 billion as of September 30, 2009. The majority of these types of liabilities are attributable to the Departments of Defense and Energy for the clean-up of radioactive waste and other nuclear material stored at former testing and storage sites.

### Federal Debt

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



The Government's borrowings from the public, including accrued interest, increased by \$1.7 trillion in FY 2009. As indicated, 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

<sup>5</sup> OPM FY 2009 Civil Service Disability Fund Report; OPM FY 2009 Performance and Accountability Report, p. 2.

<sup>6</sup> DoD FY 2009 Agency Financial Report, p. 5; DoD Military Retirement Fund (MRF) financial statements, p. 9.



imply. Each year, trillions of dollars of debt matures and new debt takes its place. In FY 2009, new borrowings were \$8.9 trillion and repayments of maturing debts held by the public were \$7.2 trillion. Both represented substantial increases over new borrowings and debt repayments for FY 2008, respectively.

Historically, the Government has incurred debt when it borrows from the public to finance budget deficits. The economic recovery efforts of the past year have precipitated a need to borrow additional funds from the public. However, part of this increase has financed investments that the Government expects to ultimately recover in whole or in part.

The Government's publicly held debt, or debt held by the public, totaled approximately \$7.6 trillion at the end of FY 2009, and was held by the public in the form of Treasury securities, such as bills, notes, and bonds, and accrued interest payable. The 'public' consists of individuals, corporations, state and local governments, Federal Reserve Banks, foreign governments, and other entities outside the Government. Debt held by the public is a balance sheet liability.

In addition to debt held by the public, the Government has outstanding nearly \$4.4 trillion in intragovernmental debt, which arises when one part of the Government borrows from another. It represents debt issued by the Treasury and held by Government funds, including the Social Security (\$2.5 trillion) and Medicare (\$372 billion) trust funds. Intragovernmental debt is primarily held in Government trust funds in the form of special nonmarketable securities by various parts of the Government. Laws establishing Government trust funds generally require excess trust fund receipts to be invested in these special securities. Because these amounts are both liabilities of the Treasury and assets of the Government trust funds, they are eliminated as part of the consolidation process for the governmentwide financial statements (see Note 14 of the Report). When those securities are redeemed, e.g., to pay future Social Security benefits—the Government will need to obtain the resources necessary to reimburse the trust funds.

The sum of debt held by the public and intragovernmental debt equals gross Federal debt, which (with some adjustments) is subject to a statutory ceiling (i.e., the debt limit). 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. The statutory limit has been increased roughly 100 times since it was established, and always in time to prevent the United States from defaulting on its debt or other statutory obligations. Congress raised the debt limit twice during FY 2009 – from \$10.6 trillion to \$11.3 trillion in October 2008 with the passage of the Emergency Economic Stabilization Act of 2008 (EESA), and again to \$12.1 trillion in February 2009 with the passage of the American Recovery and Reinvestment Act of 2009 (ARRA). At the end of FY 2009, the amount of debt subject to the limit was \$11.9 trillion, \$250.9 billion under the limit. In December 2009, the limit was raised to \$12.4 trillion, and in February 2010, it was increased again to \$14.3 trillion. If overall budget deficits continue, the Government may have to borrow more from the public in order to finance program needs and pay interest on debt held by the public. Instances where debt held by the public increases faster than the economy for extended periods can pose additional challenges.

The Federal debt held by the public as a share of GDP (Chart F above) compares the country's debt level to the size of its economy. Beginning in the late 1970s, increasing budget deficits spurred an increase in debt held by the public, which essentially doubled as a share of GDP over a 15-year period, reaching about 50 percent in 1993. The tax increases and spending reductions instituted by the Congress and the President and reinforced by improved budget enforcement mechanisms, 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 debt held by the public, (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 because of increased spending for homeland security, defense, and wars; a recession-induced decline in receipts; tax cuts; increases in some entitlement benefits; and the expiration of the budget controls established in the late 1990s. The debt held by the public-to-GDP ratio ranged from 35 to 37 percent for most of the last decade. In 2009, the ratio rose to 53 percent, the highest level in nearly 50 years, as the severe economic downturn and the policy measures taken to help the economy caused the unified deficit to rise sharply in 2008 and even more so in 2009.

## **Statement of Social Insurance – A Current Look at a Possible Future**

For the 'social insurance' programs -- Social Security, Medicare, Railroad Retirement, and Black Lung - the Statement of Social Insurance (SOSI) reports: (1) the actuarial present value of all future program revenue (mainly taxes and premiums) - excluding interest - to be received from or on behalf of current and future participants; (2) the estimated future scheduled expenditures to be paid to or on behalf of current and future participants; and (3) the

difference between (1) and (2). Amounts reported in the SOSI and in the supplemental information in this report are based on each program's official actuarial calculations. By accounting convention, the general revenues are eliminated in the consolidation of the financial statements at the governmentwide level and as such, the general revenues that are used to finance Medicare Parts B and D are not included in these calculations even though the expenditures on these programs are included.

The SOSI provides perspective on the Government's long-term estimated exposures and costs for social insurance programs. Table 7 summarizes amounts reported in the SOSI. From Table 7, net social insurance expenditures are projected to be approximately \$46 trillion as of January 1, 2009 for the 'Open Group'.<sup>7</sup> While these expenditures are not considered Government liabilities, they do have the potential to become expenses and liabilities in the future, based on the continuation of the social insurance programs' provisions contained in current law.

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

The long-run financial condition of Medicare and Social Security is analyzed annually in the Medicare and Social Security Trustees' Reports. Spending on Medicare is projected to rise from its pre-recession level of 3.2 percent of GDP to 6.4 percent in 2030 and 8.7 percent in 2050. Spending on OASDI is projected to rise from 4.4 percent in 2008 to 6.1 percent in 2030, before retreating to 5.8 percent in 2050.<sup>8</sup> Given that revenues for these programs are not projected to rise over time as a share of GDP, it is apparent that these programs are on a fiscally unsustainable path.

The preceding section has focused on the financial results for the Federal Government for FY 2009. The following section discusses the Government's economic recovery efforts and provides additional perspective on the issue of fiscal sustainability.

**Table 7: Social Insurance Future Expenditures in Excess of Future Revenues**

Dollars in Billions	2009		2008		Increase / (Decrease)	
	\$	%	\$	%	\$	%
<b>Open Group (Net):</b>						
Social Security (OASDI)	\$ (7,677)		\$ (6,555)		\$ 1,122	17%
Medicare (Parts A, B, & D)	\$ (38,107)		\$ (36,312)		\$ 1,795	5%
Other	\$ (94)		\$ (104)		\$ (10)	-9%
<b>Total Social Insurance Expenditures, Net (Open Group)</b>	<b>\$ (45,878)</b>		<b>\$ (42,970)</b>		<b>\$ 2,908</b>	<b>7%</b>
<b>Total Social Insurance Expenditures, Net (Closed Group)</b>	<b>\$ (52,145)</b>		<b>\$ (49,135)</b>		<b>\$ 3,010</b>	<b>6%</b>
<b>Social Insurance Net Expenditures as a % of Gross Domestic Product (GDP)*</b>						
<b>Open Group</b>	<b>2009</b>		<b>2008</b>			
Social Security (OASDI)	-1.0%		-0.9%			
Medicare (Parts A, B, & D)	-4.8%		-4.6%			
Other	0.0%		0.0%			
<b>Total (Open Group)</b>	<b>-5.8%</b>		<b>-5.4%</b>			
<b>Total (Closed Group)</b>	<b>-6.6%</b>		<b>-6.2%</b>			

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

\* Social Insurance values as reported in the Statement of Social Insurance. GDP values from the 2009 Social Security and Medicare Trust Fund Reports represent the present value of GDP over the 75 year projection period.

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

<sup>7</sup> 'Closed' Group and 'Open' Group differ by the population included in each calculation. From the SOSI, the 'Closed' Group includes: (1) participants who have attained eligibility and (2) participants who have not attained eligibility. The 'Open' Group adds future participants to the 'Closed' Group. See 'Social Insurance' in the Supplemental Information section in this report for more information.

<sup>8</sup> The Medicare Trustees' Report shows that, under current law, the Hospital Insurance Trust Fund will not have sufficient funds to pay scheduled benefits beginning in 2017. At that point, trust fund income would still be able to cover only 81 percent of scheduled benefits, but this share would fall to about 29 percent in 2083. The Social Security Trust Funds similarly face a long-run shortfall. Under current law, the OASDI Trust Funds will be exhausted in 2037, though revenues would still be sufficient to pay 76 percent of scheduled benefits in 2037 and 74 percent in 2083.

## Economic Recovery and Fiscal Sustainability

This section discusses the many important recovery efforts that have been initiated by the Department of the Treasury and across the Government. In addition, while economic recovery is the current priority, this section also addresses the ongoing challenge of sustaining the Nation's important Social Insurance entitlement programs.

### The Economy in Fiscal Year 2009

A review of the Nation's key economic indicators can add context to the discussion of the Government's financial results. As summarized in Table 8, the economic recession that began during FY 2008 intensified in the first half of FY 2009. Economic activity contracted sharply in the first two quarters of FY 2009. While economic production began to rise again during the last quarter of the fiscal year, employment continued to fall. By the end of FY 2009, 8 million jobs had been lost since the beginning of the recession.

After showing little change in FY 2008, real GDP growth fell at an annual average rate of 2.6 percent over the four quarters of FY 2009. Quarterly performance was sharply negative in the first and second quarters of FY 2009, with real GDP falling 5.4 percent and 6.4 percent, respectively. However, the pace of contraction eased in the third quarter, and in the final quarter of FY 2009, real GDP grew 2.2 percent at an annual rate.

	<b>FY 2009</b>	<b>FY 2008</b>
Real GDP Growth	-2.6%	0.03%
Residential Construction Growth	-18.9%	-22.6%
Average monthly payroll job change (thousands)	-468	-77
Unemployment rate (percent, end of period)	9.8%	6.2%
Consumer Price Index	-1.3%	4.9%
CPI, excluding food and energy	1.5%	2.5%
Treasury constant maturity 10-year rate (end of period)	3.3%	3.9%
Moody's Baa bond rate (end of period)	6.20%	7.85%

\*Some FY 2008 data may differ from FY 2008 Report due to update and revision.

Employment fell throughout FY 2009, although the pace of job losses began to taper off noticeably by the end of the year. Nonetheless, the unemployment rate rose from 6.2 percent in September 2008 to 9.8 percent in September 2009. Consumer price inflation fell, due to declines in energy prices from the previous year's record levels and slack in the economy, as well as slowing growth in food prices. Underlying inflation (the core rate, excluding food and energy) fell. Coupled with modest nominal wage gains, declines in prices produced some of the strongest real wage gains seen since early 1972. The level of corporate profits declined in FY 2009 over the previous fiscal year. On a quarterly basis, however, profits rose in each of the fiscal year's last three quarters after the first quarter's steep decline. Federal tax receipts declined and spending growth accelerated sharply in FY 2009. As a result, the Federal unified budget deficit jumped to \$1,417 billion, or about 10 percent of GDP (compared with 3.2 percent in FY 2008).

The following key points summarize economic performance in FY 2009:

- After falling by 0.7 percent in FY 2008, consumer spending declined 0.2 percent over the four quarters of FY 2009, reflecting a mixed pattern of growth during the year, including a 2.8 percent increase in consumption during the final quarter.
- Residential fixed investment fell sharply once again over the four quarters of FY 2009, although a sizable rebound was recorded in the final quarter of the fiscal year. Unlike the previous fiscal year, nonresidential fixed investment also fell, although the pace of decline slowed as the year progressed.
- Labor market conditions deteriorated markedly during much of FY 2009. Nonfarm payroll employment declined at an average rate of 468,000 jobs per month in FY 2009, compared with the 77,000 average increase in jobs per month in FY 2008. From the employment peak in December 2007 through the end of FY 2009, the number of unemployed persons doubled, rising from 7.7 million to 15.2 million in September.
- The pace of job loss slowed over the course of the fiscal year; in the first half, nonfarm payroll employment declined at an average rate of 622,000 jobs per month, versus 314,000 jobs per month in the second half.

- The unemployment rate rose significantly during FY 2009, reaching 9.8 percent at the end of the fiscal year, compared with 6.2 percent at the end of FY 2008.
- The overall price level, as measured by the consumer price index (CPI), fell 1.3 percent during FY 2009 as energy prices retreated after a surge in the prior year. The negative inflation rate in FY 2009 was a stark contrast with the 4.9 percent rise in prices during the 12 months of FY 2008. Core inflation (which excludes food and energy) remained well-contained, slowing to 1.5 percent in FY 2009 versus 2.5 percent in FY 2008.
- Financial market turbulence persisted through the first half of FY 2009, but by fiscal year's end, conditions had stabilized and some measures of financial risk had returned to pre-crisis levels.
  - Corporate debt yields on bonds of moderate risk ballooned to a peak of over 600 basis points above the rate on 10-year Treasury securities in December 2008, compared with a spread of about 300 basis points six months earlier; by September 2009, however, this spread had narrowed to roughly 280 basis points.
  - The difference between the 3-month London Interbank Offered Rate (LIBOR)<sup>9</sup> and the 3-month Treasury rate shot up to a peak of 457 basis points in October 2008 (after averaging less than 50 basis points in 2006 and much of 2007), but had narrowed to less than 20 basis points by the end of September 2009.

### **The Economic Recovery Effort: The Road to Stability**

The severity of the recent financial crisis reflected long-term structural changes that had made the financial system significantly more fragile. Financial intermediation and risk taking grew rapidly in the relatively stable economic environment that preceded the crisis, while rising asset prices hid weak underwriting standards and masked growing leverage throughout the system. Further, risk management systems did not evolve at the pace of financial innovation, which was being driven in part by rapid improvements in information technology. Securitization expanded, allowing for more credit to rely on securities markets. This financial innovation made the system both more interconnected and opaque. The regulatory system was ill-prepared to handle the rapid growth of complex financial activity. In addition, unregulated markets and structures provided an increasing share of short-term credit to fund long-term assets. Such gaps and weaknesses in the supervision and regulation of financial firms presented challenges to the Government's ability to monitor, prevent, or address risks as they built up in the financial system.

Starting in 2007, unanticipated mortgage-related losses weakened the balance sheets of major institutions, thereby reducing their capacity to provide credit and liquidity support to the economy and the rest of the financial system. Given the interconnections throughout the system, problems at individual institutions severely compromised confidence in the system as a whole, both in the United States and abroad. These pressures became acute as FY 2009 approached, as evidenced by the need to put Fannie Mae and Freddie Mac into conservatorship, the failure of Lehman Brothers, and significant problems at American International Group (AIG). In response, the Treasury Department, the Federal Reserve, the Federal Deposit Insurance Corporation (FDIC), and other U.S. government bodies took decisive action to help stabilize financial markets and the nation's economy, and to pull the financial system back from the brink of systemic collapse.

#### **HERA**

In July 2008, the Housing and Economic Recovery Act of 2008 (HERA) was enacted. HERA established a new regulatory agency: the Federal Housing Finance Agency (FHFA) with enhanced regulatory authority over the housing Government Sponsored Enterprises (GSEs),<sup>10</sup> including the capital requirements and business activities of Fannie Mae and Freddie Mac. HERA also provided the Treasury Secretary with temporary authority to purchase any obligations and other securities issued by the housing GSEs. FHFA placed Fannie Mae and Freddie Mac under conservatorship in September 2008 in order to preserve GSE assets and restore the GSEs to a sound and solvent financial condition.

Pursuant to HERA, the Treasury Department took three additional steps to help ensure the solvency and liquidity of the GSEs:

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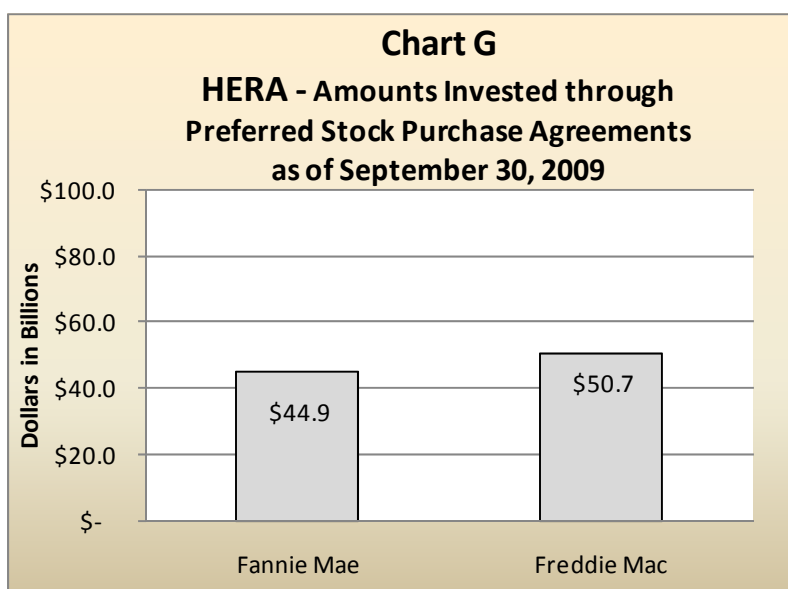
<sup>9</sup> LIBOR is the interest rate at which banks can borrow funds from other banks in the London interbank market. Set daily by the British Bankers' Association, it is the most widely used benchmark for short-term interest rates.

<sup>10</sup> The housing GSEs (Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System) are chartered by the Federal Government and pursue a federally mandated mission to support housing finance. Some GSEs are distinctly established as corporate entities - owned by shareholders of stock traded on the New York Stock Exchange. The obligations of the housing GSEs are not guaranteed by the Federal Government, however, Treasury's actions under HERA provided significant financial support to the GSEs.

- entering into senior preferred stock purchase arrangements (SPSPAs) with Fannie Mae and Freddie Mac;
- establishing a GSE credit facility; and
- establishing a GSE mortgage-backed securities (MBS) purchase program.

The SPSPAs enable Treasury to provide the financing necessary for the GSEs to maintain a positive net worth. They were designed to instill confidence in investors that Fannie Mae and Freddie Mac would remain viable entities critical to the functioning of the housing and mortgage markets. Investors purchased securities issued or guaranteed by Fannie Mae and Freddie Mac in part because ambiguities in how they operated (e.g., public mission, line of credit with Treasury, tax exemptions, no SEC filing requirement) created a perception of government backing. These perceptions fostered enormous growth in the obligations issued or guaranteed by Fannie Mae and Freddie Mac which, by the scale and breadth of their public holdings, eventually posed a systemic risk to global financial markets in the event of their failure. The focus of the SPSPAs is to enhance market stability by providing additional confidence to holders of Fannie Mae and Freddie Mac securities and to avoid a mandatory triggering of receivership. Because of the central role of Fannie Mae and Freddie Mac in the housing finance markets and the central importance of the stability of those markets, the U.S. Government had a responsibility to avert the catastrophic failure of these institutions and maintain stability in the housing markets.

The SPSPAs provide that the Government will make funding advances to the GSEs if, at the end of any quarter, the Federal Housing Finance Agency (FHFA), acting as the conservator, determines that the liabilities of either GSE, individually, exceed its respective assets. As shown in Chart G, as of September 30, 2009, actual payments to the GSEs totaled \$95.6 billion. In addition, as of September 30, 2009, Treasury accrued \$91.9 billion as a liability for liquidity commitments. In May 2009, Treasury's financial liquidity commitment under the SPSPAs was increased from an initial amount of \$100 billion per GSE to \$200 billion per GSE to provide additional confidence to the financial markets.



In December 2009, Treasury announced that it would replace the existing fixed \$200 billion per GSE cap with a formulaic cap for the next three years that will adjust upwards quarterly by the cumulative amount of any losses realized by either Fannie Mae or Freddie Mac and downwards by the cumulative amount of any gains, but not below \$200 billion per GSE.

The SPSPAs, together with the placement of the GSEs into conservatorship by the FHFA, helped prevent the deteriorating condition of the GSEs from causing a systemic disruption to the housing market and the financial system. The SPSPAs have helped ensure that Fannie Mae and Freddie Mac can continue to fulfill their critical role in the mortgage market by providing liquidity and stabilizing the market. The importance of the GSEs in the mortgage market and overall financial markets has developed over many years, and the Administration is committed to setting forth policies on the future of the GSEs and the Federal Government's role in the mortgage market.

The GSE MBS Purchase Program was created to help support the availability of mortgage credit by temporarily providing additional capital to the mortgage market. By purchasing those securities, Treasury has sought to broaden access to mortgage funding for current and prospective homeowners as well as to promote market stability. As of September 30, 2009, Treasury held about \$184.5 billion in GSE MBS during FY 2009 and received back \$27.2 billion in principal and interest on GSE MBS it had purchased.<sup>11</sup> This activity, combined with purchases by the Federal Reserve, has helped bring down mortgage rates to historically low levels and provide liquidity and stability to housing markets. The financial support provided by the SPSPAs will continue beyond December 31,

<sup>11</sup> In the first three months of FY 2010, through December 31, 2009, Treasury purchased an additional \$29.9 billion in MBS securities, and received back an additional \$9 billion in principal and interest. No further purchases were made after December 31, 2009.

2009. The GSE MBS purchase program and GSE credit facility, established by Treasury under HERA, expired on December 31, 2009.

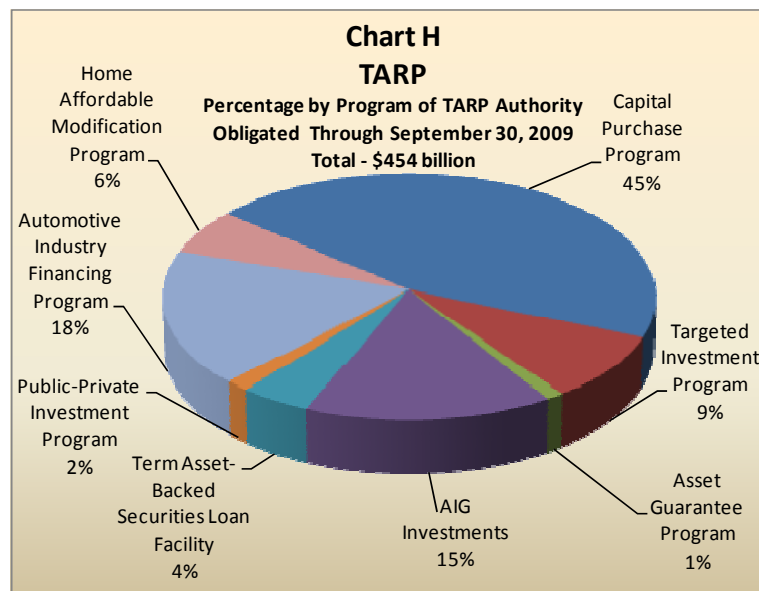
HERA also established the HOPE for Homeowners Program,<sup>12</sup> which provides another means of helping borrowers faced with foreclosure refinance through the Federal Housing Administration. As the economy continued to suffer during FY 2009 despite these actions, there was still a pressing need to address the more systemic challenges posed by the credit crisis.

### EESA, TARP, and the Office of Financial Stability

In the early days of the financial crisis, the Government's policy response was led by the Federal Reserve,<sup>13</sup> and, to a lesser extent, the FDIC. Before September 2008, the Federal Reserve was providing sorely needed liquidity to many financial institutions, which allowed them to meet near-term obligations. The FDIC was insuring deposits, which helped quell bank runs, and it was resolving troubled depository institutions, such as IndyMac. But when stress in the system dramatically intensified in the wake of the Lehman failure, investor confidence collapsed. A different sort of policy response was needed.

The Federal Reserve does not have the authority to directly inject capital into banks and other financial institutions. Although it has expanded the scope of eligible borrowers and collateral over the past few years, the Federal Reserve's liquidity provision is confined to secured lending against good collateral. By comparison, the FDIC has a broader toolset in some respects—including the ability to inject capital or to purchase or guarantee liabilities—but only for depository institutions. This proved to be a stabilizing factor, but in the fall of 2008, the crisis spread well beyond traditional banks. Investors feared that U.S. financial institutions needed, in the aggregate, hundreds of billions of dollars to offset potential credit losses.

In this context, the passage of the Emergency Economic Stabilization Act of 2008 (EESA) and the creation of the Troubled Asset Relief Program (TARP) were essential. EESA gave the Secretary of the Treasury temporary authority to purchase and guarantee assets in a wide range of financial institutions. In addition, the Secretary is directed to ensure that such authorities are used in a manner that protects home values, college funds, retirement accounts, and life savings; preserves homeownership; promotes jobs and economic growth; maximizes overall returns to taxpayers; and provides public accountability. It also provided specific authority to take certain actions to prevent avoidable foreclosures. And finally, it established the Office of Financial Stability in the Department of the Treasury (Treasury-OFS) to oversee and manage the many recovery initiatives and programs.



EESA provided authority for the TARP to purchase or guarantee up to \$700 billion of troubled assets.<sup>14</sup> Treasury-OFS used this authority to help strengthen the U.S. financial system, restore health and liquidity to credit markets to facilitate borrowing by consumers and businesses, and prevent avoidable foreclosures in the housing market. While the TARP should be evaluated primarily based on its impact on stabilizing the financial system, a critical factor in the analysis is cost. While EESA authorized Treasury to borrow funds from the public to purchase

<sup>12</sup> HOPE for Homeowners is a voluntary program for the refinancing of distressed loans by providing Federal Housing Administration insurance for refinanced loans that meet certain eligibility requirements. Both borrower and lender must agree to participate in the program.

<sup>13</sup> The Federal Reserve is an independent organization and not considered a part of the Federal reporting entity. As such, their financial results are not consolidated into the Government's financial statements.

<sup>14</sup> The Helping Families Save Their Homes Act of 2009, Pub. L. No. 111-22, Div. A, amended the EESA and reduced the maximum allowable amount of outstanding troubled assets under the act by almost \$1.3 billion, from \$700 billion to \$698.7 billion.

or guarantee up to \$700 billion in troubled assets outstanding at any one time, the TARP has not cost taxpayers \$700 billion. Treasury-OFS used the authority to make investments to help stabilize the financial system and expects that much of the funding will be repaid. While some of the TARP investments are likely to result in a cost, others are estimated to produce net income.

It is important to note that much of the discussion in this section relates to TARP activities during fiscal year 2009 and the TARP assets held as of September 30, 2009. Additional information pertaining to material 'subsequent events' is provided in summary fashion in this section and in greater detail in the notes to the financial statements. For FY 2009, Treasury-OFS reports the following key results:

- Treasury-OFS entered into obligations with a face value of \$454 billion in TARP authority during the fiscal year.
- In FY 2009, Treasury-OFS disbursed \$364 billion in TARP funds to make loans and equity investments, and reported that the net cost of those disbursements, including operating costs, for FY 2009 was about \$41.6 billion.
- During FY 2009, Treasury-OFS received about \$73 billion in repayments on certain investments made early in FY 2009. Subsequent to September 30, 2009, Treasury has received over \$90 billion in additional repayments from TARP participants.
- As of September 30, 2009, Treasury-OFS reported about \$240 billion for the value of loans, equity investments, and asset guarantees.

To guide its efforts in implementing and managing the many TARP programs, Treasury-OFS has formulated the following as its operational goals:

1. Ensure the overall stability and liquidity of the financial system, including: (a) making capital available to viable institutions; (b) providing targeted assistance as needed; and (c) increasing liquidity and volume in securitization markets.
2. Prevent avoidable foreclosures and help preserve homeownership.
3. Protect taxpayer interests.
4. Promote transparency.

#### *1. Ensure the Overall Stability and Liquidity of the Financial System*

To help ensure the overall stability and liquidity of the financial system, Treasury-OFS developed several programs under the TARP that were broadly available to financial institutions. Under the Capital Purchase Program (CPP), Treasury-OFS provided capital infusions directly to banks and insurance companies deemed viable by their regulators but in need of a stronger asset base to weather the crisis. The Capital Assistance Program (CAP) was developed to supplement the Supervisory Capital Assessment Program (SCAP), or "stress test" of the nineteen largest U.S. bank holding companies (BHCs). The stress test assessed whether these BHCs had the capital to continue lending and absorb all potential losses resulting from a more severe decline in economic conditions than projected by economic forecasters. After completion of the SCAP, the banking agencies concluded that ten of these BHCs needed to raise a total of an additional \$75 billion in capital to establish a buffer for more adverse conditions. The remaining nine BHCs were found to have sufficient capital to weather more adverse market conditions. If these institutions were unable to raise adequate private funds to meet the SCAP requirements, Treasury-OFS stood ready to provide additional capital. Treasury-OFS did not receive any applications for CAP, which terminated on November 9, 2009.

In addition, Treasury-OFS provided direct aid to certain financial industry participants through the Targeted Investment Program and the Asset Guarantee Program, as well as the program originally known as the Systemically Significant Failing Institutions (SSFI) program. These programs were designed to mitigate the potential risks to the system as a whole from the difficulties facing these firms. Because SSFI was used only for investments in American International Group, Inc. (AIG), such investments are now referred to as the AIG Investment Program.<sup>15</sup> Similarly, the Automotive Industry Financing Program provided funding for General Motors Corporation (GM), Chrysler LLC (Chrysler), as well as auto financing companies in order to prevent a significant disruption of the automotive industry, which could have negatively affected the economy. As summarized below, Treasury-OFS'

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<sup>15</sup> Details on AIG transactions and developments may be found in the notes to the financial statements in this Report. Discussion of developments at AIG before and since this Report may be found in the Treasury Secretary's January 27, 2010 testimony before the House Committee on Government Reform and Oversight at <http://www.ustreas.gov/press/releases/tg514.htm>

actions helped GM and Chrysler undertake massive and orderly restructurings through the bankruptcy courts, resulting in leaner and stronger companies.

- On December 31, 2008, Treasury-OFS agreed to make loans of \$13.4 billion to GM to fund working capital. Under the loan agreement, GM was required to implement a viable restructuring plan by March 30, 2009. The Administration determined that GM's first submitted plan failed to establish a credible path to viability, and the deadline was extended to June 1, 2009. Treasury-OFS loaned an additional \$6 billion to fund GM during this period. To achieve an orderly restructuring, GM filed bankruptcy proceedings on June 1, 2009. Treasury-OFS provided \$30.1 billion under a debtor-in-possession financing agreement to assist GM through the restructuring period. The new entity, General Motors Company (New GM), purchased most of Old GM's assets and began operating on July 10, 2009. Treasury-OFS converted most of its loans to the Old GM to \$2.1 billion of preferred stock and a 60.8 percent share of the common equity in the New GM. Also, New GM assumed \$7.1 billion of the Old GM loans due to Treasury-OFS, of which \$0.4 billion had been repaid as of September 30, 2009.
- On January 2, 2009, Treasury-OFS loaned \$4 billion to Chrysler. On March 30, 2009, the Administration determined that the business plan submitted by Chrysler failed to demonstrate viability and announced that in order for Chrysler to receive additional taxpayer funds, it needed to find a partner with whom it could establish a successful alliance. Chrysler made the determination that forming an alliance with Fiat was the best course of action for its stakeholders. Treasury-OFS continued to support Chrysler as it formed an alliance with Fiat. In connection with Chrysler's bankruptcy proceedings filed on April 30, 2009, Treasury-OFS provided an additional \$1.9 billion under a debtor-in-possession financing agreement to assist Chrysler in an orderly restructuring. On June 10, 2009, substantially all of Chrysler's assets were sold to the newly formed entity, Chrysler Group LLC (New Chrysler). Treasury-OFS committed to loan \$6.6 billion to New Chrysler in working capital funding, and as of September 30, 2009, New Chrysler had drawn \$4.6 billion of this amount. As of September 30, 2009, Treasury-OFS had a \$7.1 billion debt security (i.e., \$6.6 billion commitment and \$0.5 billion of the original \$4.0 billion loan assumed by New Chrysler) from and held 9.9 percent of the equity in New Chrysler. The original \$4 billion in loans to Chrysler remains outstanding, but has been reduced by \$0.5 billion of debt that was assumed by New Chrysler.

The Public-Private Investment Program (PPIP) was established to facilitate price discovery and liquidity in the markets for troubled real estate-related assets as well as the removal of such assets from the balance sheets of financial institutions. In addition to these initiatives, Treasury-OFS implemented the Consumer and Business Lending Initiative (CBLI) to enhance liquidity and restore the flow of credit to consumers and small businesses. The primary program through which the CBLI operated in 2009 was the Term Asset-Backed Securities Loan Facility (TALF). Through this combination of tools, the TARP helped strengthen a broad set of financial institutions and the financial markets.

## *2. Prevent Avoidable Foreclosures and Help Preserve Homeownership*

To prevent avoidable foreclosures and preserve homeownership, Treasury used authority granted under EESA to establish the Home Affordable Modification Program (HAMP) in February 2009. Other government policies have helped keep home mortgage rates at historic lows and allow millions of Americans to refinance and stay in their homes. But because of falling housing prices, many responsible homeowners are unable to refinance. Meanwhile, job losses and reductions in working hours and benefits are making it harder for these Americans to pay their mortgages. HAMP provides incentives to mortgage servicers, investors, and homeowners to work together to reduce an eligible homeowner's monthly payments to levels that are affordable in light of the homeowner's current income.

## *3. Protect Taxpayer Interests*

Government financial programs, including TARP, helped prevent a collapse of the U.S. financial system, which could have resulted in much more severe contraction in employment and production. The manner in which TARP was implemented is also designed to protect taxpayers and to compensate them for risk. For example, in exchange for capital injections, recipients of TARP funds have to adhere to corporate governance standards, limit executive pay, and provide additional reporting on lending activity. In addition, Treasury-OFS generally received preferred equity, which provides dividends. The dividend rates increase over time to encourage repayment.

Further, EESA stipulated that the taxpayer benefit as the institutions which received TARP funds recovered. In connection with most investments, Treasury-OFS also receives warrants or additional notes for additional securities in the institutions. This gives taxpayers the ability to share in the potential upside along with existing



shareholders. Finally, the Treasury-OFS seeks to achieve the goal of protecting the taxpayer through the effective management and disposition of all TARP investments.

#### 4. Promote Transparency

EESA requires transparency and accountability. Specifically, EESA reporting requirements include a monthly report from Treasury-OFS to Congress on TARP activity, a “tranche” report each time Treasury reaches a \$50 billion spending threshold, and transaction reports detailing every TARP transaction within two days of the transaction. In carrying out its operations, Treasury-OFS has sought to not only meet the statutory requirements but also to be creative and flexible with respect to additional transparency initiatives. Treasury-OFS proactively provides to the public monthly Dividends and Interest Reports reflecting dividends and interest paid to Treasury-OFS from TARP investments, loans, and asset guarantees, as well as monthly reports detailing the lending activity of participants in the Capital Purchase Program. These reports are all publicly available on *FinancialStability.gov*.

**Table 9: Troubled Asset Relief Program (TARP) - Summary**  
As of September 30, 2009<sup>1</sup>

Dollars in Billions	Purchase Price or Guaranteed Amounts	Total Disbursed	Investment Repayments	Outstanding Balance	Cash Received From Investments
Capital Purchase Program	\$ 204.6	\$ 204.6	\$ 70.7	\$ 133.9	\$ 9.7
Targeted Investment Program	\$ 40.0	\$ 40.0	\$ -	\$ 40.0	\$ 1.9
Asset Guarantee Program	\$ 5.0	\$ -	\$ -	\$ -	\$ 0.5
AIG Investments	\$ 69.8	\$ 43.2	\$ -	\$ 43.2	\$ -
Term Asset-Backed Securities Loan Facility	\$ 20.0	\$ 0.1	\$ -	\$ 0.1	\$ -
Public-Private Investment Program	\$ 6.7	\$ -	\$ -	\$ -	\$ -
Automotive Industry Financing Program	\$ 81.1	\$ 75.9	\$ 2.1	\$ 73.8	\$ 0.7
Home Affordable Modification Program <sup>2</sup>	\$ 27.1	\$ -	N/A	N/A	N/A
<b>TOTALS</b>	<b>\$ 454.3</b>	<b>\$ 363.8</b>	<b>\$ 72.8</b>	<b>\$ 291.0</b>	<b>\$ 12.7</b>

<sup>1</sup> This table shows the TARP activity for the period ended September 30, 2009 on a cash basis. Cash received from investments includes dividends and interest income reported on Treasury-OFS Statement of Net Cost and proceeds from repurchases of warrants and warrant preferred stock (an instrument that Treasury receives from non-publically traded institutions giving Treasury the right to purchase additional preferred shares).

<sup>2</sup> Reflects legal commitments to servicers as of September 30, 2009. Treasury has allocated \$50 billion in total for the program. Payments are made to servicers once temporary modifications are made permanent.

Table 9 provides a financial summary for TARP programs in FY 2009. For each program, Table 9 gives the face value of the amount obligated by each program, the amount actually disbursed during the fiscal year, repayments to Treasury-OFS during the period from program participants, net outstanding balance (the amount on the original investment that is due to be repaid to Treasury) on September 30, 2009, and cash inflows on the investments for each program in the form of dividends, interest or other fees.

During the period ended September 30, 2009, the Treasury-OFS disbursed \$364 billion, most of it in the form of investments, and \$73 billion of those TARP funds have already been repaid as of September 30. As of September 30, 2009, the total amount of investment dollars outstanding for the TARP programs at the end of FY 2009 was about \$291 billion. In addition, for the period ended September 30, 2009, the investments generated \$12.7 billion in cash received through interest, dividends, and the proceeds from the sale of warrants. For FY 2009, the reported net cost of operations for TARP was approximately \$41.6 billion, including administrative expenses.

Four TARP programs reported gains in FY 2009: the Capital Purchase Program, the Targeted Investment Program, the Asset Guarantee Program, and the Consumer and Business Lending Initiative. These gains were offset by the net cost of the investments in AIG and the automotive companies, bringing the net cost for these programs during FY 2009 to approximately \$41.6 billion. As further disbursements are made in FY 2010 and beyond, the costs of the TARP programs are likely to rise. In particular, the \$50 billion Home Affordable Modification Program or “HAMP,” is not designed to recoup money spent on loan modifications to keep people in their homes. In addition, the Treasury-OFS’ assistance to AIG includes a credit facility on which \$27 billion remained undrawn at fiscal year end, and \$30 billion of investments and loans under the Public-Private Investment Program will largely be recorded beginning in FY 2010.

Subsequent to September 30, 2009, certain TARP participants have repaid approximately \$90 billion to the Treasury and the Asset Guarantee Program was terminated. In December 2009, the Secretary certified the extension of authorities provided under EESA into October 2010.

The ultimate return on the outstanding TARP investments will depend on how the economy and financial markets evolve. Improvement in the economic and financial outlook since the spring of 2009 reflects a broad and aggressive policy response that included the financial stability policies implemented under TARP, efforts to bolster confidence in the housing and mortgage markets under HERA, other financial stability policies implemented by the FDIC and the Board of Governors of the Federal Reserve, accommodative monetary policy, and the American Recovery and Reinvestment Act of 2009.

## ARRA

The American Recovery and Reinvestment Act of 2009

(ARRA) was passed by Congress and signed into law by President Obama on February 17, 2009.

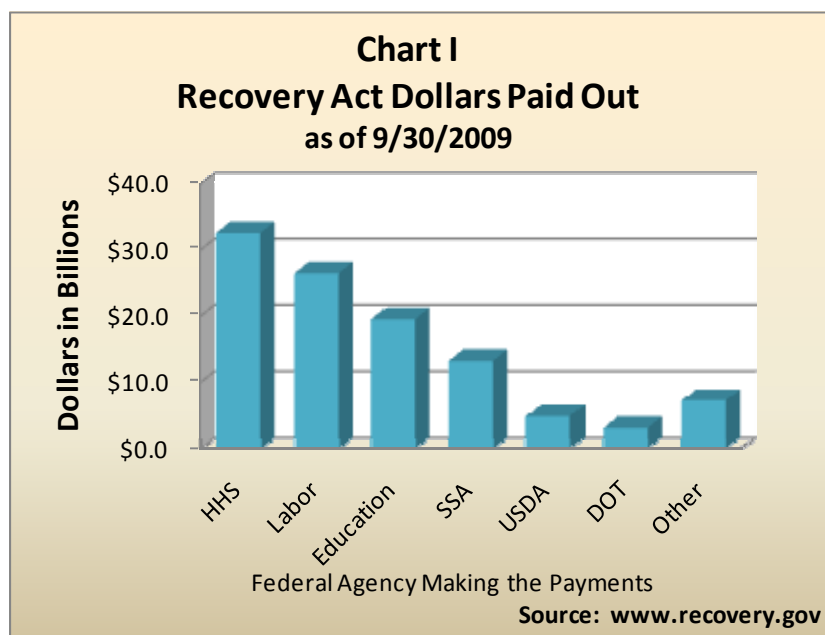
The purpose of the original \$787 billion Recovery package is to jump-start the economy and to create and save jobs.

Approximately one-third of ARRA is dedicated to tax cuts for businesses and working families.

Another third goes toward emergency relief for those who have borne the brunt of the recession. The final third of the Recovery Act is devoted to investments to create jobs, spur economic activity, and lay the foundation for future sustained growth. ARRA provides for unprecedented levels of

transparency and accountability so that the public will know how, when, and where tax dollars are spent.

The website, [Recovery.gov](http://Recovery.gov), is the centerpiece of the President's commitment to transparency and accountability. It features information on how the Act is working, tools to help hold the government accountable and up-to-date data on the expenditure of funds. It is the main vehicle to provide the public with the ability to monitor the progress of the recovery. Chart I summarizes amounts paid out by Federal agencies as of September 30, 2009. It is important to note that amounts spent by the Federal, State, and Local government agencies, as well as by the private sector are constantly changing. Readers may find the most up-to-date information on where and how these funds are being used at [www.recovery.gov](http://www.recovery.gov).<sup>16</sup>



<sup>16</sup> Amounts in Chart I reflect reported activity as of September 30, 2009. These amounts are not reflected explicitly in agency financial statements and are not audited separately as part of the annual agency or consolidated financial statement audits. For more information, see the Recovery Act website at [www.recovery.gov](http://www.recovery.gov).

## The Long-Term Fiscal Outlook: 'Where We Are Headed'

While the Government's immediate priority is to continue to foster economic recovery, it cannot lose sight of the longer term fiscal challenges, including its continued ability to fund the long-term benefits of critical social programs, including Medicare, Medicaid, and Social Security. Persistent growth of health care costs and the aging of the population, especially the onset of retirement of the 'baby boom' generation, pose significant fiscal challenges.

### The Imbalance Between Outlays and Receipts

Spending under current law for Medicare, Medicaid, and Social Security is expected to grow much faster than GDP over the next 75 years as health care costs rise and the population ages. Revenues, on the other hand, are expected to grow only modestly faster than GDP. Together, these two trends imply that without policy changes, the difference between spending and revenues—the budget deficit—will grow as a share of GDP.

Chart J shows historical and estimated program spending and revenue expressed as shares of GDP from 1980 to 2083. Program spending grew rapidly in 2008 and 2009 due to the financial crisis and the recession and the policies necessary to combat both, and is expected to fall in the next few years as the economy recovers. Starting in 2014, however, rising health care costs and the aging population are expected to cause program spending as a share of GDP to rise continuously from 19 percent in 2014 to 25 percent in 2040 and 29 percent in 2080. This reflects the expectation that health care spending per person will continue to grow faster than will the economy as a whole and the movement of the 78 million 'baby boomers' (those born between 1946 and 1964) from work to retirement.

The revenue share of GDP was depressed in 2008 and especially 2009 by the recession and tax changes enacted as part of the 2009 stimulus package. As the economy recovers, the revenue share of GDP is expected to return to historical levels and then grow slightly as increases in real incomes cause larger shares of income to fall into the upper income tax brackets. This extrapolation assumes that Congress and the President will continue to enact legislation that prevents the share of income subject to the Alternative Minimum Tax from rising.

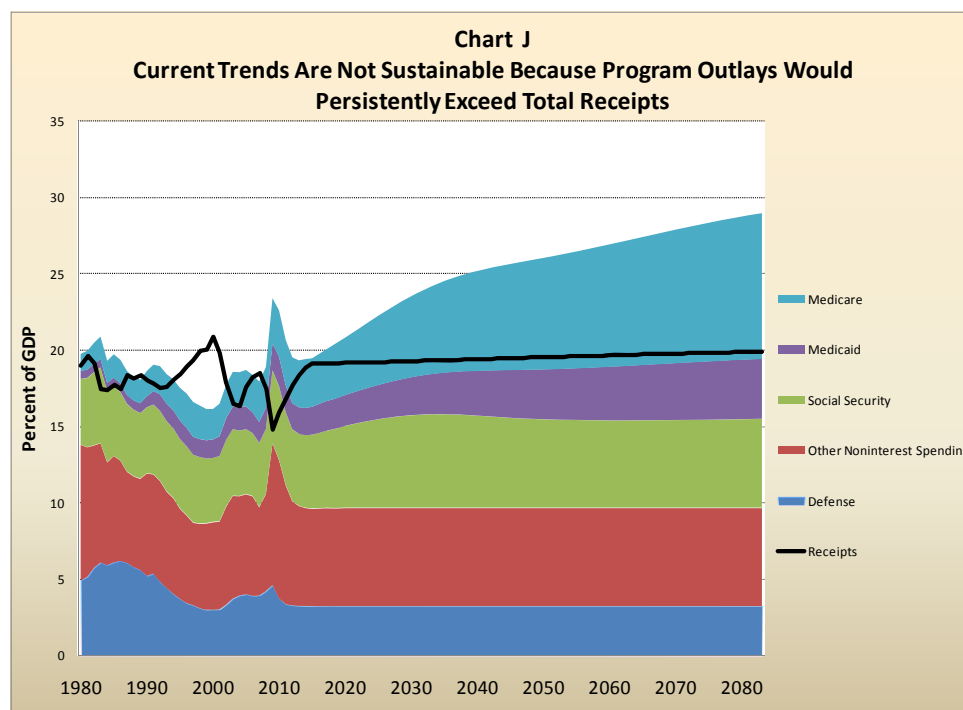


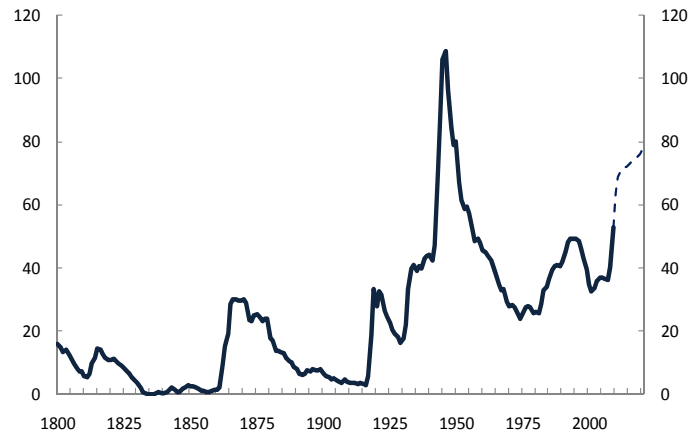
Chart J also illustrates the difference between estimated program spending (spending on mandatory and discretionary programs, excluding interest on debt held by the public) and estimated Government receipts. This difference, known as the primary deficit, is a useful concept because interest spending results from past primary deficits and interest payments on the resulting debt, and can be controlled only through the choice of future primary deficits. To stabilize the debt held by the public-to-GDP (debt-to-GDP) ratio at the projected level of debt-to-GDP when the economy recovers would require roughly a sustained primary balance—a balanced budget excluding interest payments. As such, the chart is also useful for assessing the magnitude of revenue increases or spending

reductions that would be necessary to produce fiscal stability.<sup>17</sup> If policy changes are delayed, the magnitude of the policy changes that would be needed to stabilize the debt-to-GDP ratio would be greater.

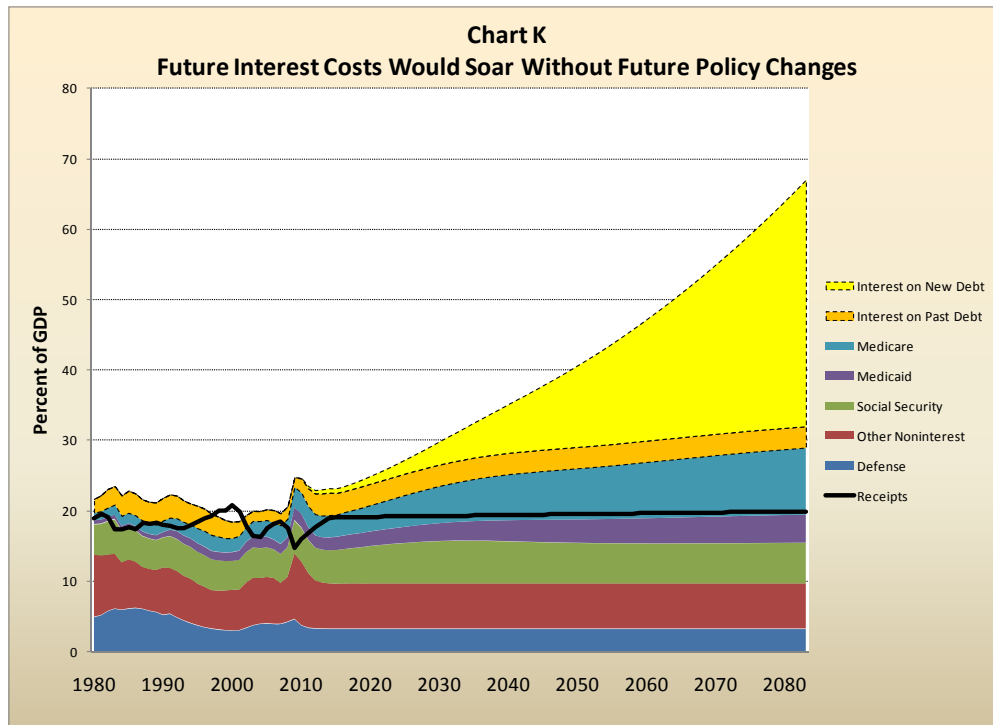
### Net Interest and Debt Held by the Public

Over time, the ratio of Government debt-to-GDP has moved in a wide range (see Figure 1). Before World War I, it was generally below 25% of GDP, and often near zero. But starting with World War I, it grew sharply, reaching 110% of GDP at the end of World War II. The ratio of Government debt-to-GDP came down rapidly in the post-war years, falling below 60% in 1953 and reaching 35% of GDP in 1966. Government debt held by the public grew rapidly from the mid 1970s till the early 1990s. Strong economic growth and fundamental fiscal decisions taken in the early 1990s, including measures to reduce the Federal deficit and implementation of strong "Pay as You Go" ("Paygo") rules, generated a significant reduction in the debt-to-GDP ratio over the course of the 1990s. From a peak of 49 percent of GDP in 1993, the debt-to-GDP ratio fell to 32 percent in 2001. During the last decade, much of this progress was undone as Paygo rules were allowed to lapse, significant permanent tax cuts were implemented, and entitlements were expanded. By September 2008, the debt-to-GDP ratio was 40% of GDP. The extraordinary demands of the current economic and fiscal crisis have pushed up debt held by the public significantly.

Figure 1: Federal Government Debt (Percent of GDP)

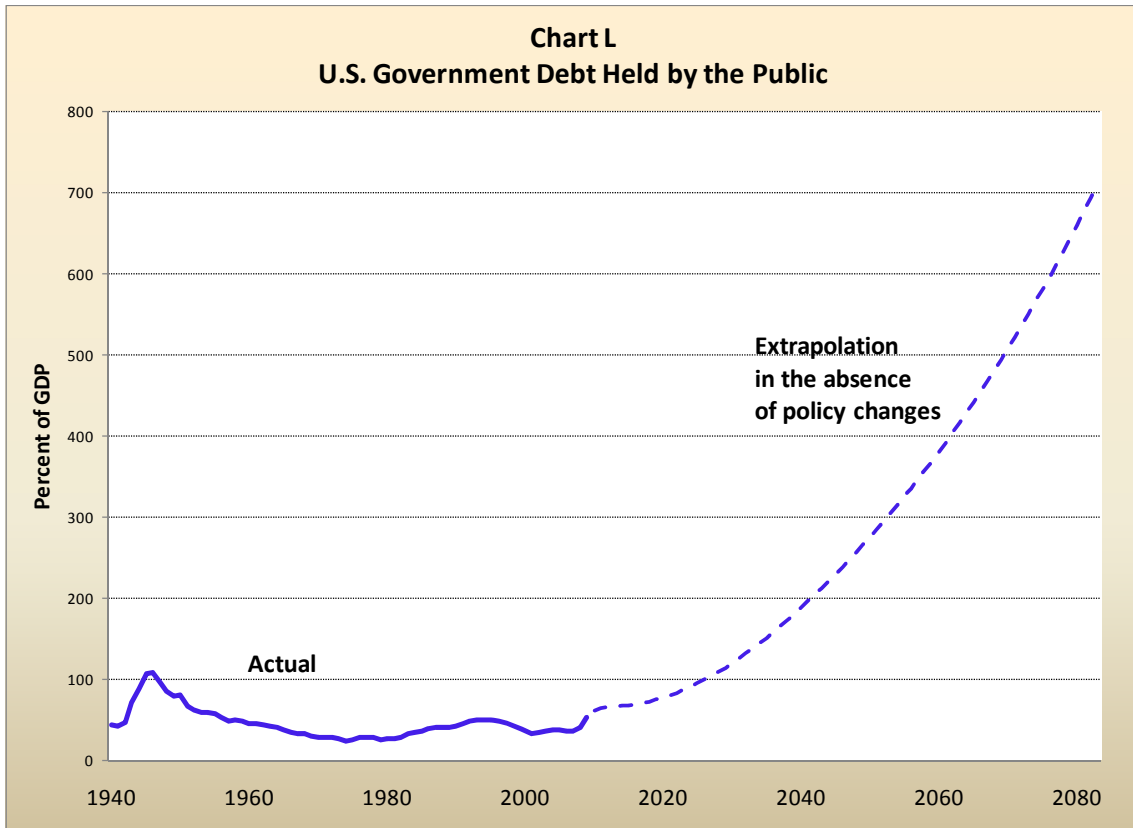


From a peak of 49 percent of GDP in 1993, the debt-to-GDP ratio fell to 32 percent in 2001. During the last decade, much of this progress was undone as Paygo rules were allowed to lapse, significant permanent tax cuts were implemented, and entitlements were expanded. By September 2008, the debt-to-GDP ratio was 40% of GDP. The extraordinary demands of the current economic and fiscal crisis have pushed up debt held by the public significantly.



<sup>17</sup> The conditions for a stable debt-to-GDP ratio also depend on the relationship between the interest rate on Government debt and the growth rate of the economy.

Looking forward, in the absence of policy changes, large and growing primary deficits will increase debt held by the public and related interest on that debt. Chart K shows that net interest expressed as a share of GDP could rise from 1.3 percent in 2009 to 10 percent in 2040 and 35 percent in 2080. Because interest expenses grow so rapidly, the total deficit and debt held by the public grow much more rapidly than does the primary deficit. Extrapolating forward, Chart L shows an extrapolation of increases in the outyears in debt held by the public as a share of GDP if policies remain unchanged. These estimates illustrate that current policies are not sustainable.



## Financial Management Progress and Priorities

The Office of Federal Financial Management (OFFM) within the Office of Management and Budget (OMB) is responsible for the Federal Government's financial management policy and manages government-wide financial management priorities. As required in the Chief Financial Officers Act (31 U.S.C. 3512), OMB is required to provide an annual report on the status of federal financial management and the goals for improvement.<sup>18</sup> This section summarizes recent progress and outlines several key initiatives intended to achieve improved results moving forward.

### Progress To Date

Since the passage of the Chief Financial Officers Act of 1990, the Federal financial community has made important strides in instilling strong accounting and financial reporting practices. Over the past 20 years, an increasing number of Federal agencies have initiated and sustained disciplined and consistent financial reporting operations, implemented effective internal controls around financial reporting, and have successfully integrated transaction processing and accounting records. These efforts have resulted in improved results on financial statement audits, with 20 out of the 24 major "CFO Act" agencies achieving a clean opinion in FY 2009. In addition, the number of auditor-identified material weaknesses stands at 38, an almost 40% decline from the 61 material weaknesses that were identified at the start of this past decade.

A significant accomplishment in FY 2009 was the successful deployment of financial management solutions to meet the emerging challenge of tracking and reporting on economic recovery activities.

- *Troubled Asset Relief Program (TARP)*. In its first full year of operation, the Office of Financial Stability (OFS) within the Treasury Department successfully stood up the necessary financial management solutions to meet the reporting, accounting, and internal control challenges of the complex TARP program. As a result, OFS achieved a clean opinion with no material weaknesses on its first-ever prepared annual financial statements, providing an important indicator to the public that TARP dollars are being effectively accounted for and reported.
- *The American Recovery and Reinvestment Act (ARRA)*. Within days of ARRA's enactment, Federal agencies began successfully reporting weekly updates on ARRA spending on Recovery.gov. In addition, the Federal financial management community partnered with the Recovery Accountability and Transparency Board and other key stakeholders to deploy, within the few short months, a nation-wide data reporting system to collect and report quarterly detailed information on how ARRA dollars are being spent at the local level. Collecting, reviewing, and publishing information on more than 150,000 different awards, the new data collection effort follows Federal dollars in greater depth and detail than previously achieved for most Federal programs.

The foundations for the accomplishments achieved over the past 20 years are numerous. In particular, and as envisioned by OMB Circular A-123, *Management's Responsibility for Internal Control*, the Federal financial management community approached these reporting challenges holistically, integrating both programmatic and financial management disciplines in building successful financial reporting programs. Given the size and complexity of the programs and transactions involved, these results would not have been possible without the advances in Federal financial management.

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<sup>18</sup> The CFO Act requires OMB to submit to Congress an annual "financial management status report," the relevant components of which are included in this Financial Report. Specifically, the "Financial Management Progress and Priorities" section of the MD&A updates and outlines the financial management priorities and planned actions associated with these priorities. Also, specific data on the results of Federal agency financial management efforts (e.g., audit results, material weakness totals, etc.) are included in the Other Accompanying Information Section of this Financial Report.

## Ongoing Challenges

Despite the progress identified above, critical gaps in financial management performance remain. Weaknesses in basic financial management practices continue to prevent four major agencies, and the Government as a whole, from achieving a clean audit opinion. The cost of maintaining effective financial operations is increasing, driven largely by the growing and unacceptably high costs agencies are incurring to modernize agency financial systems. While Federal agencies have mobilized resources to meet the new and growing demand for real-time transparency into where recovery-related and other Federal dollars are going, more work is necessary to sustain these solutions in a cost-effective manner over the long term. Federal agencies made nearly \$100 billion in improper payments in FY 2009 and continue to maintain thousands of unneeded real property assets on their books. These instances of Government waste compromise the integrity of Federal programs, lead to damaging inefficiencies, and erode citizens' trust in Government.

## Improvement Initiatives

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

- **Eliminating Waste** – Efforts to cut Government waste should be prioritized through renewed focus and emphasis on eliminating improper payments, removing unneeded real property from the Government's books, and strengthening the audit framework for Federally-funded State and local activities.
- **Closing the Efficiency and Technology Gap in Financial Operations** – Expensive and long-term investments in technology solutions to support financial reporting and accounting must be reconsidered in favor of shorter-term, lower cost, and easier to manage solutions that meet critical business needs, drive operational efficiency, and leverage shared service solutions.
- **Promoting Accountability and Innovation through Open Government** – Efforts should be directed towards improving the content and quality of currently reported information to provide better value to taxpayers and Government decision-makers. Further, solutions must be developed and deployed in partnerships that extend beyond the borders of the Federal financial management community, to involve Federal and State stakeholders, and most critically, members of the public.

### Eliminating Waste

- *Addressing Improper Payments.* The Improper Payments Information Act of 2002 (IPIA) created a framework for assessing every Federal program and dollar for risk of improper payments, annually measuring the accuracy of payments, and initiating improvements to ensure that errors are reduced and eliminated. Based on information submitted by agencies in their FY 2009 Performance and Accountability Reports, the Government-wide error rate is five percent or roughly \$100 billion. This is the highest amount reported to date, in part due to better controls to identify and report improper payments. In response, the President issued Executive Order 13520, Reducing Improper Payments, to boost transparency of these errors, increase agency accountability through the designation of a Senate-confirmed official responsible for these errors, and create incentives for compliance for contractors and State and Local Government partners. Specifically, agencies will define and publish new metrics to provide information on root causes of error (e.g., Unemployment Insurance recipients that failed to report that they returned to work) and whether corrective actions to reduce errors are successful. Further, we are considering regulatory changes that could allow States that meet established reduction targets retain a portion of recovered improper payments or be subject to relaxed limits on the amount of Federal funds that can be used to cover the State's administrative expenses.
- *Renewing Efforts to Better Manage Federal Real Property.* The Administration is focused on improving the management of real property assets. We support creating incentives to dispose of unneeded Federal real property, including the incentive for all Federal agencies to retain net proceeds from the sale of excess property. In addition to accelerating current effort to dispose of the approximate 15,000 surplus assets on the Federal inventory, new opportunities to make the real property inventory more efficient are also emerging. Under *Executive Order 13514, Federal Leadership in Environmental, Energy, and Economic Performance*, the Federal Government is required to set aggressive goals to "green" the Government and make it more energy

efficient. This order is an opportunity to go beyond “greening” Federal space and take a closer look at opportunities to better optimize the space itself.

- *Improving Grants Management.* Each year, the Federal Government provides over \$500 billion in grants to State, local and tribal governments, colleges and universities, and other non-profit organizations—roughly one-sixth of the Federal budget. In 2009, the American Recovery and Reinvestment Act (ARRA) authorized an additional \$400 billion in grants to recipients through new ARRA programs and existing programs. In 2009, OFFM initiated a pilot project for an early review and reporting on internal controls for major ARRA programs using the Single Audit process, as required under OMB Circular A-133. This process, along with other efforts to strengthen A-133, is intended to mitigate instances of fraud, waste, abuse, and improper payments in Federal grant programs. We are also committed to working with the grants community to make the grant process efficient and citizen-friendly through streamlining grant applications and reports and modernizing the grants system, Grants.gov.

### **Closing the Efficiency and Technology Gap in Financial Operations**

- *Decreasing the Cost of Financial System Modernizations.* Complexity and inefficiency in our financial management operations has led to an increasingly expensive environment for modernizing financial systems. Also, once deployed, our modern systems do not consistently meet our business needs or produce the right information to support decision-making. By the spring of 2010, OMB will issue new guidelines and strategies for approaching financial system modernizations.
- *Implementing Common Solutions for Financial Management Functions:* New capabilities have emerged to automate and centrally implement financial management activities. For example, through a common electronic vendor invoicing solution, it is possible to input vendor invoice data rather than manually keying the information into a financial system. In the spring of 2010, the Treasury Department will pilot the capture of vendor invoices using a central utility that all agencies could eventually access. This utility will enable a seamless flow of invoice data from entry to payment. The electronic invoicing capability will improve data quality through automation, increase efficiency for agencies that use this service, and vendors to process invoices. Beyond vendor invoicing, the Treasury Department is exploring further opportunities to define common solutions for improved financial operations.

### **Promoting Accountability and Innovation through Open Government**

- *Improving Data Quality for Federal Spending Information.* Agencies have been reporting Federal spending information publicly through the government-wide website – USASpending.gov—since January 2008 pursuant to the Federal Funding Accountability and Transparency Act. The quality of the Federal spending information varies widely and has resulted in some data being missing, erroneous, or otherwise reported untimely. In response, OMB issued the Open Government Directive (Memorandum-10-06) in December 2009, to improve accountability through the designation of a single official within each agency responsible for data quality, and the requirement to implement an internal control environment around Federal spending information. In February, OMB issued a new framework for ensuring the reliability of Federal spending data. This framework heavily relies on agencies’ existing internal control programs as required under OMB Circular A-123. Agencies are required to modify and enhance internal controls over Federal spending data to meet the changing environment of disseminating more information to the public at a quicker pace.
- *Partnering For Solutions.* In FY 2010, OMB was appropriated \$37.5 million to establish the Partnership Fund for Program Integrity Innovation. The purpose of the Partnership Fund is to improve service delivery, payment accuracy, and administrative efficiency, while reducing access barriers and protecting beneficiaries of federal assistance programs administered by states or localities. The Partnership Fund will allow Federal, State, or local agencies to pilot new ideas in service delivery in a controlled environment with a comprehensive evaluation. Successful pilots could be expanded and used to inform further administrative or legislative action. The partnership will also provide an online clearinghouse for best practices, a collaboration forum, and fund new solutions through grants and other means. The public can contribute innovative approaches and suggestions to reduce improper payments and improve administrative efficiency and service delivery at [www.partner4solutions.gov](http://www.partner4solutions.gov). In spring 2010, the site will be expanded to provide more robust collaboration and search tools, including profiles of best practice innovations.
- *Strengthening the Reporting Model.* The Federal Government’s “reporting model” defines the information that is included in federal entity financial statements and other required supplemental information (e.g., Management’s Discussion and Analysis) and the scope of internal controls related to financial reporting. Inclusion in the financial statements or required supplemental information also affects the nature and extent of



the auditor's responsibilities. The overall goal of this initiative is to maintain public faith and confidence in Federal financial management by proposing improvements to the usefulness of financial reports to decision makers and the public and strengthening audit requirements on areas where financial risks are the most significant. Particular emphasis is being placed on obtaining improved information on the cost of Government activities and the results achieved. OMB, working with the CFO Council, will put forward a new, proposed framework for financial reporting by the spring of 2010. At that time, OFFM will initiate a dialogue with interested stakeholders (Congress, GAO, the Federal Accounting Standards Advisory Board, the Council of Inspectors General on Integrity and Efficiency (CIGIE), etc.) to validate and refine proposals to improve the reporting model, and propose an implementation plan for deploying the new model.

The sweeping challenges we face in the Government today require our financial managers to move beyond the status quo and to generate a higher return on investment for our financial management activities. The steps outlined above leverage the tools and capacities in place today, but refocus energies on critical and emerging priorities – cutting wasteful spending, improving the efficiency of our operations and information technology, and laying a foundation for data quality and collaboration as we enter a new era of transparency and open Government.

## Additional Information

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

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

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Office of the  
Comptroller General  
of the United States

United States Government Accountability Office  
Washington, DC 20548

February 26, 2010

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

Given the federal government's near- and long-term fiscal challenges, the need for transparency and for the Congress, the administration, and federal managers to have reliable, useful, and timely financial and performance information is greater than ever. As our report on the U.S. government's consolidated financial statements illustrates, however, even though certain progress has been made, much work remains to improve federal financial management. Consequently, financial management needs to be a top priority of this administration and the Congress.

The economic recession and the federal government's unprecedented actions intended to stabilize the financial markets and to promote economic recovery have significantly affected the federal government's financial condition. The resulting substantial investments and increases in liabilities, net operating cost, the unified budget deficit, and debt held by the public are reported in the U.S. government's consolidated financial statements for fiscal year 2009. Because the valuation of these assets and liabilities is based on assumptions and estimates that are inherently subject to substantial uncertainty arising from the uniqueness of certain transactions and the likelihood of future changes in general economic, regulatory, and market conditions, actual results may be materially different from the reported amounts. Further, the ultimate cost of these actions and their impact on the federal government's financial condition will not be known for some time. More significantly, the federal government faces long-term challenges resulting from large and growing structural deficits that are driven primarily by rising health care costs and known demographic trends. This unsustainable path must be addressed soon by policymakers. The longer actions are delayed, the more difficult adjustments are likely to become.

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

- Certain material weaknesses in internal control over financial reporting and other limitations on the scope of our work resulted in conditions that prevented us from expressing an opinion on the fiscal year 2009 and 2008 financial statements other than the Statements of Social Insurance. About \$906 billion, or 34 percent, of the federal government's reported total assets as of September 30, 2009, and

approximately \$784 billion, or 23 percent, of the federal government's reported net cost for fiscal year 2009 relate to four agencies' fiscal year 2009 financial statements that as of the date of our report, received disclaimers of opinion or were not audited.<sup>1</sup>

- The 2009, 2008, and 2007 Statements of Social Insurance are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles.<sup>2</sup> Given the importance of social insurance programs to the federal government's long-term fiscal outlook, the Statement of Social Insurance is critical to understanding the federal government's financial condition and fiscal sustainability.
- Material weaknesses resulted in ineffective internal control over financial reporting (including safeguarding of assets).
- Our work to test compliance with selected provisions of laws and regulations in fiscal year 2009 was limited by the material weaknesses and other scope limitations discussed in our report.

While significant progress has been made in improving federal financial management since the federal government began preparing consolidated financial statements years ago, three major impediments continued to prevent us from rendering an opinion on the federal government's accrual-based consolidated financial statements over this period of time<sup>3</sup>: (1) serious financial management problems at the Department of Defense (DOD) that have prevented DOD's financial statements from being auditable, (2) the federal government's inability to adequately account for and reconcile intragovernmental activity and balances between federal agencies, and (3) the federal government's ineffective process for preparing the consolidated financial statements. In addition, the financial statements of the Department of Homeland Security and the National Aeronautics and Space Administration for fiscal years 2009 and 2008 were not auditable or were not subjected to audit by agency auditors.

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<sup>1</sup>Of the 24 Chief Financial Officers Act agencies, the agencies that, as of the date of our report, received disclaimers of opinions on all of their fiscal year 2009 financial statements were the Department of Defense and the National Aeronautics and Space Administration. For the Department of Homeland Security for fiscal year 2009, only the Consolidated Balance Sheet and the Statement of Custodial Activity were subjected to audit; the auditor was unable to express an opinion on these two financial statements. In addition, the auditor of the Department of State's (State) fiscal year 2009 financial statements was unable to obtain sufficient evidential support for property and equipment amounts presented in State's fiscal year 2009 financial statements.

<sup>2</sup>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.

<sup>3</sup>The accrual-based consolidated financial statements for the fiscal years ended September 30, 2009 and 2008, 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 2009, 2008, 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 with the accrual-based consolidated financial statements.

In addition to the material weaknesses underlying these major impediments, we noted three material weaknesses involving the federal government's inability to (1) determine the full extent to which improper payments occur and reasonably assure that appropriate actions are taken to reduce improper payments, currently estimated to be at least \$98 billion; (2) identify and resolve information security control deficiencies and manage information security risks on an ongoing basis; and (3) effectively manage its tax collection activities. 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.

The material weaknesses discussed in our report continued to

- hamper the federal government's ability to reliably report a significant portion of its assets, liabilities, costs, and other related information;
- 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;
- impair the federal government's ability to adequately safeguard significant assets and properly record various transactions; and
- hinder the federal government from having reliable financial information to operate in an efficient and effective manner.

The federal government reported a net operating cost of \$1.3 trillion and a unified budget deficit of \$1.4 trillion for fiscal year 2009, significantly higher than the amounts in fiscal year 2008. As of September 30, 2009, debt held by the public increased to 53 percent of gross domestic product (GDP). These increases are primarily the result of the effects of the recession and the costs of the federal government's actions to stabilize the financial markets and to promote economic recovery.

In December 2007, the United States entered what has turned out to be its deepest recession since the end of World War II. Between the fourth quarter of 2007 and the third quarter of 2009, GDP fell by about 2.8 percent. The nation's unemployment rate rose from 4.9 percent in 2007 to 10.2 percent in October 2009, a level not seen since April 1983. Federal tax revenues automatically decline when GDP and incomes fall, and at the same time, spending on unemployment benefits and other income-support programs automatically increases.

As of September 30, 2009, the federal government's actions to stabilize the financial markets and to promote economic recovery resulted in an increase in reported federal assets of over \$500 billion (e.g., the Troubled Asset Relief Program (TARP) equity investments, and investments in the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) and mortgage-backed securities guaranteed by them), which is net of about \$80 billion in valuation losses. In addition, the federal government reported incurring additional significant liabilities (e.g.,

liquidity guarantees to Fannie Mae and Freddie Mac) and related net cost resulting from these actions. Because the valuation of these assets and liabilities is based on assumptions and estimates that are inherently subject to substantial uncertainty arising from the uniqueness of certain transactions and the likelihood of future changes in general economic, regulatory, and market conditions, actual results may be materially different from the reported amounts. For example, assets and liabilities subject to substantial uncertainty include the following:

- The U.S. government's consolidated financial statements for fiscal year 2009 include approximately \$65 billion of investments in Fannie Mae and Freddie Mac (net of about \$38 billion in valuation losses), about \$92 billion of liabilities for future payments under liquidity guarantees with these entities, and about \$126 billion of related net cost. The statements also discuss an estimated additional liability and net cost of about \$130 billion related to these guarantees that could be incurred under an "extreme case" scenario, based on the estimates as of September 30, 2009. Also, these estimates could be affected by the Department of the Treasury agreement, subsequent to September 30, 2009, to increase, as necessary, its liquidity guarantees to Fannie Mae and Freddie Mac to accommodate any cumulative reduction in the net worth of these two entities over the next 3 years.
- The federal government reported TARP direct loans and equity investments of approximately \$238 billion as of September 30, 2009 (net of about \$53 billion in valuation losses, including \$30 billion related to American International Group, Inc. (AIG) and \$31 billion related to loans to and equity investments in certain entities in the automotive industry, including General Motors and Chrysler, partially offset by valuation gains of \$8 billion primarily related to investments in financial institutions).
- The federal government reported Federal Deposit Insurance Corporation (FDIC) liabilities of \$59 billion as of September 30, 2009, and about \$45 billion of net cost related to estimated failures of insured financial institutions, guarantees, and bank resolutions. These liabilities and cost resulted in a negative reported ratio of reserves to estimated insured deposits in FDIC's Deposit Insurance Fund (DIF), far below the statutory minimum of 1.15 percent. FDIC recently reported additional losses incurred by the DIF from actual and anticipated financial institution failures and resolution activity through December 31, 2009, resulting in a further increase in DIF's negative reported ratio of reserves to estimated insured deposits. FDIC has implemented a restoration plan to replenish the DIF's reserves to the statutory minimum. Further losses could occur if potentially vulnerable insured institutions ultimately fail, guarantees result in greater than anticipated losses, or economic and market conditions further deteriorate.
- Further deterioration in the residential real estate market could result in additional losses for the Federal Housing Administration (FHA) beyond the reported loan guarantee liability of about \$34 billion as of September 30, 2009. During fiscal year 2009, FHA's guaranteed loan principal amount outstanding increased by about 42 percent compared to the amount in fiscal year 2008.

In addition, the federal government's financial condition will be further affected as its actions continue to be implemented in fiscal year 2010 and later. For example, several hundred billion dollars of the total estimated \$862 billion cost under the American Recovery and Reinvestment Act of 2009 (Recovery Act)<sup>4</sup> remain to be disbursed.<sup>5</sup> Also, continued implementation of TARP,<sup>6</sup> which was extended through October 3, 2010, is likely to result in additional cost, and the FHA mortgage guarantee program could result in additional cost. Consequently, the ultimate cost of the federal government's actions and their effect on the federal government's financial condition will not be known for some time.

Further, there are risks that the federal government's financial condition could be affected in the future by other factors, including the following:

- Several initiatives undertaken in 2009 by the Federal Reserve to stabilize the financial markets have led to a significant change in the reported composition and size of the Federal Reserve's balance sheet, including the purchase of over \$900 billion in mortgage-backed securities guaranteed by Fannie Mae, Freddie Mac, and the Government National Mortgage Association as of the end of 2009. If the Federal Reserve sells these securities at a loss, additional federal government deposits at the Federal Reserve may be needed, future payments of Federal Reserve earnings to the federal government may be reduced, or both.<sup>7</sup>
- Although the Recovery Act provided some fiscal relief to the states, expected continued state fiscal challenges could place pressure on the federal government to provide further relief to them.

Looking ahead, the federal government will need to determine the most expeditious manner in which to bring closure to its financial stabilization initiatives while optimizing its investment returns. In addition to managing these actions, problems in the nation's financial sector have exposed serious weaknesses in the current U.S. financial regulatory system, which, if not effectively addressed, may cause the system to fail to prevent similar or even worse crises in the future. The current system, which was put into place over the past 150 years, is fragmented and complex and simply has not kept pace with the major financial structures, innovations, and products that emerged during the years

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<sup>4</sup>Pub. L. 111-5, 123 Stat. 115 (Feb. 17, 2009).

<sup>5</sup>Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2010 to 2020* (Washington, D.C., January 2010).

<sup>6</sup>GAO, *Financial Audit: Office of Financial Stability (Troubled Asset Relief Program) Fiscal Year 2009 Financial Statements*, GAO-10-301 (Washington, D.C.: Dec. 9, 2009).

<sup>7</sup>Under Federal Reserve System policy, Federal Reserve bank earnings in excess of statutory dividends to member banks are paid to the federal government. The federal government received about \$34 billion of such payments in fiscal year 2009.

leading up to the recent financial crisis. Consequently, meaningful financial regulatory reform is of utmost concern.<sup>8</sup>

The federal government faces even larger fiscal challenges in the long term. As discussed in this *2009 Financial Report of the United States Government (Financial Report)*, the federal government is on an unsustainable long-term fiscal path driven primarily by rising health care costs and known demographic trends. The Statement of Social Insurance, for example, shows that the present value of projected scheduled benefits exceeds earmarked revenues for social insurance programs (e.g., Social Security and Medicare) by about \$46 trillion over the next 75-year period.<sup>9</sup> In addition, our most recent long-term simulations for all federal government programs show that absent policy changes, debt held by the public as a percentage of GDP could exceed the historical high reached in the aftermath of World War II in a little over 10 years.<sup>10</sup> Absent a change in policy, under this scenario, the interest costs on the growing debt together with spending on major entitlement programs could absorb 92 cents of every dollar of federal revenue in 2019.<sup>11</sup> Clearly, this is not sustainable.

Accounting and financial reporting standards have continued to evolve to provide greater transparency and accountability for the federal government's operations, financial condition, and fiscal outlook. New financial reporting standards will require fiscal sustainability reporting in the federal government's financial statements beginning in fiscal year 2010. Such reporting will include clear and transparent information about the long-term fiscal condition of the federal government and annual changes therein, and will expand upon the information currently provided in the Management's Discussion and Analysis section of the *Financial Report*. Our nation's leaders need a clear and realistic assessment of the federal government's financial condition to address the long-term challenges that lie ahead.

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<sup>8</sup>GAO, *Financial Regulation: A Framework for Crafting and Assessing Proposals to Modernize the Outdated U.S. Financial Regulatory System*, GAO-09-216 (Washington, D.C.: Jan. 8, 2009). Our report describes the nine characteristics that should be included in any new regulatory system: (1) clearly defined regulatory goals; (2) appropriately comprehensive; (3) systemwide focus; (4) flexible and adaptive; (5) efficient and effective; (6) consistent consumer and investor protection; (7) regulators provided with independence, prominence, authority, and accountability; (8) consistent financial oversight; and (9) minimal taxpayer exposure.

<sup>9</sup>On an open group basis (current and future participants).

<sup>10</sup>GAO, *The Federal Government's Long-Term Fiscal Outlook: Fall 2009 Update*, GAO-10-137SP (Washington, D.C.: October 2009). These simulations will be updated in a report forthcoming in early March 2010.

<sup>11</sup>GAO's Fall 2009 alternative simulation is based on the 2009 Trustees' assumptions for Social Security and Medicare. Discretionary spending other than the Recovery Act provisions grows with GDP after 2009; and the Recovery Act provisions are included but assumed to be temporary. Expiring tax provisions are extended and the Alternative Minimum Tax exemption amount is indexed to inflation through 2019. After 2019, revenue as a share of GDP is brought to its 40-year historical average of 18.3 percent of GDP. Medicare spending is adjusted based on the assumption that physician payments are not reduced as specified under current law.



In addition, there is a continuing need to (1) consider whether any further changes are needed in the federal reporting model to more effectively meet the needs of agency management, policymakers, the Congress, and the public and (2) develop a combined report on the performance and financial accountability of the federal government as a whole. This report could 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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Our report on the U.S. government's consolidated financial statements would not be possible without the commitment and professionalism of inspectors general throughout the federal government who are responsible for annually auditing the financial statements of individual federal entities. We also appreciate the cooperation and assistance of Department of the Treasury and Office of Management and Budget officials as well as the federal entities' chief financial officers. We look forward to continuing to work with these individuals, the administration, and the Congress to achieve the goals and objectives of federal financial management reform.

Our audit report begins on page 209. Our guide<sup>12</sup> to the *Financial Report of the United States Government* is intended to help those who seek to obtain a better understanding of the *Financial Report*. In addition, our guide<sup>13</sup> entitled *Understanding Similarities and Differences between Accrual and Cash Deficits* provides a useful perspective on the different purposes cash and accrual measures serve in providing a comprehensive picture of the federal government's fiscal condition today and over time. These guides are available on GAO's Web site at [www.gao.gov](http://www.gao.gov).

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<sup>12</sup>GAO, *Understanding the Primary Components of the Annual Financial Report of the United States Government*, GAO-05-958SP (Washington, D.C.: September 2005). In September 2009, we issued an update to this guide to reflect recent changes to the federal accounting standards and resulting changes to the *Financial Report*; see GAO-09-946SP (Washington, D.C.: September 2009).

<sup>13</sup>GAO, *Understanding Similarities and Differences between Accrual and Cash Deficits*, GAO-07-117SP (Washington, D.C.: December 2006). In January 2007 and 2008, we issued updates to this guide for fiscal years 2006 and 2007; see GAO-07-341SP (Washington, D.C.: January 2007) and GAO-08-410SP (Washington, D.C.: January 2008).

Our report was prepared under the direction of Robert F. Dacey, Chief Accountant, and Gary T. Engel, Director, Financial Management and Assurance. If you have any questions, please contact me on (202) 512-5500 or them on (202) 512-3406.

A handwritten signature in black ink that reads "Gene L. Dodaro". The signature is written in a cursive, flowing style with a large initial "G" and "D".

Gene L. Dodaro  
Acting 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

# Financial Statements of the United States Government for the Years Ended September 30, 2009 and 2008

## Statements of Net Cost

These statements present the net cost of fiscal years 2009 and 2008 Government<sup>1</sup> operations, including the operations related to earmarked funds (funds financed by specifically identified revenues, often supplemented by other financing sources, which remain available over time). The Government's fiscal year begins October 1 and ends September 30. Costs and earned revenues are categorized on the Statement of Net Cost by significant entity, providing greater accountability by showing the relationship of the agencies' net cost to the Governmentwide net cost. Costs and earned revenues are presented in this report by department on an accrual basis, while the budget presents costs and revenues by obligations and receipts, generally on a cash basis. The focus of the budget of the United States is by agency. Budgets are prepared, defended, and monitored by agency. In reporting by agency, we are assisting the external users in assessing the budget integrity, operating performance, stewardship, and systems and controls of the Government.

These statements contain the following three components:

- Gross cost—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—is exchange revenue resulting from the Government providing goods and services to the public at a price.
- Net cost—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 their user agencies for Governmentwide reporting purposes. The remaining costs for GSA and OPM on the Statements of Net Cost are the administrative operating costs, the expenses from prior and past costs from health and pension plan amendments, and the actuarial gains and losses for these agencies. The interest on securities issued by the Department of the Treasury (Treasury) and held by the public is reported on Treasury's financial statements, but because of its importance, and the dollar amounts involved, it is reported separately in these statements.

## Statements of Operations and Changes in Net Position

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

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<sup>1</sup> For purposes of this document, "Government" refers to the United States Government.

## Revenue

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

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

Miscellaneous earned revenues consist of earned revenues received from the public with virtually no associated cost. Therefore, unlike other earned revenues on the Statement of Net Cost, miscellaneous earned revenues are not subtracted from gross cost to derive net cost. It 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 required by statute to be used for designated activities, benefits or purposes and must be accounted for separately from the rest of the Government's non-earmarked revenues. See Note 24—Earmarked Funds for detailed information.

Intragovernmental interest represents interest earned from the investment of surplus earmarked revenues, which finance the deficit spending of non-earmarked operations. These investments are recorded as intragovernmental debt holdings and are included in Note 14—Federal Debt Securities, 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 (an example is the annual transfer to the Department of Health and Human Services' (HHS) Supplementary Medical Insurance Trust Fund (Medicare Parts B and D) which receives sufficient funding from the General Fund to equal the annual costs incurred by these Medicare programs). Additionally, this line item includes contributions to earmarked funds made by Federal agencies on behalf of their employees, beneficiaries, or others.

## Unmatched Transactions and Balances

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

## Net Position, Beginning of Period

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

Prior period adjustments are revisions to adjust the beginning net position and balances presented on the prior year financial statements due to corrections of errors or changes in accounting principles. See Note 1B—Basis of Accounting and Revenue Recognition, and Note 21—Prior Period Adjustments for detailed information.

## Net Position, End of Period

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

## Reconciliations of Net Operating Cost and Unified Budget Deficit

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

Receipts and outlays in the President's budget are measured primarily on a cash basis and differ from the accrual basis of accounting 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 in benefits payable for veterans, military and civilian employees, the environmental liabilities, and depreciation expense not included in the budget results.

## Components of the Budget Deficit Not Part of Net Operating Cost

This information includes the budget components, such as capitalized fixed assets, changes in net inventory, and increases in other assets not included in the operating results. These items impact the balance sheet only and are not part of the operating results.

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

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

These statements reconcile the unified budget deficit to the change in cash and other monetary assets during the fiscal year and explain how the budget deficits (fiscal years 2009 and 2008) were financed. A budget deficit is the result of outlays (expenditures) exceeding receipts (revenue) during a particular fiscal year.

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

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

## Balance Sheets

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

### Assets

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

### Liabilities and Net Position

Liabilities are obligations of the Government resulting from prior actions that will require financial resources. The most significant liabilities reported on the balance sheets are Federal debt securities held by the public and accrued interest and Federal employee and veteran benefits payable. Liabilities also include environmental and disposal liabilities 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 Government has entered into contractual commitments requiring the future use of financial resources and has unresolved contingencies where existing conditions, situations, or circumstances create uncertainty about future losses. Commitments, as well as contingencies that do not meet the criteria for recognition as liabilities on the balance sheets, but for which there is at least a reasonable possibility that losses have been incurred, are disclosed in Note 22—Contingencies and Note 23—Commitments.

The collection of earmarked taxes and other earmarked revenue is credited to the corresponding Earmarked Fund that will use these funds to meet a particular Government purpose. If the collections from taxes and other sources exceed the payments to the beneficiaries, the excess revenue is invested in Treasury securities or “loaned” to Treasury’s General Fund; therefore, the trust fund balances do not represent cash. An explanation of the trust funds for social insurance and many of the other large trust funds is included in Note 24—Earmarked Funds. That note also contains information about trust fund receipts, disbursements, and assets.

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

## 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), HHS, the Railroad Retirement Board (RRB), and the Department of Labor (DOL), respectively. The estimates are actuarial present values<sup>2</sup> 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 RRB and the DOL (Black Lung).

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

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<sup>2</sup> 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, 2009, and September 30, 2008**

	Gross	Earned	Net	Gross	Earned	Net
	Cost	Revenue	Cost	Cost	Revenue	Cost
(In billions of dollars)	2009			2008		
Department of Health and Human Services .....	866.4	59.5	806.9	769.1	56.4	712.7
Social Security Administration .....	736.6	0.4	736.2	663.9	0.3	663.6
Department of Defense .....	718.4	35.6	682.8	767.6	26.8	740.8
Department of the Treasury.....	254.6	19.4	235.2	197.0	12.4	184.6
Interest on Treasury Securities held by the public.....	189.1	-	189.1	241.6	-	241.6
Department of Labor.....	140.2	-	140.2	60.6	-	60.6
Department of Agriculture.....	132.0	10.5	121.5	109.3	9.8	99.5
Department of Transportation.....	80.1	0.5	79.6	71.5	0.8	70.7
Department of Housing and Urban Development.....	62.6	1.0	61.6	60.6	0.8	59.8
Department of Homeland Security .....	62.1	8.4	53.7	60.0	7.9	52.1
Federal Deposit Insurance Corporation .....	63.4	18.8	44.6	24.3	1.7	22.6
Department of Energy .....	46.8	3.9	42.9	35.8	4.2	31.6
Department of Education.....	44.9	6.5	38.4	66.9	5.0	61.9
Department of Justice.....	31.2	1.1	30.1	31.7	1.1	30.6
Office of Personnel Management.....	41.2	16.9	24.3	39.5	16.0	23.5
National Aeronautics and Space Administration.....	24.2	0.1	24.1	20.4	0.2	20.2
Department of State .....	25.6	2.5	23.1	22.1	2.6	19.5
Department of the Interior.....	20.8	2.2	18.6	23.4	2.1	21.3
Pension Benefit Guaranty Corporation.....	22.9	10.5	12.4	2.3	3.5	(1.2)
Department of Commerce .....	13.9	2.1	11.8	11.9	2.0	9.9
Railroad Retirement Board .....	22.7	11.2	11.5	20.7	4.2	16.5
Agency for International Development .....	11.8	0.7	11.1	9.1	(0.1)	9.2
Environmental Protection Agency .....	10.1	0.6	9.5	10.1	0.5	9.6
Federal Communications Commission.....	8.8	0.5	8.3	8.5	0.4	8.1
National Science Foundation.....	6.1	-	6.1	6.0	-	6.0
Small Business Administration.....	6.3	0.4	5.9	1.9	0.4	1.5
National Credit Union Administration.....	6.1	1.3	4.8	0.5	0.1	0.4
Smithsonian Institution .....	0.9	-	0.9	0.9	-	0.9
Export-Import Bank of the United States.....	1.5	0.8	0.7	0.4	0.7	(0.3)
U.S. Nuclear Regulatory Commission.....	1.3	0.8	0.5	1.2	0.8	0.4
General Services Administration .....	1.0	0.5	0.5	1.0	0.5	0.5
Securities and Exchange Commission.....	1.1	1.1	-	1.1	1.0	0.1
Farm Credit System Insurance Corporation .....	-	0.3	(0.3)	-	0.2	(0.2)
Tennessee Valley Authority.....	10.2	11.0	(0.8)	10.2	10.1	0.1
U.S. Postal Service.....	58.2	67.1	(8.9)	60.0	73.7	(13.7)
Department of Veterans Affairs .....	(38.8)	4.0	(42.8)	434.6	4.2	430.4
All other entities .....	51.3	0.7	50.6	45.9	0.6	45.3
<b>Total .....</b>	<b>3,735.6</b>	<b>300.9</b>	<b>3,434.7</b>	<b>3,891.6</b>	<b>250.9</b>	<b>3,640.7</b>

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, 2009, and September 30, 2008**

(In billions of dollars)	Non- Earmarked Funds	Earmarked Funds	Consolidated	Non- Earmarked Funds	Earmarked Funds	Consolidated
	2009			2008		
<b>Revenue:</b>						
Individual income tax and tax withholdings ...	912.7	862.3	1,775.0	1,210.0	868.4	2,078.4
Corporation income taxes .....	130.3		130.3	299.7		299.7
Unemployment taxes .....		38.1	38.1		39.4	39.4
Excise taxes .....	18.6	48.9	67.5	15.3	51.8	67.1
Estate and gift taxes .....	23.4		23.4	28.8		28.8
Customs duties .....	21.7		21.7	27.3		27.3
Other taxes and receipts .....	35.4	52.2	87.6	50.7	34.3	85.0
Miscellaneous earned revenues .....	50.4	4.4	54.8	29.9	5.8	35.7
Intragovernmental interest .....		184.6	184.6		201.0	201.0
Total revenue .....	<u>1,192.5</u>	<u>1,190.5</u>	<u>2,383.0</u>	<u>1,661.7</u>	<u>1,200.7</u>	<u>2,862.4</u>
Eliminations.....			(184.6)			(201.0)
Consolidated revenue .....			<u>2,198.4</u>			<u>2,661.4</u>
<b>Net Cost:</b>						
Net cost.....	1,906.6	1,528.1	3,434.7	2,186.4	1,454.3	3,640.7
Intragovernmental interest .....	184.6		184.6	201.0		201.0
Total net cost .....	<u>2,091.2</u>	<u>1,528.1</u>	<u>3,619.3</u>	<u>2,387.4</u>	<u>1,454.3</u>	<u>3,841.7</u>
Eliminations.....			(184.6)			(201.0)
Consolidated net cost.....			<u>3,434.7</u>			<u>3,640.7</u>
<b>Intragovernmental transfers</b> .....	(386.0)	386.0		(338.0)	338.0	
Unmatched transactions and balances (Note 1) .....	(17.4)		(17.4)	(29.8)		(29.8)
<b>Net operating (cost)/revenue</b> .....	<u>(1,302.1)</u>	<u>48.4</u>	<u>(1,253.7)</u>	<u>(1,093.5)</u>	<u>84.4</u>	<u>(1,009.1)</u>
<b>Net position, beginning of period</b> .....	(10,908.1)	704.6	(10,203.5)	(9,826.0)	620.2	(9,205.8)
Prior period adjustments—changes in accounting principles (Note 21).....	1.6	(0.3)	1.3	11.4		11.4
Net operating (cost)/revenue.....	(1,302.1)	48.4	(1,253.7)	(1,093.5)	84.4	(1,009.1)
<b>Net position, end of period</b> .....	<u>(12,208.6)</u>	<u>752.7</u>	<u>(11,455.9)</u>	<u>(10,908.1)</u>	<u>704.6</u>	<u>(10,203.5)</u>

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, 2009, and September 30, 2008**

(In billions of dollars)	2009	2008
<b>Net operating cost</b> .....	(1,253.7)	(1,009.1)
<b>Components of Net Operating Cost Not Part of the Budget Deficit:</b>		
<b>Increase in Liability for Military Employee Benefits (Note 15):</b>		
Increase in military pension liabilities .....	23.0	125.3
Increase/(decrease) in military health liabilities .....	5.2	(15.3)
(Decrease) in other military benefits.....	(2.6)	(0.1)
Increase in liability for military employee benefits.....	25.6	109.9
<b>(Decrease)/Increase in liability for veteran's compensation (Note 15):</b>		
(Decrease)/increase in liabilities for veterans .....	(101.2)	287.9
(Decrease)/increase in liabilities for survivors .....	(46.9)	50.2
(Decrease)/increase in liabilities for burial benefits .....	(1.1)	0.9
(Decrease)/increase in liability for veteran's compensation.....	(149.2)	339.0
<b>Increase in liabilities for civilian employee benefits (Note 15):</b>		
Increase in civilian pension liabilities .....	74.6	68.5
Increase in civilian health liabilities.....	10.4	30.2
Increase in other civilian benefits .....	3.4	2.2
Increase in liabilities for civilian employee benefits .....	88.4	100.9
<b>(Decrease)/Increase in environmental and disposal liabilities (Note 16):</b>		
Increase in Energy's environmental and disposal liabilities .....	1.6	2.4
(Decrease) in all others' environmental and disposal liabilities .....	(2.6)	(1.6)
(Decrease)/increase in environmental and disposal liabilities .....	(1.0)	0.8
Depreciation expense .....	59.5	54.8
Property, plant, and equipment disposals and revaluations .....	6.5	5.0
Increase in benefits due and payable.....	16.4	10.7
Increase in insurance and guarantee program liabilities .....	81.1	12.4
Increase in other liabilities .....	12.1	34.3
Seigniorage and sale of gold .....	(0.4)	(0.7)
(Decrease)/increase in accounts payable .....	(0.1)	7.1
Decrease/(increase) in net accounts and taxes receivable .....	2.8	(5.2)
TARP downward re-estimate .....	(110.0)	-
Stock received from Government sponsored enterprises .....	-	(7.0)
(Increase) in Beneficial interest in trust .....	(23.5)	-
Increase in liquidity guarantee.....	78.1	13.8
Valuation loss on investments in Government sponsored enterprises .....	37.9	-
<b>Components of the budget deficit that are not part of net operating cost:</b>		
<b>Capitalized Fixed Assets:</b>		
Department of Defense .....	(81.5)	(71.6)
All other agencies.....	(30.9)	(34.8)
Total Capitalized Fixed Assets .....	(112.4)	(106.4)
Decrease/(increase) in net inventory.....	5.0	(12.5)
Investments in Government sponsored enterprises .....	(95.6)	-
(Increase)/decrease in securities and investments .....	(22.4)	17.7
(Increase) in other assets.....	(66.4)	(24.0)
Principal repayments of precredit reform loans .....	(10.1)	14.6
All other reconciling items .....	14.3	(10.9)
Unified budget deficit.....	(1,417.1)	(454.8)

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, 2009, and September 30, 2008**

(In billions of dollars)	2009	2008
<b>Unified budget deficit .....</b>	(1,417.1)	(454.8)
<b>Adjustments for noncash outlays included in the budget:</b>		
Interest accrued by Treasury on debt held by the public .....	171.9	209.0
TARP downward re-estimate .....	110.0	-
Subsidy expense/(income) (Notes 4 and 5) ...	(3.1)	3.0
Subtotal .....	278.8	212.0
<b>Items affecting the cash balance not included in the Budget:</b>		
<i>Net Transactions from financing activity:</i>		
Borrowings from the public .....	8,931.0	5,615.8
Repayment of debt held by the public .....	(7,185.6)	(4,853.1)
Subtotal .....	1,745.4	762.7
<i>Transactions from monetary and other activity:</i>		
Interest paid by Treasury on debt held by the public .....	(170.7)	(213.3)
Net TARP direct loans and equity investments activity .....	(291.0)	-
Net GSE—mortgage backed securities activity .....	(171.0)	(5.0)
Net loan activity .....	58.7	(30.9)
Allocations of special drawing rights .....	48.3	-
Other .....	(112.7)	25.8
Subtotal .....	(638.4)	(223.4)
<b>Cash and other monetary assets (Note 2):</b>		
(Decrease)/increase in cash and other monetary assets .....	(31.3)	296.5
Balance, beginning of period .....	424.5	128.0
Balance, end of period .....	393.2	424.5

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

**United States Government  
Balance Sheets  
as of September 30, 2009, and September 30, 2008**

(In billions of dollars)	2009	2008
<b>Assets:</b>		
Cash and other monetary assets (Note 2) .....	393.2	424.5
Accounts and taxes receivable, net (Note 3).....	90.2	93.0
Loans receivable and mortgage backed securities, net (Note 4) ...	538.9	253.8
TARP direct loans and equity investments, net (Note 5) .....	239.7	-
Beneficial interest in trust (Note 6) .....	23.5	-
Inventories and related property, net (Note 7).....	284.6	289.6
Property, plant, and equipment, net (Note 8) .....	784.1	737.7
Securities and investments (Note 9) .....	93.1	79.6
Investments in Government sponsored enterprises (Note 11).....	64.7	7.0
Other assets (Note 12) .....	155.9	89.5
Total assets.....	<u>2,667.9</u>	<u>1,974.7</u>
Stewardship land and heritage assets (Note 27)		
<b>Liabilities:</b>		
Accounts payable (Note 13) .....	73.2	73.3
Federal debt securities held by the public and accrued interest (Note 14) .....	7,582.7	5,836.2
Federal employee and veteran benefits payable (Note 15) .....	5,283.7	5,318.9
Environmental and disposal liabilities (Note 16).....	341.8	342.8
Benefits due and payable (Note 17).....	160.8	144.4
Insurance and guarantee program liabilities (Note 18) .....	166.2	85.1
Loan guarantee liabilities (Note 4).....	69.4	72.9
Liquidity guarantee (Note 11) .....	91.9	13.8
Other liabilities (Note 19) .....	354.1	290.8
Total liabilities .....	<u>14,123.8</u>	<u>12,178.2</u>
Contingencies (Note 22) and Commitments (Note 23)		
<b>Net position:</b>		
Earmarked funds (Note 24) .....	752.7	704.6
Non-earmarked funds.....	(12,208.6)	(10,908.1)
Total net position .....	<u>(11,455.9)</u>	<u>(10,203.5)</u>
Total liabilities and net position .....	<u>2,667.9</u>	<u>1,974.7</u>

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

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

(In billions of dollars)	2009	2008	2007	2006	UNAUDITED 2005
<b>Federal Old-Age, Survivors and Disability Insurance (Social Security):</b> <sup>14</sup>					
<i>Revenue (Contributions and Earmarked Taxes) from:</i>					
Participants who have attained eligibility age (62 and over) .....	575	542	477	533	464
Participants who have not attained eligibility age .....	18,559	18,249	17,515	16,568	15,290
Future participants .....	18,082	17,566	16,121	15,006	13,696
All current and future participants .....	37,217	36,357	34,113	32,107	29,450
<i>Expenditures for Scheduled Future Benefits for:</i>					
Participants who have attained eligibility age (62 and over) .....	(7,465)	(6,958)	(6,329)	(5,866)	(5,395)
Participants who have not attained eligibility age .....	(30,207)	(29,021)	(27,928)	(26,211)	(23,942)
Future participants .....	(7,223)	(6,933)	(6,619)	(6,480)	(5,816)
All current and future participants .....	(44,894)	(42,911)	(40,876)	(38,557)	(35,154)
<i>Present value of future expenditures in excess of future revenue .....</i>	(7,677) <sup>1</sup>	(6,555) <sup>2</sup>	(6,763) <sup>3</sup>	(6,449) <sup>4</sup>	(5,704) <sup>5</sup>
<b>Federal Hospital Insurance (Medicare Part A):</b> <sup>14</sup>					
<i>Revenue (Contributions and Earmarked Taxes) from:</i>					
Participants who have attained eligibility age (65 and over) .....	209	202	178	192	162
Participants who have not attained eligibility age .....	6,348	6,320	5,975	5,685	5,064
Future participants .....	5,451	5,361	4,870	4,767	4,209
All current and future participants .....	12,008	11,883	11,023	10,644	9,435
<i>Expenditures for Scheduled Future Benefits for:</i>					
Participants who have attained eligibility age (65 and over) .....	(2,958)	(2,747)	(2,558)	(2,397)	(2,179)
Participants who have not attained eligibility age .....	(18,147)	(17,365)	(15,639)	(15,633)	(12,668)
Future participants .....	(4,673)	(4,506)	(5,118)	(3,904)	(3,417)
All current and future participants .....	(25,778)	(24,619)	(23,315)	(21,934)	(18,264)
<i>Present value of future expenditures in excess of future revenue .....</i>	(13,770) <sup>1</sup>	(12,736) <sup>2</sup>	(12,292) <sup>3</sup>	(11,290) <sup>4</sup>	(8,829) <sup>5</sup>
<b>Federal Supplementary Medical Insurance (Medicare Part B):</b> <sup>14</sup>					
<i>Revenue (Premiums) from:</i>					
Participants who have attained eligibility age (65 and over) .....	498	461	433	409	363
Participants who have not attained eligibility age .....	4,224	3,859	3,184	3,167	2,900
Future participants .....	1,270	1,158	1,172	906	924
All current and future participants .....	5,992	5,478	4,789	4,481	4,187
<i>Expenditures for Scheduled Future Benefits for:</i>					
Participants who have attained eligibility age (65 and over) .....	(2,142)	(1,986)	(1,834)	(1,773)	(1,622)
Participants who have not attained eligibility age .....	(16,342)	(14,949)	(12,130)	(12,433)	(11,541)
Future participants .....	(4,672)	(4,262)	(4,257)	(3,407)	(3,408)
All current and future participants .....	(23,156)	(21,197)	(18,221)	(17,613)	(16,571)
<i>Present value of future expenditures in excess of future revenue</i> <sup>6</sup> .....	(17,165) <sup>1</sup>	(15,719) <sup>2</sup>	(13,432) <sup>3</sup>	(13,131) <sup>4</sup>	(12,384) <sup>5</sup>

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

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

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

(In billions of dollars)	2009	2008	2007	2006	UNAUDITED 2005
<b>Federal Supplementary Medical Insurance (Medicare Part D):</b> <sup>14</sup>					
<i>Revenue (Premiums and State Transfers) from:</i>					
Participants who have attained eligibility age (65 and over) .....	140	123	167	173	185
Participants who have not attained eligibility age .....	1,442	1,380	1,627	1,700	1,790
Future participants .....	618	604	611	492	572
All current and future participants .....	<u>2,199</u>	<u>2,107</u>	<u>2,405</u>	<u>2,366</u>	<u>2,547</u>
<i>Expenditures for Scheduled Future Benefits for:</i>					
Participants who have attained eligibility age (65 and over) .....	(595)	(581)	(794)	(792)	(880)
Participants who have not attained eligibility age .....	(6,144)	(6,527)	(7,273)	(7,338)	(7,913)
Future participants .....	(2,632)	(2,856)	(2,699)	(2,121)	(2,440)
All current and future participants .....	<u>(9,371)</u>	<u>(9,964)</u>	<u>(10,766)</u>	<u>(10,250)</u>	<u>(11,233)</u>
<i>Present value of future expenditures in excess of future revenue</i> <sup>6</sup> .....	<u>(7,172)</u> <sup>1</sup>	<u>(7,857)</u> <sup>2</sup>	<u>(8,361)</u> <sup>3</sup>	<u>(7,884)</u> <sup>4</sup>	<u>(8,686)</u> <sup>5</sup>
<b>Railroad Retirement:</b>					
<i>Revenue (Contributions and Earmarked Taxes) from:</i>					
Participants who have attained eligibility .....	5	5	5	5	4
Participants who have not attained eligibility .....	48	43	41	40	37
Future participants .....	70	54	54	56	41
All current and future participants .....	<u>123</u>	<u>102</u>	<u>100</u>	<u>100</u>	<u>82</u>
<i>Expenditures for Scheduled Future Benefits for:</i>					
Participants who have attained eligibility .....	(102)	(97)	(93)	(92)	(84)
Participants who have not attained eligibility .....	(91)	(88)	(86)	(84)	(73)
Future participants .....	(30)	(26)	(26)	(25)	(16)
All current and future participants .....	<u>(223)</u>	<u>(212)</u>	<u>(205)</u>	<u>(201)</u>	<u>(173)</u>
<i>Present value of future expenditures in excess of future revenue</i> <sup>7</sup> .....	<u>(100)</u> <sup>1</sup>	<u>(109)</u> <sup>2</sup>	<u>(105)</u> <sup>3</sup>	<u>(101)</u> <sup>4</sup>	<u>(91)</u> <sup>5</sup>
<b>Black Lung (Part C):</b>					
<i>Present value of future revenue in excess of future expenditures</i> <sup>8</sup> .....	<u>6</u> <sup>9</sup>	<u>5</u> <sup>10</sup>	<u>5</u> <sup>11</sup>	<u>4</u> <sup>12</sup>	<u>5</u> <sup>13</sup>
<b>Total present value of future expenditures in excess of future revenue</b> .....	<u>(45,878)</u>	<u>(42,970)</u>	<u>(40,948)</u>	<u>(38,851)</u>	<u>(35,689)</u>

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

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

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

(In billions of dollars)	2009	2008	2007	2006	UNAUDITED 2005
<b>Social Insurance Summary:</b> <sup>14</sup>					
<i>Participants who have attained eligibility age:</i>					
Revenue (e.g., Contributions and earmarked taxes) .....	1,427	1,333	1,260	1,312	1,178
Expenditures for scheduled future benefits .....	(13,262)	(12,369)	(11,608)	(10,920)	(10,160)
Present value of future expenditures in excess of future revenue .....	(11,835)	(11,036)	(10,348)	(9,608)	(8,982)
<i>Participants who have not attained eligibility age:</i>					
Revenue (e.g., Contributions and earmarked taxes) .....	30,621	29,851	28,342	27,160	25,081
Expenditures for scheduled future benefits .....	(70,931)	(67,950)	(63,056)	(61,696)	(56,138)
Present value of future expenditures in excess of future revenue .....	(40,310)	(38,099)	(34,714)	(34,536)	(31,057)
<b>Closed group – Total present value of future expenditures in excess of future revenue</b> .....	<b>(52,145)</b>	<b>(49,135)</b>	<b>(45,062)</b>	<b>(44,145)</b>	<b>(40,039)</b>
<i>Future participants:</i>					
Revenue (e.g., Contributions and earmarked taxes) .....	25,491	24,743	22,828	21,227	19,442
Expenditures for scheduled future benefits .....	(19,224)	(18,578)	(18,714)	(15,933)	(15,092)
Present value of future revenue in excess of future expenditures .....	6,267	6,165	4,114	5,294	4,350
<b>Open group – Total present value of future expenditures in excess of future revenue</b> .....	<b>(45,878)</b>	<b>(42,970)</b>	<b>(40,948)</b>	<b>(38,851)</b>	<b>(35,689)</b>

<sup>1</sup> The projection period is 1/1/2009 -12/31/2083 and the valuation date is 1/1/2009.

<sup>2</sup> The projection period is 1/1/2008 -12/31/2082 and the valuation date is 1/1/2008.

<sup>3</sup> The projection period is 1/1/2007 -12/31/2081 and the valuation date is 1/1/2007.

<sup>4</sup> The projection period is 1/1/2006 -12/31/2080 and the valuation date is 1/1/2006.

<sup>5</sup> The projection period is 1/1/2005 -12/31/2079 and the valuation date is 1/1/2005.

<sup>6</sup> These amounts represent the present value of the future transfers from the General Fund of the Treasury to the Supplementary Medical Insurance Trust Fund. These future intragovernmental transfers are included as income in both HHS' and the Centers for Medicare & Medicaid Services' Financial Reports but are not income from the Governmentwide perspective of this report.

<sup>7</sup> These amounts approximate the present value of the future financial interchange and the future transfers from the General Fund of the Treasury to the Social Security Equivalent Benefit Account (see discussion of Railroad Retirement Program in the 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.

<sup>8</sup> Does not include interest expense accruing on the outstanding debt.

<sup>9</sup> The projection period is 9/30/2009 -9/30/2040 and the valuation date is 9/30/2009.

<sup>10</sup> The projection period is 9/30/2008 -9/30/2040 and the valuation date is 9/30/2008.

<sup>11</sup> The projection period is 9/30/2007 -9/30/2040 and the valuation date is 9/30/2007.

<sup>12</sup> The projection period is 9/30/2006 -9/30/2040 and the valuation date is 9/30/2006.

<sup>13</sup> The projection period is 9/30/2005 -9/30/2040 and the valuation date is 9/30/2005.

<sup>14</sup> Participants for the Social Security and Medicare programs are assumed to be the "closed group" of individuals who are at least age 15 at the start of the projection period, and are participating as either taxpayers, beneficiaries, or both, except for the 2007 Medicare programs for which current participants are assumed to be at least 18 instead of 15 years of age.

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

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



# United States Government Notes to the Financial Statements for the Years Ended September 30, 2009, and 2008

## Note 1. Summary of Significant Accounting Policies

### A. Reporting Entity

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

During fiscal year 2008, the Government began a number of additional emergency economic measures relating to the economy that involved various financing programs. Key initiatives effective for fiscal year 2008 involved programs concerning two GSEs, provision of a credit facility for GSE and Federal Home Loan Banks, purchase of Mortgage Backed Securities (MBS), and setup of a Money Market Guarantee Program (see Note 11—Investments in Government Sponsored Enterprises and Other Financial and Housing Market Stabilization ). The Government increased its investment in the recovery effort in fiscal year 2009. The Emergency Economic Stabilization Act of 2008 (EESA) gave the Secretary of the Treasury temporary authority to purchase and guarantee assets in a wide range of financial institutions and markets (see Note 5—TARP Direct Loans and Equity Investments, Net).

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

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

### B. Basis of Accounting and Revenue Recognition

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

- Expenses are generally recognized when incurred.
- Nonexchange revenues, including taxes, duties, fines, and penalties, are recognized when collected and adjusted to the change in net measurable and legally collectable amounts receivable. Related refunds and other offsets, including those that are measurable and legally payable, are netted against nonexchange revenue.

- Exchange (earned) revenues are recognized when the Government provides goods and services to the public for a price. Exchange revenues include user charges such as admission to Federal parks and premiums for certain Federal insurance.

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

Beginning in fiscal year 2009, the Government has implemented the requirements of SFFAS No. 31, Accounting for Fiduciary Activities. This statement requires the Government to distinguish fiduciary activities from all other activities of the Government. For further information related to fiduciary activities, see Note 25—Fiduciary Activities. In addition, fiscal year 2008 financial statements are not allowed to be restated to distinguish fiduciary activities from all other activities of the Government.

## 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 represent claims to cash or other assets from entities outside the Government that arise from the sale of goods or services, duties, fines, certain license fees, recoveries, or other provisions of the law. Accounts receivable are reported net of an allowance for uncollectible accounts. An allowance is established when it is more likely than not the receivables will not be totally collected. The allowance method varies among the agencies in the Government and is usually based on past collection experience and is re-estimated periodically as needed. Methods include statistical sampling of receivables, specific identification and intensive analysis of each case, aging methodologies, and percentage of total receivables based on historical collection.

Taxes receivable consist primarily of uncollected tax assessments, penalties, and interest when taxpayers have agreed the amounts are owed or a court has determined the assessments are owed. The Balance Sheets do not include unpaid assessments when neither taxpayers nor a court have agreed that the amounts are owed (compliance assessments) or the Government does not expect further collections due to factors such as the taxpayer's death, bankruptcy, or insolvency (writeoffs). Taxes receivable are reported net of an allowance for the estimated portion deemed to be uncollectible. The allowance for doubtful accounts is based on projections of collectibles from a statistical sample of unpaid tax assessments.

## E. TARP Direct Loans and Equity Investments, Net

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

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

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

The Government used the following methodologies for valuation of the TARP Direct Loans and Equity Investments:

The estimated future cashflows for TARP direct loans were derived using analytical models that estimate the cashflows to and from Treasury over the life of the loan. These cashflows include the scheduled principal, interest, and other payments to Treasury, including estimated proceeds from equity interest obtained or additional notes. These models also include estimates of default and recoveries, incorporating the value of any collateral provided by the contract. The probability and timing of default and losses relating to a default are estimated by using applicable historical data when available, or publicly available proxy data, including credit rating agency historical performance data. The models include an adjustment for market risk which is intended to capture the risk of unexpected losses, but are not intended to represent fair value, i.e., the proceeds that would be expected to be received if the loans were sold to a market participant.

TARP preferred stock cashflows are projected using an analytical model developed to incorporate the risk of losses associated with adverse events, such as failure of the institution or increases in market interest rates. The model estimates how cashflows vary depending on: (1) current interest rates, which may affect the decision whether to repay the preferred stock; and (2) the strength of a financial institution's assets. Inputs to the model include institution specific accounting data obtained from regulatory filings, an institution's stock price volatility, and historical bank failure information, as well as market prices of comparable securities trading in the market. Treasury estimates the values and projects the cashflows of warrants using an option-pricing approach based on the current stock price and its volatility. Investments in common stock which are exchange traded are valued at the market price. The result of using market prices, either quoted prices for the identical asset or quoted prices for comparable assets, is that the equity investments are recorded at estimated fair value.

## F. Beneficial Interest in Trust

The beneficial interest in trust represents the Government's beneficial interest in the American International Group (AIG) stock held by a trust established by the Federal Reserve Bank of New York (FRBNY), under the terms of a credit facility agreement with AIG and the FRBNY. The value of beneficial interest is based on the market value of the trust's AIG holdings as of the reporting date; as the underlying AIG common stock is actively traded on the New York Stock Exchange, this represents the best independent valuation available for the Government's beneficial interest (See Note 6—Beneficial Interest in Trust for further details).

## G. Inventories and Related Property

Inventory is tangible personal property that is (1) held for sale, principally to Federal agencies, (2) in the process of production for sale, or (3) to be consumed in the production of goods for sale or in the provision of services for a fee. Inventories within the Government are valued using historical cost. However, most of the inventories are held by the Department of Defense (DOD) and its inventory value for most activities is not reported in accordance with GAAP. Historical cost methods include first-in-first-out, weighted average, and moving average.

To a lesser degree, the DOD also uses latest acquisition cost (LAC) methods adjusted for holding gains and losses to approximate the historical cost of resale inventory items remaining in the legacy systems. When using historical cost valuation, estimated repair costs reduce the value of inventory held for repair. Excess, obsolete, and unserviceable inventories are valued at estimated net realizable value. When latest acquisition cost is used to value inventory held for sale, it is adjusted for holding gains and losses in order to approximate historical cost.

Related property includes 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.

## H. Property, Plant, and Equipment

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

Property, plant, and equipment used in Government operations are carried at acquisition cost, with the exception of DOD military equipment (e.g., ships, aircraft, combat vehicles, and weapons). DOD military equipment is valued at estimated historical costs, which are calculated using internal DOD records. DOD identified the universe of military equipment by accumulating information relating to program funding and associated military equipment, equipment useful life, and program acquisitions and disposals to create a baseline. The equipment baseline is updated using expenditure information and information related to acquisition and logistics to identify acquisitions and disposals.

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

## I. Securities and Investments

Securities and investments are classified as held-to-maturity, available-for-sale, and trading securities and investments. Held-to-maturity securities and investments are reported at amortized cost, net of unamortized premiums and discounts. Available-for-sale securities and investment are reported at fair value with unrealized changes in fair value excluded from revenue. Trading securities and investments are reported at fair value.

## J. Investments in Government Sponsored Enterprises and Liquidity Guarantee

The senior preferred stock liquidity preference (preferred stock) and associated common stock warrant (warrant(s)) in GSEs are presented at their fair value as permitted by OMB Circular No. A-136. This Circular includes language that generally requires agencies to value non-Federal investments at acquisition cost, and also permits the use of other measurement basis, such as fair value, in certain situations. The Office of Management and Budget (OMB) issued guidance noting that while OMB Circular No. A-136 focuses primarily on Federal securities, which are normally accounted for at amortized cost, it is reasonable to interpret OMB Circular No. A-136 to permit non-Federal investments on an instrument by instrument election, to be reported on a basis other than cost. OMB's

guidance allows the use of fair value accounting for non-Federal securities beginning with reporting for fiscal year 2009. OMB Circular No. A-136 also directs agencies with non-Federal securities to consult FASB's Statement of Financial Accounting Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, for additional guidance. The investments in GSEs disclosed as of September 30, 2008, were recorded at acquisition cost at the date of purchase with disclosure of fair values as of fiscal year end 2008.

Annual valuations are performed, as of September 30, of the preferred stock and warrants. Any changes in valuation, including impairment, is recorded and disclosed in accordance with SFFAS No. 7, *Accounting for Revenue and Other Financing Sources*. Since the valuation is an annual process, the changes in valuation of the preferred stock and warrants are deemed usual and recurring. Accordingly, changes in valuation are recorded as an exchange transaction that is either an expense or revenue. Since the costs of preferred stock and warrants are exchange transactions, any change in valuation is also recorded as an exchange transaction.

Dividends are accrued when declared; therefore, no accrual is made for future dividends. Quarterly payments to the GSEs are made pursuant to the preferred stock purchase agreements, when a GSE's liabilities exceed its assets at the end of any quarter. A liability ("liquidity guarantee") is recognized for estimated future quarterly payments to the GSEs under the senior preferred stock purchase agreements. In addition, a range of the potential liability is disclosed, if applicable. Repayments of estimated future quarterly payments to the GSEs are not deemed reasonably estimable. Increases in the preferred stock liquidity preference occur when quarterly payments to the GSEs are made pursuant to the preferred stock purchase agreements. (See Note 11—Investments in Government Sponsored Enterprises and Other Financial and Housing Market Stabilization for further details).

## **K. Federal Debt**

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

## **L. Federal Employee and Veteran Benefits Payable**

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

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

## **M. Environmental and Disposal Liabilities**

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

## N. Insurance and Guarantee Program Liabilities

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

## O. Deferred Maintenance

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

## P. Contingent Liabilities

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

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

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

Contingent liabilities that do not meet the above criteria for recognition, but for which there is at least a reasonable possibility that a loss may have been incurred, are disclosed in Note 22—Contingencies.

## Q. Commitments

In the normal course of business, the Government has a number of unfulfilled commitments that may require the use of its financial resources. Note 23—Commitments describes the components of the Government's actual commitments that need to be disclosed because of their nature and/or their amount. They include long-term leases, undelivered orders, and other commitments.

## R. Social Insurance

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

## S. Related Party Transactions

Federal Reserve banks (FRBs) and private banks, which are not part of the reporting entity, serve as the Government's depository and fiscal agents. They process Federal payments and deposits to the Treasury General Account (which functions as the government's checking account for deposits and disbursements) and service Treasury securities. As of September 30, 2009, the FRBs had total holdings of \$769.2 billion, with a very small amount lent to dealers and not collateralized by other Treasury securities. As of September 30, 2008, the FRBs owned \$221.3 billion, net of \$255.3 billion in securities lent to dealers and not collateralized by other Treasury securities, for total holdings of \$476.6 billion. These securities are held in the FRBs' System Open Market Account (SOMA) for the purpose of conducting monetary policy. Additionally, under the Supplementary Financing Program (SFP), the Government had on deposit \$165 billion and \$300 billion with the Federal Reserve as of September 30, 2009, and 2008 respectively, to support Federal Reserve initiatives (see Note 2—Cash and Other Monetary Assets). FRBs earnings that exceed statutory amounts of surplus established for FRBs are paid to the Government and are recognized as nonexchange revenue. Those earnings totaled \$34.3 billion and \$33.6 billion for the years ended September 30, 2009, and 2008, respectively. The primary source of these earnings is from interest earned on Treasury securities held by the FRBs. Also, the FRBs hold Special Drawing Rights Certificates (SDRCs) (see Note 19—Other Liabilities, international monetary liabilities and gold certificates). The U.S. Government—primarily Treasury and the Federal Deposit Insurance Corporation—and the Board of Governors of the Federal Reserve System and the FRBs engaged in concurrent and/or coordinated actions during fiscal years 2008 and 2009 to help stabilize the financial system and the housing market. See further details in Note 5—TARP Direct Loans and Equity Investments, net, Note 6—Beneficial Interest in Trust, and Note 11—Investments in Government Sponsored Enterprises and Other Financial and Housing Market Stabilization.

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

The Government generally does not guarantee payment of the liabilities of Government Sponsored Enterprises such as Fannie Mae, Freddie Mac, or the Federal Home Loan Banks, which are privately owned. Fannie Mae and Freddie Mac have been placed under conservatorship as of September 7, 2008, and as of September 30, 2009, the Government has committed to provide up to \$400 billion in capital to Fannie Mae and Freddie Mac to the extent that these entities liabilities exceed assets (see Note 11—Investments in Government Sponsored Enterprises and Other Financial and Housing Market Stabilization). See Note 28—Subsequent Events regarding modification to the amount available to Fannie Mae and Freddie Mac. These entities also are excluded from the reporting entity.

## T. Unmatched Transactions and Balances

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

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

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

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

## U. Derivatives

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

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

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

The accounting for derivative instruments are governed by Financial Accounting Standards Board (FASB) Accounting Standards Codification Section 815 (formerly SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* and amended by SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities*) which aims to highlight to financial statement users additional disclosures on an entity's objectives in its use of derivatives and the method of accounting for such financial instruments. This standard requires that entities with derivatives disclose the following:

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

This accounting standard for derivatives was implemented in fiscal year 2009. Comparative disclosures for prior years are not presented. For further information, see Note 10—Derivatives.

## V. Reclassifications

Certain fiscal year 2008 amounts have been reclassified to conform to the fiscal year 2009 presentation in the following notes: 3—Accounts and Taxes Receivable, Net, 4—Loans Receivable, Mortgage Backed Securities, and Loan Guarantee Liabilities, Net, 12—Other Assets, 13—Accounts Payable, 18—Insurance and Guarantee Program Liabilities, 19—Other Liabilities, 23—Commitments, and 24—Earmarked Funds. The reclassifications from Notes 4 to 12 and Notes 18 to 19 are also reflected in the Balance Sheet and in the Reconciliation of Net Operating Cost and Unified Budget Deficit. In addition, certain fiscal year 2008 amounts have been reclassified on the Statement of Changes in Cash Balance from Unified Budget and Other Activities to conform to the fiscal 2009 presentation.

## W. Restatements

Certain fiscal year 2008 amounts have been restated to correct errors within the notes to the financial statements. See Notes 4—Loans Receivable, Mortgage Backed Securities, and Loan Guarantee Liabilities, Net, 23—Commitments, and 24—Earmarked Funds, for further information. These errors did not impact the principal financial statements.



## X. Fiduciary Activities

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

## Y. Use of Estimates

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

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

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

The forecasted future cashflows used to determine these amounts as of September 30, 2009, are sensitive to slight changes in model assumptions, such as general economic conditions, specific stock price volatility of the entities in which the Government has an equity interest, estimates of expected default, and prepayment rates. Forecasts of future financial results have inherent uncertainty and the TARP Direct Loans and Equity Investments, Net line item as of September 30, 2009, is reflective of relative illiquid, troubled assets whose values are particularly sensitive to future economic conditions and other assumptions.

The GSE preferred stock purchase agreements provide that the Government will make funding advances to the GSEs, if at the end of any quarter, the Federal Housing Finance Agency (FHFA), acting as the conservator, determines that the liabilities of either GSE, individually, exceed its respective assets. Based on U.S. GAAP, these contingent liquidity commitments predicated on the future occurrence of any shareholders' deficits of the GSEs at the end of any reporting quarter, are potential liabilities of the Government. Valuation analyses were performed to attempt to provide a "sufficiently reliable" estimate of the outstanding commitment in order for the Government to record the remaining liability in accordance with SFFAS No. 5. The valuation incorporated various forecasts, projections and cash flow analysis to develop an estimate of potential liability. Note 11—Investments in Government Sponsored Enterprises and Other Financial and Housing Market Stabilization discusses the results of the valuation and the contingent liability recorded as of September 30, 2009.

## Z. Credit Risk

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

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

## Note 2. Cash and Other Monetary Assets

### Cash and Other Monetary Assets as of September 30

(In billions of dollars)	2009	2008
Unrestricted cash:		
Cash held by Treasury for Governmentwide operations .....	104.0	64.3
Other .....	8.4	6.5
Restricted cash:		
Cash held by Treasury for Governmentwide operations .....	165.0	300.0
Other .....	17.7	14.0
Total cash .....	<u>295.1</u>	<u>384.8</u>
International monetary assets .....	71.4	14.3
Gold .....	11.1	11.0
Foreign currency .....	15.6	14.4
Total cash and other monetary assets .....	<u>393.2</u>	<u>424.5</u>

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

Restricted cash is restricted due to the imposition on cash deposits by law, regulation, or agreement. Restricted cash is primarily composed of the SFP and cash held by the Foreign Military Sales programs. On September 18, 2008, Treasury began issuing specific cash management bills to fund the SFP. The SFP is a temporary program that deposits cash with the Federal Reserve to support Federal Reserve initiatives aimed at addressing the ongoing crisis in financial markets. As of September 30, 2009, there were a total of five SFP cash management bills outstanding that totaled \$165 billion. As of September 30, 2008, there were eight SFP cash management bills outstanding that totaled \$300 billion. The decrease is a result of outstanding SFP bills that have matured and have not been reinvested in the program. The Foreign Military Sales program included \$17.2 billion and \$13.3 billion as of September 30, 2009, and 2008, respectively. All cash held by depository institutions is either insured (for balances up to \$100,000 and temporarily increased to \$250,000 through December 31, 2013) by the Federal Deposit Insurance Corporation (FDIC) or collateralized by securities pledged by the depository institution or through securities held under reverse repurchase agreements. 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 payment system to facilitate growth in the world economy. Its primary activities are surveillance of member economies, financial assistance as appropriate and technical assistance.

Only a portion of the U.S. financial subscriptions to the IMF is made in the form of reserve assets; the remainder is provided in the form of a letter of credit from the United States to the IMF. The balance available under the letter of credit totaled \$53.1 billion and \$53.0 billion as of September 30, 2009, and 2008, respectively. The U.S. reserve position in the IMF has a U.S. dollar equivalent of \$13.4 billion and \$4.8 billion as of September 30, 2009, and 2008, respectively.

SDRs are in 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 \$58.0 billion and \$9.5 billion equivalent as of September 30, 2009, and 2008, respectively. In fiscal year 2009, the ESF received 27.5 billion SDRs (equivalent to approximately \$43 billion in U.S. dollars) as the U.S. share of a general allocation from the IMF, and 2.9 billion SDRs (equivalent to approximately \$4.5 billion in U.S. dollars) as the United States share of a special allocation from the IMF.

The IMF allocates SDRs to its members in proportion to each member's quota in the IMF. The SDR Act, enacted in 1968, authorized the Secretary of the Treasury to issue SDRCs to the Federal Reserve in exchange for dollars. The amount of SDRCs outstanding cannot exceed the dollar value of SDR holdings. The Secretary of the Treasury determines when Treasury will issue or redeem SDRCs. SDRCs outstanding totaled \$5.2 billion and \$2.2 billion as of September 30, 2009, and 2008 respectively, and are included in Note 19—Other Liabilities.

As of September 30, 2009, and 2008, other liabilities included \$56.0 billion and \$7.6 billion of interest-bearing liability to the IMF for SDR allocations. The SDR allocation item represents the cumulative total of SDRs distributed by the IMF to the United States in allocations that occurred in 1970, 1971, 1972, 1979, 1980, 1981, and 2009.

Gold is valued at the statutory price of \$42.2222 per fine troy ounce. The number of fine troy ounces was 261,498,900 as of September 30, 2009, and 2008. The market value of gold on the London Fixing was \$996 and \$885 per fine troy ounce as of September 30, 2009, and 2008, respectively. Gold totaling \$11.1 billion and \$11.0 billion as of September 30, 2009, and 2008, respectively, was pledged as collateral for gold certificates issued and authorized to the FRBs by the Secretary of the Treasury and is included in Note 19—Other Liabilities. Treasury may redeem the gold certificates at any time. Foreign currency is translated into U.S. dollars at the exchange rate at fiscal yearend. The foreign currency is maintained by various U.S. Federal agencies and foreign banks.

### Note 3. Accounts and Taxes Receivable, Net

#### Accounts and Taxes Receivable as of September 30

(In billions of dollars)

	2009	2008
Accounts Receivable:		
Gross accounts receivable .....	80.2	77.1
Allowance for uncollectible accounts.....	<u>(20.9)</u>	<u>(15.2)</u>
Accounts receivable, net .....	59.3	61.9
Taxes Receivable:		
Gross taxes receivable .....	131.2	115.5
Allowance for doubtful accounts.....	<u>(100.3)</u>	<u>(84.4)</u>
Taxes receivable, net .....	30.9	31.1
 Total accounts and taxes receivable, net .....	 <u>90.2</u>	 <u>93.0</u>

Accounts receivable includes related interest receivable of \$5.7 billion and \$6.4 billion as of September 30, 2009, and 2008, respectively.

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

### Direct Loan and Defaulted Guaranteed Loan Programs as of September 30

	Face Value of Loans Outstanding		Long-term Cost of/(Income From) Direct Loans and Defaulted Guaranteed Loans Outstanding		Loans Receivable and Mortgage Backed Securities, Net		Subsidy Expense/ (Income) for the Fiscal Year	
	2009	2008	2009	2008	2009	2008	2009	2008
(In billions of dollars)								
GSE Mortgage Backed Securities Purchase Program - Treasury .....	173.3	3.3	(11.1)	(0.1)	184.4	3.4	(12.9)	(0.1)
Federal Direct Student Loans - Education .....	157.8	124.4	4.5	14.2	153.3	110.2	(9.6)	5.2
Federal Family Education Loans - Education .....	84.0	32.7	3.1	8.2	80.9	24.5	(4.1)	(0.2)
Electric Loans - USDA.....	40.0	37.5	2.3	2.0	37.7	35.5	0.2	0.5
Rural Housing Services - USDA.....	28.4	27.6	6.9	7.0	21.5	20.6	0.3	0.3
Water and Environmental Loans - USDA.....	10.4	9.9	0.8	0.9	9.6	9.0	(0.1)	0.2
Farm Loans - USDA .....	7.3	6.7	0.3	(0.4)	7.0	7.1	0.8	(0.4)
Disaster Loan Programs - SBA.....	8.4	8.6	1.6	1.5	6.8	7.1	-	-
Export-Import Bank Loans .....	7.7	6.4	3.1	2.6	4.6	3.8	(0.1)	-
Housing and Urban Development Loans.....	5.4	4.9	0.8	(0.8)	4.6	5.7	1.1	1.1
Food Aid - USDA .....	6.1	6.7	1.9	2.8	4.2	3.9	(0.4)	(0.3)
Telecommunications Loans - USDA....	4.1	4.0	-	(0.1)	4.1	4.1	0.2	0.2
U.S. Agency for International Development Loans .....	5.6	6.3	1.8	2.3	3.8	4.0	-	-
Housing for the Elderly and Disabled - HUD.....	3.5	3.9	-	-	3.5	3.9	-	-
All Other Programs.....	19.4	15.5	6.5	4.5	12.9	11.0	1.3	0.4
<b>Total Direct Loans and Defaulted Guaranteed Loans.....</b>	<b>561.4</b>	<b>298.4</b>	<b>22.5</b>	<b>44.6</b>	<b>538.9</b>	<b>253.8</b>	<b>(23.3)</b>	<b>6.9</b>

<b>Loan Guarantees as of September 30</b>								
	<b>Principal Amount of Loans under Guarantee</b>		<b>Principal Amount Guaranteed by the United States</b>		<b>Loan Guarantee Liabilities</b>		<b>Subsidy Expense (Income) for the Fiscal Year</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008 (Restated)</b>	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
(In billions of dollars)								
Federal Housing Administration Loans - HUD.....	804.2	576.4	757.3	534.9	34.1	19.6	(0.7)	(1.0)
Federal Family Education Loans - Education.....	457.3	414.6	445.4	405.2	20.6	43.2	(25.9)	(2.7)
Small Business Loans - SBA.....	74.9	75.1	62.2	61.7	4.0	1.8	4.8	0.4
Export-Import Bank Guarantees.....	57.7	51.8	57.7	51.8	2.2	1.4	(0.2)	-
Veterans Housing Benefit Programs - VA.....	183.4	220.8	50.4	63.9	3.9	3.5	-	(0.6)
Rural Housing Services - USDA.....	34.8	22.5	31.3	20.3	1.1	0.8	0.2	0.1
Israeli Loan Guarantee Program - AID ...	12.2	12.5	12.2	12.5	1.8	1.2	0.3	-
Export Credit Guaranteed Programs - USDA.....	7.0	3.9	6.9	3.8	0.2	0.2	-	-
Overseas Private Investment Corporation Credit Program.....	4.9	4.7	4.9	4.7	0.1	0.1	-	-
Business and Industry Loans - USDA.....	4.4	3.8	3.3	2.8	0.4	0.3	0.1	-
Federal Ship Financing Fund (Title XI) - DOT.....	2.4	2.4	2.4	2.4	0.3	0.3	0.1	(0.1)
All Other Guaranteed Loan Programs.....	18.1	14.2	16.8	13.0	0.7	0.5	0.1	-
<b>Total Loan Guarantees.....</b>	<b>1,661.3</b>	<b>1,402.7</b>	<b>1,450.8</b>	<b>1,177.0</b>	<b>69.4</b>	<b>72.9</b>	<b>(21.2)</b>	<b>(3.9)</b>

The Government has different types of loans and loan guarantees. One major type of loan is financing agreements such as the Treasury's GSE MBS Purchase Program. The second major type of loan is direct loans such as the Department of Education's (Education) Federal Direct Student Loans. The third type is loan guarantee programs such as Education's Federal Family Education Loan (FFEL) program and the Department of Agriculture's (USDA) Electric Loans.

Direct loans and loan guarantee programs are used to promote the Nation's welfare by making financing available to segments of the population not served adequately by non-Federal institutions. For those unable to afford credit at the market rate, Federal credit programs provide subsidies in the form of direct loans offered at an interest rate lower than the market rate. For those to whom non-Federal financial institutions are reluctant to grant credit because of the high risk involved, Federal credit programs guarantee the payment of these non-Federal loans and absorb the cost of defaults.

The amount of the long-term cost of post-1991 direct loans and loan guarantees outstanding equals the subsidy cost allowance for direct loans and the liability for loan guarantees as of September 30. The amount of the long-term cost of pre-1992 direct loans and loan guarantees equals the allowance for uncollectible amounts (or present value allowance) for direct loans and the liability for loan guarantees. The long-term cost is based on all direct loans and guaranteed loans disbursed in this fiscal year and previous years that are outstanding as of September 30. It includes the subsidy cost of these loans and guarantees estimated as of the time of loan disbursement and subsequent adjustments such as modifications, reestimates, amortizations, and writeoffs.

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

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

## Major Loan Programs

The Housing and Economic Recovery Act of 2008 (HERA), Public Law 110-289, enacted on July 30, 2008, authorized Treasury to enter into several different types of financing arrangements with GSEs to provide stability to the financial markets; prevent disruptions in the availability of mortgage finance; and protect the taxpayer. Two of these arrangements include the GSE MBS Purchase Program and GSE Credit Facility (GSECF).

The GSE MBS Purchase Program was a program to further support the availability of mortgage financing for millions of Americans and to mitigate pressures on mortgage rates. Under this program, Treasury, via asset managers, purchased GSE MBS in the open market. By purchasing these credit-guaranteed securities, Treasury sought to broaden access to mortgage funding for current and prospective homeowners and to promote stability in the mortgage market. The asset managers were also authorized to enter into other trade/sell transactions such as pair offs, turns, assignments, and dollar rolls to further support the market under HERA. While the size and timing of the MBS purchases were subject to the discretion of the Secretary of the Treasury, the authority granted by Congress to purchase MBS expired on December 31, 2009.

Treasury purchased mortgage-backed pass-through securities through the GSE MBS Purchase Program. Consistent with the Federal Credit Reform Act, these securities were treated as direct loans, and the value of Treasury's position and the associated credit subsidy requirements are determined based on the net present value of the securities' forecasted future cashflows. Treasury estimated nominal future cashflows using a financial model that incorporated each security's payment characteristics together with assumptions about the future prepayment, default, and loss severity performance of underlying loan collateral and the GSEs' ability to uphold their guarantee. Nominal cashflow forecasts were discounted at interest rates of Treasury securities with comparable maturities using the OMB's Credit Subsidy Calculator. Cashflows were estimated under the assumption that all securities will be held to maturity.

Security-level data used as the basis for cashflow model forecasts were obtained directly from Treasury's program custodian. Assumptions about security and program performance were drawn from widely available market sources as well as information published by the GSEs. Key inputs to the cashflow forecast include:

- Security characteristics such as unpaid principal balance, pass-through coupon rate, weighted-average loan age, and weighted-average maturity.
- Forecast prepayment rates and default rates.

The GSECF was established to ensure credit availability to the GSEs and the Federal Home Loan Banks. This lending facility was to provide secured funding on an as needed basis under terms and conditions established by the Secretary of the Treasury to protect taxpayers. Fannie Mae, Freddie Mac, and the Federal Home Loan Banks were eligible to borrow under this program. The GSECF provided liquidity, if needed, until December 31, 2009. There were no loans made through the GSECF in fiscal year 2009 or 2008. No draws occurred between the date of Treasury's press release (December 24, 2009) and when the facility expired on December 31, 2009.

Education has two major education loan programs. The first 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 program, the FFEL 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. During fiscal year 2009, FFEL loans receivable increased significantly due to the Ensuring Continued Access to Student Loans Act of 2008 (ECASLA). The ECASLA gave Education temporary loan purchase authority to purchase FFEL loans and interest in those 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 (RD) mission area.

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

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

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

HUD's Federal Housing Administration (FHA) provides mortgage insurance to encourage lenders to make credit available to expand home ownership. FHA predominantly serves borrowers that the conventional market does not serve adequately. This includes first-time homebuyers, minorities, low-income families, and residents of underserved areas. Borrowers obtain an FHA insured mortgage and pay an upfront premium and an annual premium to FHA. The proceeds from those premiums are used to fund FHA program costs, including claims on defaulted mortgages and holding costs, property management fees, property sales, and other associated costs. The possibility of a sizable volume of delinquencies remains a significant risk for the housing market and for FHA in the near term. Nonetheless, HUD anticipates that the Mutual Mortgage Insurance Fund will remain financially sound. FHA continues to be a financially conservative and stabilizing presence for credit markets in times of economic disruption.

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

## **Restatements**

Due to a correction of an error by VA, the Principal Amount Guaranteed by the U.S. for the Veterans Housing Benefit Programs—VA increased from \$36.1 billion to \$63.9 billion, as of September 30, 2008. This restatement had no impact on the loan guarantee liabilities reported on the Balance Sheet and had no impact on 2008 net position as reported.



## Note 5. TARP Direct Loans and Equity Investments, Net

The TARP was authorized by the Emergency Economic Stabilization Act of 2008 (EESA or “The Act”). The Act gave the Secretary of the Treasury broad flexible authority to establish the TARP to purchase and guarantee mortgages, mortgage related securities and other troubled assets held by financial institutions. This permitted the Secretary of the Treasury to inject capital into, and receive equity interests in, banks and other financial institutions. Treasury established several programs under the TARP to help stabilize the financial system and restore the flow of credit to consumers and businesses, and tackle the foreclosure crisis.

The following TARP programs were designed to stabilize the financial system and restore the flow of credit to consumers and businesses. Treasury made direct loans and made equity investments and entered into asset guarantees. The table below is a list and type of the TARP programs.

Program	Program Type
Capital Purchase Program	Equity Investment/Subordinated Debentures
American International Group, Inc. Investment Program *	Equity Investment
Targeted Investment Program	Equity Investment
Automotive Industry Financing Program	Equity Investment and Direct Loan
Consumer and Business Lending Initiative	Direct Loan
Public-Private Investment Program	Equity Investment and Direct Loan
Asset Guarantee Program	Guarantee
Home Affordable Modification Program**	Expenditure

\* Formerly known as the Systemically Significant Failing Institutions Program.  
 \*\*HAMP is not designed to recoup money spent on loan modifications. As such, this program does not include direct loans, equity investments, or asset guarantees.

TARP direct loans, equity investments, and asset guarantee balances as of September 30, 2009 are as follows:

<b>Troubled Asset Relief Program as of September 30</b>	
(In billions of dollars)	<b>2009</b>
Direct Loans and Equity Investments, Net.....	237.9
Asset Guarantee Program .....	1.8
<b>Total .....</b>	<b>239.7</b>

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

<b>Troubled Asset Relief Program Direct Loans and Equity Investments as of September 30, 2009</b>				
(In billions of dollars)	<b>Direct Loans and Equity Investments</b>	<b>Subsidy Cost Allowance</b>	<b>Net Direct Loans and Equity Investments</b>	<b>Subsidy Expense (Income) for the Fiscal Year</b>
Capital Purchase Program .....	133.9	7.8	141.7	(15.0)
American International Group, Inc. Investment Program.....	43.2	(30.0)	13.2	30.4
Targeted Investment Program.....	40.0	0.3	40.3	(1.9)
Automotive Industry Financing Program .....	73.8	(31.5)	42.3	30.4
Consumer and Business Lending Initiative .....	0.1	0.3	0.4	(0.3)
<b>Total .....</b>	<b>291.0</b>	<b>(53.1)</b>	<b>237.9</b>	<b>43.6</b>

### Capital Purchase Program

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

### American International Group, Inc. Investment Program (AIG)

Treasury provided assistance to AIG in order to prevent its disorderly failure as well as to prevent broader disruption to the financial markets. In November 2008, Treasury invested \$40 billion in AIG's cumulative Series D perpetual cumulative preferred stock with a dividend rate of 10.0 percent compounded quarterly. The \$40 billion from Treasury was used to repay a portion of a loan from the FRBNY. On April 17, 2009, AIG and Treasury restructured their November 2008 agreement. Under the restructuring, Treasury exchanged \$40 billion of cumulative Series D preferred stock for \$41.6 billion of non-cumulative 10 percent Series E preferred stock. The amount of Series E preferred stock is equal to the original \$40 billion plus dividends not paid as of April 17, 2009. In addition to the exchange, Treasury agreed to make available an additional \$29.8 billion capital facility to allow AIG to draw additional funds if needed to assist in AIG's restructuring. As of September 30, 2009, Treasury had funded approximately \$3.2 billion under this additional capital facility. Consistent with SFFAS No. 2, the unused portion of the AIG capital facility is not recognized as an asset as of September 30, 2009.

As of September 30, 2009, AIG had not made any dividend payments on any of the perpetual preferred stock. Subsequently, AIG failed to make dividend payments through February 1, 2010. Per the terms of the preferred stock, if AIG misses four dividend payments, Treasury may appoint to the AIG board of directors, the greater of two members or 20.0 percent of the total number of directors of the Company.

### Targeted Investment Program (TIP)

The TIP was designed to prevent a loss of confidence in financial institutions that could result in significant market disruptions, threatening the financial strength of similarly situated financial institutions, impairing broader financial markets, and undermining the overall economy. Treasury considers institutions for the TIP on a case-by-case basis, based on a number of factors described in the program guidelines. These factors include the threats posed by destabilization of the institution, the risks caused by a loss of confidence in the institution, and the institution's importance to the nation's economy.

In December 2008, Treasury invested \$20.0 billion in Citigroup cumulative perpetual preferred stock with an 8.0 percent stated annual dividend rate and received a warrant for the purchase of Citigroup common stock. In January 2009, Treasury invested \$20.0 billion in Bank of America cumulative perpetual preferred stock with an 8.0 percent stated annual dividend rate and received a warrant for the purchase of Bank of America common stock. In December 2009, Citigroup and Bank of America each repaid to Treasury the \$20.0 billion received under TIP.

### Automotive Industry Financing Program

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

**General Motors**—Prior to June 2009, Treasury provided General Motors (GM) with a total of \$19.4 billion in direct loan financing and received warrants for GM common stock and additional senior unsecured notes. On June 1, 2009, GM filed for Chapter 11 bankruptcy. Under the terms of a debtor-in-possession (DIP) credit agreement, Treasury provided an additional \$30.1 billion to GM. A new entity, General Motors Company (New GM) purchased most of old GM's assets and began operating on July 10, 2009. Treasury's previous \$19.4 billion in loans and \$30.1 billion DIP loans were mostly converted to a combination of loans, preferred stock and common stock of New GM. Specifically, New GM assumed \$7.1 billion of the DIP loan, simultaneously paying \$0.4 billion, resulting in a balance of \$6.7 billion. Treasury also received \$2.1 billion in 9.0 percent cumulative perpetual preferred stock and 60.8 percent of the common equity interest in New GM. In addition, approximately \$1.0 billion remained outstanding relating to the DIP due from the old GM.

In addition, in December 2008, Treasury agreed to lend up to \$1.0 billion to GM for participation in a rights offering by GMAC (or GMAC Financial Services) in support of GMAC's reorganization as a bank holding company. The loan was secured by the GMAC common interests acquired in the rights offering. The loan agreement specified that at any time, at the option of the lender, the unpaid principal balance and accrued interest was exchangeable for the membership interests purchased by GM, during the rights offering. The note was funded for approximately \$0.9 billion. In May 2009, Treasury exercised its exchange option under the loan and received 190,921 membership interests, representing approximately 35.4 percent of the voting interest in GMAC, in full satisfaction of the loan.

**Chrysler**—In January 2009, Treasury provided a \$4.0 billion loan to a parent company of Chrysler (Chrysler Holdings) and received a senior unsecured note in the principal amount of approximately \$0.3 billion. On April 30, 2009, Chrysler filed for Chapter 11 bankruptcy. On June 10, 2009, substantially all of the assets of Chrysler were sold to a newly-created entity (New Chrysler). In May 2009, Treasury provided an additional \$1.9 billion to Chrysler under the terms of a DIP credit agreement. Recovery of the DIP loan is subject to the bankruptcy process associated with the Chrysler assets remaining after the sale to New Chrysler.

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

**GMAC**—In December 2008, Treasury purchased preferred membership interests for \$5.0 billion with an 8 percent annual distribution right (dividends) from GMAC. In May 2009, Treasury had invested \$7.5 billion in Mandatory Convertible Preferred Stock in GMAC to support its ability to originate new loans to Chrysler dealers and consumers, and help address GMAC's capital needs. As part of these transactions, Treasury also received warrants which it exercised immediately.

As of September 30, 2009, Treasury-OFS owned \$13.1 billion in preferred shares in GMAC, through purchases and the exercise of warrants, in addition to 35 percent of the common equity in GMAC, as described previously under GM.

During December 2009, Treasury made additional investments in GMAC and increased its ownership interest by converting some Mandatory Convertible Preferred Stock. See further information in Note 28—Subsequent Events.

### **Term Asset-Backed Securities Loan Facility**

The Term Asset-Backed Securities Loan Facility (TALF), was created by the Board of Governors of the Federal Reserve System and Treasury to provide low cost funding to investors in certain classes of ABS. Treasury participates in the program as part of Treasury's Consumer and Business Lending Initiative by providing liquidity and credit protection to the FRBNY. As part of the program, the FRBNY has entered into a put agreement with the TALF, LLC, a special purpose vehicle created by the FRBNY. In the event of a TALF borrower default, the FRBNY will seize the collateral and sell it to the TALF, LLC under this agreement. Under the TALF, the FRBNY, as implementer of the TALF program, originates loans on a non-recourse basis to holders of certain AAA rated ABS. The TALF, LLC receives a monthly fee as compensation for entering into the put agreement. The accumulation of this fee will be used to fund purchases. In the event there are insufficient funds to purchase the collateral, Treasury has committed to invest up to \$20.0 billion in non-recourse subordinate notes issued by the TALF, LLC. Treasury disbursed \$0.1 billion upon creation of the TALF, LLC and the remainder can be drawn to purchase collateral in the event the accumulated fees are not sufficient to cover purchases. As of September 30, 2009, the FRBNY had originated \$50.9 billion in TALF loans of which \$42.7 billion were outstanding.

### **Public Private Investment Program (PPIP)**

The PPIP is part of Treasury's efforts to help restart the markets and provide liquidity for legacy assets. Under this program, Treasury will make equity and debt investments in investment vehicles (referred to as Public Private Investment Funds or "PPIFs") established by private investment managers. The equity investment will be used to match private capital and will equal not more than 50 percent of the total equity invested. The debt investment will be, at the option of the investment manager, equal to 50 percent or 100 percent of the total equity (including private equity). The PPIFs invest primarily in commercial mortgage-backed securities and non-agency residential MBS. At least 90 percent of the assets underlying any eligible asset must be situated in the United States. On September 30, 2009, Treasury signed limited partnership and loan agreements with two investment managers, committing to potentially disburse up to \$6.7 billion. However, as of September 30, 2009, for PPIP no private fund managers had made any investments and Treasury had not disbursed any funds.

As of December 31, 2009, Treasury had signed limited partnership and loan agreements with nine PPIFs which committed Treasury to potentially disburse up to \$30 billion. As of December 31, 2009, the PPIFs had drawn-down approximately \$4.2 billion (\$1.2 billion from private capital, \$1.2 from Treasury capital, and approximately \$1.8 from Treasury debt) which has been invested in eligible assets and cash equivalents pending investments.

**Asset Guarantee Program (AGP)**

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

In January 2009, Treasury finalized the terms of a guarantee agreement with Citigroup. Under the agreement, Treasury, FDIC, and the FRBNY provided protection against the possibility of large losses on an asset pool of approximately \$301 billion of loans and securities which remain on Citigroup's balance sheet. The following loss-sharing terms applied to the transaction: Citigroup would absorb the first \$39.5 billion in losses, and losses over the \$39.5 billion would be shared by the Government and the FRBNY (90.0 percent) and Citigroup (10.0 percent) (the "second loss"). For the second loss, Treasury would absorb up to \$5.0 billion, then FDIC would absorb up to \$10.0 billion, and lastly the FRBNY would fund any losses above Treasury and the FDIC commitments through a non-recourse loan. As a premium for the guarantee, Citigroup issued approximately \$7.0 billion of cumulative preferred stock with an 8.0 percent stated dividend rate and a warrant for the purchase of common stock; approximately \$4.0 billion and the warrant was issued to Treasury and approximately \$3.0 billion was issued to the FDIC. For the period ended September 30, 2009, the AGP's subsidy cost (income) was about \$(2.2) billion. Subsequent to September 30, 2009, the guarantee was terminated without the Federal Government incurring any losses.

On December 23, 2009, Treasury, the Federal Reserve, the Federal Deposit Insurance Corporation and Citigroup terminated this program. The Government parties did not pay any losses under the program and will keep \$5.2 billion of \$7 billion in trust preferred securities as well as warrants for common shares that were issued by Citigroup as consideration for such guarantee. With this termination, the AGP is being terminated at a profit to the taxpayer.

**Home Affordable Modification Program (HAMP)**

The HAMP is designed to assist eligible homeowners by providing reductions in their monthly mortgage payments for up to five years. As of September 30, 2009, Treasury had entered into agreements with 63 servicers to provide up to approximately \$27.1 billion in payments and incentives to borrowers, servicers, and investors. As of September 30, 2009, approximately \$1 million in incentive payments had been made.

For more details on the TARP, please see the Performance and Accountability Report for Treasury.

## Note 6. Beneficial Interest in Trust

Under the initial terms of a credit facility agreement with AIG and the FRBNY, a 77.9 percent equity interest in AIG (in the form of Series C Convertible Participating Serial Preferred Stock convertible into approximately 77.9 percent of the issued and outstanding shares of common stock) was issued to a trust established by the FRBNY. Subsequent to the initial agreement, a reverse stock split of AIG's common stock increased this to 79.8 percent. The Government is the sole beneficiary of that trust, so that when the stock is ultimately liquidated the proceeds will be deposited into the General Fund of the U. S. Treasury. The Government will be the ultimate recipient of any dividends on the stock and any proceeds from the liquidation of the stock. The accounting and reporting for any activities related to the Government's beneficial interest in the stock held by the trust will be done by Treasury. The trustees of the trust are independent of both Treasury and the FRBNY, and are not involved in day-to-day management of AIG.

As the Government is the sole beneficiary of the trust, it is anticipated that the Government will ultimately realize an economic benefit from its beneficial interest in the trust. The \$23.5 billion value recorded is based on the market value of the trust's AIG holdings at September 30, 2009; as the underlying AIG common stock is actively traded on the New York Stock Exchange, this represents the best independent valuation available for the Government's beneficial interest. The Government's proceeds will be received when AIG's credit line with the FRBNY is terminated, AIG has redeemed the preferred stock owned by Treasury through TARP, and the trustees sell the stock held by the trust. The Government will re-value its beneficial interest in the trust each year until the trust is liquidated. Like any asset, future events may increase or decrease the value of the Government's interest in the trust. The amount ultimately realized by the Government upon liquidation of the trust is inherently subject to substantial uncertainty regarding future economic events that could affect the future value of AIG common stock.

Treasury's participation in enhancing AIG's capital and liquidity in order to facilitate an orderly restructuring of the company is in addition to the FRBNY activities in this regard.

## Note 7. Inventories and Related Property, Net

<b>Inventories and Related Property as of September 30</b>						
(In billions of dollars)	<b>All</b>			<b>All</b>		
	<b>Defense</b>	<b>Others</b>	<b>Total</b>	<b>Defense</b>	<b>Others</b>	<b>Total</b>
	<b>2009</b>			<b>2008</b>		
Inventory purchased for resale .....	87.8	0.8	88.6	101.1	0.8	101.9
Inventory and operating material and supplies held for repair .....	46.0	0.6	46.6	44.1	0.6	44.7
Inventory—excess, obsolete, and unserviceable .....	7.8	-	7.8	7.8	-	7.8
Operating materials and supplies held for use.....	128.9	5.3	134.2	131.7	4.9	136.6
Operating materials and supplies held in reserve for future use .....	-	0.9	0.9	-	0.2	0.2
Operating materials and supplies—excess, obsolete, and unserviceable .....	3.4	0.1	3.5	3.6	0.2	3.8
Stockpile materials .....	-	47.2	47.2	-	46.1	46.1
Stockpile materials held for sale .....	0.7	0.2	0.9	0.7	0.2	0.9
Other related property .....	1.0	1.1	2.1	0.7	1.0	1.7
Allowance for loss .....	(46.9)	(0.3)	(47.2)	(53.7)	(0.4)	(54.1)
<b>Total inventories and related property, net ..</b>	<b>228.7</b>	<b>55.9</b>	<b>284.6</b>	<b>236.0</b>	<b>53.6</b>	<b>289.6</b>

Inventory purchased for resale is the cost or value of tangible personal property purchased by an agency for resale. DOD values approximately 68 percent of its resale inventory using the moving average cost (MAC) method. An additional 6 percent (fuel inventory) is reported using the first-in-first-out method. DOD reports the remaining 26 percent of resale inventories at an approximation of historical cost using LAC adjusted for holding gains and losses. The LAC method is used because its legacy inventory systems do not maintain historical cost data.

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

Inventory and operating materials and supplies held for repair are damaged inventory that require repair to make them suitable for sale (inventory) or is more economic to repair than to dispose of (operating materials and supplies).

Inventory—excess, obsolete, and unserviceable consists of:

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

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

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

Operating materials and supplies held in reserve for future use are materials retained because they are not readily available in the market or because they will not be used in the normal course of operations, but there is more than a remote chance they will eventually be needed. DOD, which accounts for most of the reported operating materials and supplies held for use, uses LAC, MAC, and Standard Price and expenses a significant amount of them when purchased instead of when consumed.

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

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

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

Please refer to the individual financial statements of DOD and National Aeronautics and Space Administration (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 DOD is stockpile materials held for sale, and the amount reported by others is stockpile materials held in reserve, with the majority of it being reported by the Department of Energy (DOE). Please refer to their individual financial statements for more information on stockpile materials.

Other related property consists of the following:

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



## Note 8. Property, Plant, and Equipment, Net

### Property, Plant, and Equipment as of September 30, 2009

(In billions of dollars)	<u>Cost</u>		<u>Accumulated Depreciation/ Amortization</u>		<u>Net</u>	
	<u>Defense</u>	<u>All Others</u>	<u>Defense</u>	<u>All Others</u>	<u>Defense</u>	<u>All Others</u>
Buildings, structures, and facilities.....	191.7	201.4	108.0	104.6	83.7	96.8
Furniture, fixtures, and equipment.....	877.5	151.4	446.9	91.6	430.6	59.8
Construction in progress.....	30.8	41.2	N/A	N/A	30.8	41.2
Land.....	10.5	11.7	N/A	N/A	10.5	11.7
Internal use software.....	9.0	15.0	5.6	7.5	3.4	7.5
Assets under capital lease.....	1.0	2.8	0.6	1.3	0.4	1.5
Leasehold improvements.....	0.7	5.7	0.5	2.8	0.2	2.9
Other property, plant, and equipment.....	0.1	8.5	-	5.5	0.1	3.0
Subtotal.....	<u>1,121.3</u>	<u>437.7</u>	<u>561.6</u>	<u>213.3</u>	<u>559.7</u>	<u>224.4</u>
Total property, plant, and equipment, net.....		<u>1,559.0</u>		<u>774.9</u>		<u>784.1</u>

### Property, Plant, and Equipment as of September 30, 2008

(In billions of dollars)	<u>Cost</u>		<u>Accumulated Depreciation/ Amortization</u>		<u>Net</u>	
	<u>Defense</u>	<u>All Others</u>	<u>Defense</u>	<u>All Others</u>	<u>Defense</u>	<u>All Others</u>
Buildings, structures, and facilities.....	180.2	193.3	105.3	99.6	74.9	93.7
Furniture, fixtures, and equipment.....	789.5	156.5	386.7	91.5	402.8	65.0
Construction in progress.....	22.5	39.0	N/A	N/A	22.5	39.0
Land.....	10.5	11.7	N/A	N/A	10.5	11.7
Internal use software.....	8.9	12.8	5.5	5.9	3.4	6.9
Assets under capital lease.....	1.0	2.0	0.5	0.8	0.5	1.2
Leasehold improvements.....	0.6	4.9	0.4	2.6	0.2	2.3
Other property, plant, and equipment.....	0.1	8.6	-	5.6	0.1	3.0
Subtotal.....	<u>1,013.3</u>	<u>428.8</u>	<u>498.4</u>	<u>206.0</u>	<u>514.9</u>	<u>222.8</u>
Total property, plant, and equipment, net.....		<u>1,442.1</u>		<u>704.4</u>		<u>737.7</u>

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

DOD comprises approximately 71 percent of the Government's reported property, plant, and equipment as of September 30, 2009. Refer to the individual financial statements of DOD, DOE, the Tennessee Valley Authority (TVA), the United States Postal Service (USPS), GSA, Department of the Interior (DOI), and DHS for significant detailed information on the useful lives and related capitalization thresholds for property, plant, and equipment. These agencies comprise 89 percent of the Government's total reported net property, plant, and equipment of \$784.1 billion as of September 30, 2009.

## Note 9. Securities and Investments

### Securities and Investments as of September 30, 2009

(In billions of dollars)	By Category									Total
	Held-to-Maturity			Available-for-Sale			Trading			
	Cost Basis	Unamortized Premium/Discount	Net Investment	Cost Basis	Unrealized Gain/Loss	Fair Value	Cost Basis	Unrealized Gain/Loss	Fair Value	
<b>Fixed/debt securities:</b>										
Non-U.S. Government .....	0.2	-	0.2	12.1	0.4	12.5	2.7	0.3	3.0	15.7
Commercial.....	-	-	-	-	-	-	0.1	-	0.1	0.1
Mortgage/asset backed .....	-	-	-	-	-	-	2.9	(0.1)	2.8	2.8
Corporate and other bonds.....	-	-	-	-	-	-	8.7	(0.1)	8.6	8.6
All other fixed debt securities....	1.1	-	1.1	-	-	-	1.5	0.1	1.6	2.7
<b>Equity securities:</b>										
Common stocks .....	-	-	-	-	-	-	0.9	(0.1)	0.8	0.8
Unit trust .....	-	-	-	-	-	-	17.0	5.1	22.1	22.1
All other equity securities.....	-	-	-	3.0	-	3.0	2.0	(0.2)	1.8	4.8
Other.....	<u>2.2</u>	-	<u>2.2</u>	-	-	-	<u>33.2</u>	<u>0.1</u>	<u>33.3</u>	<u>35.5</u>
Total Securities and Investments.....	<u>3.5</u>	-	<u>3.5</u>	<u>15.1</u>	<u>0.4</u>	<u>15.5</u>	<u>69.0</u>	<u>5.1</u>	<u>74.1</u>	<u>93.1</u>

**Securities and Investments as of September 30, 2008****By Category**

(In billions of dollars)	Held-to-Maturity			Available-for-Sale			Trading			Total
	Cost Basis	Unamor-	Net Investment	Cost Basis	Unreal-	Fair Value	Cost Basis	Unreal-	Fair Value	
		tized Premium/Discount			ized Gain/Loss			ized Gain/Loss		
<b>Fixed/debt securities:</b>										
Non-U.S. Government .....	10.8	-	10.8	-	-	-	2.9	(0.3)	2.6	13.4
Commercial.....	-	-	-	-	-	-	(0.2)	-	(0.2)	(0.2)
Mortgage/asset backed .....	0.2	-	0.2	-	-	-	3.8	(0.4)	3.4	3.6
Corporate and other bonds .....	-	-	-	-	-	-	13.4	(2.3)	11.1	11.1
All other fixed debt securities....	-	-	-	-	-	-	0.2	(0.1)	0.1	0.1
<b>Equity securities:</b>										
Common stocks .....	-	-	-	-	-	-	3.6	(0.7)	2.9	2.9
Unit trust .....	-	-	-	-	-	-	6.2	3.4	9.6	9.6
All other equity securities .....	-	-	-	-	-	-	1.1	(0.1)	1.0	1.0
Other.....	2.1	-	2.1	-	-	-	36.0	-	36.0	38.1
Total Securities and Investments.....	13.1	-	13.1	-	-	-	67.0	(0.5)	66.5	79.6

**Securities and Investments as of September 30****By Agency**

(In billions of dollars)

**2009****2008****Securities and Investments:**

Pension Benefit Guaranty Corporation .....	43.6	33.6
Railroad Retirement Board .....	22.2	24.9
Exchange Stabilization Fund .....	13.6	10.6
Tennessee Valley Authority .....	8.0	7.9
All other .....	5.7	2.6
Total Securities and Investments .....	93.1	79.6

These securities and investments do not include nonmarketable Treasury securities, which have been eliminated in consolidation. Held-to-maturity securities and investments are reported at amortized cost, net of unamortized premiums and discounts. Available-for-sale securities and investments are reported at fair value with unrealized changes in fair value excluded from revenue. Trading securities and investments are reported at fair value. The Pension Benefit Guaranty Corporation (PBGC) and the TVA invest primarily in fixed maturity and equity securities, classified as trading. TVA also has a small investment in available-for-sale securities. The National Railroad Retirement Investment Trust (NRRIT), on behalf of the RRB, manages and invests railroad retirement assets that are to be used to pay retirement benefits to the Nation's railroad workers under the Railroad Retirement Program. The NRRIT's investments are all classified as other trading equity securities. Treasury's ESF invests primarily in foreign currency, bonds, and bills. Certain Foreign Currency Denominated Assets totaling \$12.5 billion as of September 30, 2009, are considered available-for-sale securities and recorded at fair value as permitted by OMB Circular No. A-136, beginning in fiscal year 2009. Prior to fiscal year 2009, these assets, which totaled \$10.8 billion at September 30, 2008, were classified as investment securities held-to-maturity and reported at cost. The TVA balance includes \$6.8 billion and \$6.9 billion as of September 30, 2009, and 2008, respectively, for the Tennessee Valley Authority Retirement System (TVARS). Please refer to the individual financial statements of PBGC, NRRIT, Treasury, TVA and TVARS for more detailed information related to securities and investments. These agencies comprise 93.9 percent of the total reported securities and investments of \$93.1 billion as of September 30, 2009.

## Note 10. Derivatives

Derivatives are financial instruments that entities use to hedge their particular exposure to some sort of financial risk. These financial risks include interest rate risk, market price risk, credit risk, foreign exchange risk and commodity risk. As FASAB (which determines GAAP for Federal entities) is silent on this issue, the accounting for derivative instruments are governed by Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 815 Derivatives and Hedging (formerly SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* and amended by SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities*) which aims to highlight to financial statement users additional disclosures on an entity's objectives in its use of derivatives and the method of accounting for such financial instruments. Derivatives are accounted for at market value in accordance with this standard. Derivatives are marked to market with changes in value reported within financial income. The hedge strategy (i.e., fair value, cash flow or foreign currency) employed determines the financial statement impact on their statement of operations and net position.

PBGC uses derivatives to mitigate investment risks, enhance investment returns and as a liquid and cost efficient substitute for positions in physical securities. As of September 30, 2009, PBGC had \$2.8 billion worth of derivatives in an asset position (recorded in accounts receivable) and \$2.9 billion worth of derivatives in a liability position (recorded in other liabilities). During fiscal year 2009, PBGC's investment managers decreased their utilization of derivative instruments as they became a less preferred way of implementing portfolio strategies relative to fiscal year 2008. TVA uses derivatives purely for hedging purposes and not for speculative purposes. TVA, as of September 30, 2009, had \$0.04 billion worth of derivatives in an asset position (recorded in other assets) and \$1.0 billion worth of derivatives in a liability position (recorded in other liabilities). The amount of gain/(loss) on these derivatives for fiscal year 2009 was a \$0.2 billion gain for PBGC and a \$0.3 billion loss for TVA.

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

## Note 11. Investments in Government Sponsored Enterprises and Other Financial and Housing Market Stabilization

Fannie Mae and Freddie Mac are stockholder-owned GSEs. Congress established the GSEs to increase the supply of mortgage loans and to reduce the accompanying costs. A key Fannie Mae and Freddie Mac business responsibility is to package purchased mortgages into securities. These securities are subsequently sold to investors. Proceeds from sales are used to buy additional mortgages and keep money flowing through the mortgage markets.

Increasingly difficult conditions in the housing market challenged the soundness and profitability of Fannie Mae and Freddie Mac, thereby undermining the entire housing market. This led Congress to pass HERA. This Act created the new FHFA, with enhanced regulatory authority over the GSEs, and provided the Secretary of the Treasury with certain authorities intended to ensure the financial stability of the GSEs, if necessary.

The HERA authorized Treasury to enter into several different types of financing arrangements with GSEs to:

- provide stability to the financial markets;
- prevent disruptions in the availability of mortgage finance; and
- protect the taxpayer.

As authorized by HERA, the Secretary of the Treasury entered into Senior Preferred Stock Purchase Agreements (SPSPA) with Fannie Mae and Freddie Mac on September 7, 2008, and began providing substantial financial support to the enterprises; thereby minimizing potential systemic financial risks associated with the deteriorating financial condition of Fannie Mae and Freddie Mac. Per SFFAC No. 2, *Entity and Display*, these entities meet the criteria under paragraph 50. Accordingly, Treasury has not consolidated them into the financial statements, but included “disclosure of the relationship(s) with the entities and any actual or potential material costs or liabilities” in the consolidated financial statements.

The Federal Reserve has also conducted activities during 2009 in support of Fannie Mae and Freddie Mac. In November 2008, the Federal Reserve announced that it would purchase up to \$500 billion in agency MBS and has since extended its intent to purchase up to \$1.25 trillion of agency MBS by the end of the first quarter of 2010. As of December 31, 2009, the Federal Reserve reported that it had purchased approximately \$1 trillion of Fannie Mae and Freddie Mac MBS. In addition, the Federal Reserve reported that it has increased its intent to purchase agency debt from \$100 billion, announced in November 2008, to a total of \$175 billion. As of December 31, 2009, the Federal Reserve reported that it had purchased approximately \$125 billion of Fannie Mae and Freddie Mac debt.

### Senior Preferred Stock Purchase Agreements (SPSPA)

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

The senior preferred stock accrues dividends at 10 percent per year, payable quarterly. This rate shall increase to 12 percent if, in any quarter, the dividends are not paid in cash, until all accrued dividends have been paid. During fiscal year 2009, approximately \$4.3 billion in dividends on GSE Senior Preferred Stock are included in earned revenue on the Statement of Net Cost. In addition, beginning on March 31, 2011, the GSE will pay Treasury a periodic commitment fee on a quarterly basis. This fee will be initially set by December 31, 2010, based on mutual agreement between Treasury and each GSE in consultation with the Chairman of the Board of Governors of the Federal Reserve System. The fee shall be established for 5-year periods, and may be waived by Treasury for one year at a time if warranted by adverse mortgage market conditions. It may be paid in cash or may be added to the liquidation preference.

These agreements, which have no expiration date, provide that Treasury will make funding advances to the GSEs if at the end of any quarter the FHFA determines that the liabilities of either GSE exceed its assets. The maximum amount available to each GSE under this agreement was \$100 billion and was increased to \$200 billion in May 2009. See Note 28—Subsequent Events for additional changes in the maximum amount available to each GSE. Actual payments to the GSEs to date are \$95.6 billion. As of September 30, 2009, \$140.1 billion and \$149.3 billion remain available to Fannie Mae and Freddie Mac, respectively, after quarterly payments made or accrued.

Treasury determined the estimated amount of the remaining liability to the GSEs under the SPSPA as of September 30, 2009. The valuation analysis resulted in estimates ranging from the “best case” scenario of \$76.9 billion to an “extreme case” scenario of \$206.7 billion. The results also noted that no value within the range is a better estimate than any other amount. However, future payments under the SPSPA are deemed to be probable. SFFAS No. 5 provides that when a probable contingent liability is a range of amounts and no amount within the range is a better estimate than any other amount, the estimated liability should be based on the minimum value in the range. Accordingly, \$76.9 billion is recorded as a contingent liability as of September 30, 2009.

As of September 30, 2009, \$91.9 billion is recorded as a liquidity guarantee liability which consists of \$15.0 billion accrued liability and the contingent liability of \$76.9 billion. Revenue of \$7.0 billion was recognized from the acquisition of preferred stock and warrants in fiscal year 2008.

The investments in GSEs disclosed as of September 30, 2008, were recorded at acquisition cost at the date of purchase with disclosure of market values as of fiscal year end 2008. OMB issued guidance to Treasury on October 7, 2009, allowing the use of fair value accounting for non-Federal securities beginning with reporting for fiscal year 2009. As a result, the GSE investments are reported at fair value at September 30, 2009. Annual valuations are performed, as of September 30, of the preferred stock and warrants. In accordance with SFFAS No. 7, the annual valuation is classified as usual and recurring and thus recorded as an expense or revenue to the financial statements.

As of September 30, 2009, and September 30, 2008, GSE investments consisted of the following:

<b>Investments in GSE as of September 30, 2009</b>					
	Liquidation Preference Value At Beginning of Year	Current Year Increase in Liquidation Preference Value	Net Increase in Liquidation Preference Value	Valuation Gain/(Loss)	9/30/09 Fair Value at Reporting Date
(In billions of dollars)					
Fannie Mae Senior Preferred Stock .....	0.8	44.9	45.7	(20.6)	25.1
Freddie Mac Senior Preferred Stock .....	0.8	50.7	51.5	(23.2)	28.3
Fannie Mae Warrants Common Stock .....	3.1	-	3.1	3.6	6.7
Freddie Mac Warrants Common Stock .....	2.3	-	2.3	2.3	4.6
Total GSE Investment ...	<u>7.0</u>	<u>95.6</u>	<u>102.6</u>	<u>(37.9)</u>	<u>64.7</u>
<b>Investments in GSE as of September 30, 2008</b>					
	Cost at Purchase Date	9/30/08 Liquidation Preference Value Balance	Valuation Gain/(Loss)	9/30/08 Fair Value at Reporting Date	
(In billions of dollars)					
Fannie Mae Senior Preferred Stock .....	0.8	0.8	(0.1)	0.7	
Freddie Mac Senior Preferred Stock .....	0.8	0.8	(0.1)	0.7	
Fannie Mae Warrants Common Stock .....	3.1	3.1	3.4	6.5	
Freddie Mac Warrants Common Stock .....	2.3	2.3	2.1	4.4	
Total GSE Investment ...	<u>7.0</u>	<u>7.0</u>	<u>5.3</u>	<u>12.3</u>	

### **Government Sponsored Enterprise Credit Facility**

The GSE Credit Facility was established to ensure credit availability to the GSEs and the Federal Home Loan Banks. This lending facility provided secured funding on an as needed basis under terms and conditions established by the Secretary of the Treasury to protect taxpayers. The GSEs and the Federal Home Loan Banks were eligible to borrow under this program. The GSECF provided liquidity, if needed, until December 31, 2009. There were no loans made through the GSECF in fiscal years 2009 or 2008 (see Note 4—Loans Receivable, Mortgage Backed Securities, and Loan Guarantee Liabilities, Net).

### **GSE Mortgage-Backed Securities Purchase Program**

Under this program, Treasury, via asset managers, purchased GSE MBS in the open market. The asset managers were also authorized to enter into other trade/sell transactions such as pair offs, turns, assignments, and dollar rolls. By purchasing these credit-guaranteed securities, the Treasury sought to broaden access to mortgage funding for current and prospective homeowners and to promote stability in the mortgage market. The size and timing of the MBS purchases was subject to the discretion of the Secretary. The scale of the program was based on developments in the capital and housing markets. As these securities are backed by individual mortgages, they are accounted for under the Federal Credit Reform Act and are included in Note 4—Loans Receivable, Mortgage Backed Securities, and Loan Guarantee Liabilities, Net.

### **Temporary Guarantee Program for Money Market Funds**

In September 2008, the Treasury Department established a Temporary Guarantee Program (Program) for Money Market Funds. Under this program, Treasury guaranteed to investors that they would receive the stable share price (SSP) for shares held in participating money market funds up to the number of shares held as of the close of business on September 19, 2008. To participate in the program, eligible money market funds had to submit an application and pay a premium of 1 basis point if the fund's net asset value (NAV) is greater than or equal to 99.75 percent of the SSP, or 1.5 basis points of the SSP if the fund's NAV is less than 99.75 percent of the SSP but greater than or equal to 99.50 percent of the SSP.

Under this program, any outlays would have been paid out initially from the ESF, and then from funds available under the EESA. Under Section 131 of the Act such outlays would be reimbursed from funds available under TARP. The temporary guarantee program was extended and continued to provide coverage through September 19, 2009, to shareholders up to amounts that they held in participating money market funds as of the close of business on September 19, 2008. As of September 30, 2009, the program had expired and Treasury did not receive any claims for payment. As of September 30, 2009, Treasury had collected a total of approximately \$1.2 billion in program participation payments that is recorded as earned revenue in the Statement of Net Cost. All participant payments are invested into Government securities.



## Note 12. Other Assets

### Other Assets as of September 30

(In billions of dollars)	2009	2008
Advances and prepayments .....	76.9	45.0
FDIC Receivable from Resolution Activity .....	32.1	14.6
NCUA Loans .....	18.4	1.1
Regulatory assets .....	14.4	12.0
Other .....	14.1	16.8
Total other assets .....	<u>155.9</u>	<u>89.5</u>

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

With regard to regulatory assets, the DOE's Power Marketing Authorities (PMAs) and the TVA record certain amounts as assets in accordance with FASB ASC 980-Regulated Operations (formerly) SFAS No. 71, Accounting for the Effects of Certain Types of Regulation. The provisions of FASB ASC 980 require that regulated enterprises reflect rate actions of the regulator in their financial statements, when appropriate. These rate actions can provide reasonable assurance of the existence of an asset, reduce or eliminate the value of an asset, or impose a liability on a regulated enterprise. In order to defer incurred costs under FASB ASC 980, a regulated entity must have the statutory authority to establish rates that recover all costs, and those rates must be charged to and collected from customers. If the PMAs' or TVA's rates should become market-based, FASB ASC 980 would no longer be applicable, and all of the deferred costs under that standard would be expensed.

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

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

The NCUA 2008 amount of \$1.1 billion and \$8.5 billion of the FDIC 2008 amounts were reclassified from the All Other Programs line of Note 4—Loans Receivable, Mortgage Backed Securities, and Loan Guarantees, Net to conform to the fiscal year 2009 presentation.

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

Advances and prepayments increased significantly from 2008 to 2009, primarily as a result of a \$26.9 billion correction of an error by DOD. In fiscal year 2009, DOD made corrections to recognize \$26.9 billion in assets for contract financing payments of shipbuilding procurement during the period October 1, 2005, through September 30, 2008. DOD correction is reflected in the September 30, 2009, advances and prepayments amount.

## Note 13. Accounts Payable

### Accounts Payable as of September 30

(In billions of dollars)

	2009	2008
Department of Defense.....	35.4	32.1
Department of the Treasury.....	4.8	3.8
Department of Veterans Affairs.....	4.5	6.2
Department of Homeland Security.....	2.8	2.9
Tennessee Valley Authority.....	2.7	3.2
Department of Justice.....	2.3	2.1
General Services Administration.....	2.3	2.1
Department of State.....	2.0	2.8
Department of Education.....	1.9	1.3
Agency for International Development.....	1.8	1.9
U.S. Postal Service.....	1.7	1.7
Department of Energy.....	1.7	1.6
Department of Labor.....	1.4	0.9
National Aeronautics and Space Administration.....	1.3	1.4
Department of Housing and Urban Development.....	1.0	0.9
All other.....	5.6	8.4
Total accounts payable.....	<u>73.2</u>	<u>73.3</u>

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

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

### Federal Debt Securities Held by the Public and Accrued Interest

(In billions of dollars)	Balance September 30, 2008	Net Change During Fiscal Year 2009	Balance September 30, 2009	Average Interest Rate	
				2009	2008
<b>Treasury securities (public):</b>					
Marketable securities:					
Treasury bills .....	1,484.3	501.9	1,986.2	0.3%	1.6%
Treasury notes .....	2,623.4	1,149.6	3,773.0	3.0%	4.1%
Treasury bonds .....	578.5	99.0	677.5	6.5%	7.1%
Treasury inflation-protected securities (TIPS) .....	524.0	27.3	551.3	2.1%	2.0%
Total marketable Treasury securities .....	5,210.2	1,777.8	6,988.0		
Nonmarketable securities .....	598.5	(34.6)	563.9	3.7%	4.1%
Net unamortized premium/ (discounts) .....	(36.1)	2.2	(33.9)		
Total Treasury securities, net (public) .....	5,772.6	1,745.4	7,518.0		
<b>Agency securities:</b>					
Tennessee Valley Authority .....	22.6	-	22.6		
All other agencies .....	0.4	-	0.4		
Total agency securities, net of unamortized premiums and discounts .....	23.0	-	23.0		
<b>Accrued interest payable</b> .....	40.6	1.1	41.7		
<b>Total Federal debt securities held by the public and accrued interest</b> .....	<u>5,836.2</u>	<u>1,746.5</u>	<u>7,582.7</u>		

Types of marketable securities:

Bills—Short-term obligations issued with a term of 1 year or less.

Notes—Medium-term obligations issued with a term of at least 1 year, but not more than 10 years.

Bonds—Long-term obligations of more than 10 years.

TIPS—Term of more than 5 years.

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

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

- Interest-bearing marketable securities (bills, notes, bonds, and inflation-protected).
- Interest-bearing nonmarketable securities (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 2009 and 2008.

During the fiscal year, changes in economic conditions resulted in the need for an increase in borrowings from the public to finance federal spending. Treasury responded to the increase in marketable borrowing requirements by raising issuance sizes of regular weekly and monthly bills, increasing the frequency and issuance sizes of cash management bills, increasing the issuance sizes of nominal coupon security offerings, and adjusting the securities offering calendar to include the reintroduction of certain Treasury notes.

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. Congress raised the debt limit twice during fiscal year 2009—from \$10,615 billion to \$11,315 billion in October 2008 with the passage of the EESA, and again to \$12,104 billion in February 2009 with the passage of the ARRA. On December 28, 2009, Public Law 111-123 was enacted, which increased the statutory debt limit to \$12,394 billion. On February 12, 2010, Public Law 111-139 was enacted, which increased the statutory debt limit to \$14,294 billion (See Note 28—Subsequent Events). As of September 30, 2009, and 2008, respectively, debt outstanding was \$11,853.1 billion and \$9,959.9 billion. The debt subject to the limit includes Treasury securities held by the public and Government guaranteed debt of Federal agencies (shown in the table above) and intragovernmental debt holdings (shown in the following table).

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

(In billions of dollars)	Balance 2008	Net Change During Fiscal Year 2009	Balance 2009
Social Security Administration, Federal Old-Age and Survivors Insurance .....	2,150.7	145.6	2,296.3
Office of Personnel Management, Civil Service Retirement and Disability .....	728.8	25.4	754.2
Department of Health and Human Services, Federal Hospital Insurance Trust Fund .....	318.7	(9.0)	309.7
Department of Defense, Military Retirement Fund .....	215.9	24.9	240.8
Social Security Administration, Federal Disability Insurance Trust Fund .....	216.5	(8.6)	207.9
Department of Defense, Medicare-Eligible Retiree Health Care Fund .....	112.7	14.1	126.8
Department of Health and Human Services, Federal Supplementary Medical Insurance Trust Fund .....	59.1	2.7	61.8
Department of Energy, Nuclear Waste Disposal .....	42.6	2.0	44.6
Office of Personnel Management, Employees' Life Insurance Fund .....	34.4	1.7	36.1
Office of Personnel Management, Postal Service Retiree Health Benefits Fund .....	32.3	2.8	35.1
Federal Deposit Insurance Corporation Funds .....	33.3	(6.9)	26.4
Department of Labor, Unemployment Trust Fund .....	72.4	(52.8)	19.6
Department of the Treasury, Exchange Stabilization Fund .....	16.8	1.8	18.6
Pension Benefit Guaranty Corporation Fund .....	22.4	(4.9)	17.5
Office of Personnel Management, Employees' Health Benefits Fund .....	15.6	(0.2)	15.4
Department of State, Foreign Service Retirement and Disability Fund .....	14.9	0.4	15.3
Department of Transportation, Highway Trust Fund .....	12.8	(1.3)	11.5
Housing and Urban Development, Federal Housing Administration (FHA) - Liquidating Account .....	19.1	(8.4)	10.7
All other programs and funds .....	97.0	12.1	109.1
Subtotal .....	<u>4,216.0</u>	<u>141.4</u>	<u>4,357.4</u>
Unamortized net (discounts)/premiums .....	32.6	1.3	33.9
Total intragovernmental debt holdings, net .....	<u>4,248.6</u>	<u>142.7</u>	<u>4,391.3</u>

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

## Note 15. Federal Employee and Veteran Benefits Payable

### Federal Employee and Veteran Benefits Payable as of September 30

(In billions of dollars)	Civilian		Military		Total	
	2009	2008	2009	2008	2009	2008
Pension and accrued benefits .....	1,529.4	1,454.8	1,177.1	1,154.1	2,706.5	2,608.9
Post-retirement health and accrued benefits .....	352.2	341.8	825.8	820.6	1,178.0	1,162.4
Veterans compensation and burial benefits .....	N/A	N/A	1,317.5	1,466.7	1,317.5	1,466.7
Life insurance and accrued benefits .....	39.7	37.5	12.1	12.6	51.8	50.1
FECA benefits .....	17.9	16.6	8.1	8.8	26.0	25.4
Liability for other benefits .....	0.3	0.4	3.6	5.0	3.9	5.4
Total Federal employee and veteran benefits payable .....	<u>1,939.5</u>	<u>1,851.1</u>	<u>3,344.2</u>	<u>3,467.8</u>	<u>5,283.7</u>	<u>5,318.9</u>

### Change in Pension and Accrued Benefits

(In billions of dollars)	Civilian	Military	Total
<b>Actuarial accrued pension liability as of September 30, 2008....</b>	1,454.8	1,154.1	2,608.9
<b>Pension Expense:</b>			
Prior (and past) service costs from plan amendments.....	(0.4)	0.3	(0.1)
Assumption changes .....	2.1	7.8	9.9
Expected Normal costs .....	29.7	22.8	52.5
Interest on pension liability during the period.....	89.1	65.6	154.7
Actuarial (gains)/losses .....	24.7	(23.0)	1.7
Total pension expense.....	145.2	73.5	218.7
Less benefits paid.....	70.6	50.5	121.1
<b>Actuarial accrued pension liability as of September 30, 2009 ...</b>	<u>1,529.4</u>	<u>1,177.1</u>	<u>2,706.5</u>

<b>Change in Post-Retirement Health and Accrued Benefits</b>			
(In billions of dollars)	<b>Civilian</b>	<b>Military</b>	<b>Total</b>
<b>Actuarial accrued post-retirement health benefits liability, as of September 30, 2008</b> .....	341.8	820.6	1,162.4
<b>Post-Retirement Health Benefits Expense:</b>			
Normal costs.....	11.6	21.3	32.9
Interest on liability.....	20.5	47.7	68.2
Change in medical inflation rate assumption (gains) .....	-	(1.1)	(1.1)
Other actuarial (gains).....	(8.7)	(43.7)	(52.4)
Total post-retirement health benefits expense .....	23.4	24.2	47.6
Less claims paid.....	13.0	19.0	32.0
<b>Actuarial accrued post-retirement health benefits liability, as of September 30, 2009</b> .....	<u>352.2</u>	<u>825.8</u>	<u>1,178.0</u>

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

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

	<b>Civilian</b>		<b>Military</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
	Rate of interest.....	6.25%	6.25%	5.75%
Rate of inflation .....	3.50%	3.50%	3.00%	3.00%
Projected salary increases.....	4.25%	4.25%	3.75%	3.75%

	<b>Civilian</b>		<b>Military</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
	Rate of interest.....	6.25%	6.25%	5.75%
Medical trend rate .....	8.00%	7.00%	6.25%	6.25%

Separate boards of actuaries for OPM and DOD approve 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 liability and related expense. These rates are shown in the table above. OPM approves the long-term assumptions for interest, inflation, and across-the-board salary increases shown in the table above. The DOD Health Care Board approves the assumptions used for the Medicare-eligible portion of the military post-retirement health benefit liabilities. DOD uses a range of medical trend rate assumptions, varying by year and type of service, with an ultimate rate for the long-term as shown in the table above.

DOD's long-term ultimate medical trend rate for fiscal year 2009 post-retirement health benefits liability is 6.25 percent. For disclosure and comparison purposes, DOD's estimate of a single equivalent medical trend rate for fiscal year 2009 is 6.5 percent, which is an approximation of the single equivalent rate that would produce that same actuarial liability as the actual rates used. Please refer to the individual financial statements of DOD for further details regarding Military Retirement Health Benefits—Medical Trend.

## Civilian Employees

### Pensions

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

CSRDF monies are generated primarily from employees' contributions, agency contributions, payments from the General Fund, and interest on investments in Treasury securities. See Note 24—Earmarked Funds.

The Federal Retirement Thrift Investment Board administers the Thrift Savings Plan (TSP) Fund. The TSP Fund investment options include two fixed income funds (the G and F Funds), three stock funds (the C, S, and I Funds) and five lifecycle funds (L 2040, L 2030, L 2020, L 2010, and L Income). The L-Funds diversify participant accounts among the G, F, C, S, and I Funds, using professionally determined investment mixes (allocations) that are tailored to different time horizons. Treasury securities held in the G-Fund are included in Federal debt securities held by the public and accrued interest in the Balance Sheets. The G-Fund held \$113.3 billion and \$101.5 billion in non-marketable Treasury securities as of September 30, 2009, and 2008, respectively.

### Post-Retirement Health Benefits

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

### Life Insurance Benefits

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



## Workers' Compensation Benefits

The DOL determines both civilian and military agencies' liabilities for future workers' compensation benefits for civilian Federal employees, as mandated by the Federal Employees' Compensation Act (FECA), for death, disability, medical, and miscellaneous costs for approved compensation cases, and a component for incurred, but not reported, claims. The FECA liability is determined annually using historical benefit payment patterns related to injury years to predict the ultimate payments. These estimated payments have been discounted to present value using OMB's interest rate assumptions for 10-year U.S. Treasury notes. For 2009, a 4.22 percent interest rate was assumed in year one and 4.72 percent was assumed for year two and thereafter.

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

Fiscal Year	COLA	CPIM
2010	0.47%	3.42%
2011	1.40%	3.29%
2012	1.50%	3.48%
2013	1.80%	3.71%
2014+	2.00%	3.71%

## Military Employees (Including Veterans)

### Pensions

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

The Fund receives income from three sources: monthly normal cost payments from the Services to pay for the current year's service cost; annual payments from Treasury to amortize the unfunded liability and pay for the increase in the normal cost attributable to Concurrent Receipt per Public Law 108-136; and investment income. During fiscal year 2009, the Fund received approximately \$18 billion in normal cost payments, a \$55 billion Treasury payment, and approximately \$3 billion in investment income, net of premium/discount amortization and accrued inflation compensation.

Pension and accrued benefits increased in fiscal year 2009 primarily due to changes in assumptions, benefits and actuarial experience. The new assumptions include a lower Career Status Bonus (CSB) take rate, updated permanent disability retiree rates, and updated Survivor Benefit Plan/offset factors. The net effect of these new assumptions is an increase of \$7.8 billion. Actuarial experience, including an across-the-board salary increase for January 2010, and a lower than expected cost of living adjustment, led to a \$23.0 billion decrease. The change in retirement benefits, including the Dependency and Indemnity Coverage Supplement increase enacted in Public Law 111-31, led to a \$0.3 billion increase. The remaining increase results primarily from an expected increase in the actuarial liability of \$37.9 billion (growth due to normal cost, interest cost, and liability released through benefit payments).

The military retirement system consists of a funded, noncontributory, defined benefit plan. It applies to military personnel (Departments of the Army, Navy, Air Force, and Marine Corps). This system includes nondisability retirement pay, disability retirement pay, and survivor annuity programs. Military personnel who remain on active duty for 20 years or longer are eligible for retirement. There are three different retirement benefit formulas that are currently being used by the military: Final Pay, High-3 Year Average, and Career Status Bonus/Military Retirement Reform Act of 1986 (REDUX). The date an individual enters the military determines which retirement system they would fall under and if they have the option to pick their retirement system. For more information on these benefits, see DOD's websites (<http://www.dfas.mil/army2/bonuses/redux.html>, and <http://www.defenselink.mil/militarypay/retirement/index.html>).

### **Post-Retirement Health Benefits**

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

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

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

In addition to the health care benefits for civilian and military retirees and their dependents, the VA also provides medical care to veterans on an "as available" basis, subject to the limits of the annual appropriations. In accordance with 38 CFR 17.36 (c), VA's Secretary makes an annual enrollment decision that defines the veterans, by priority, who will be treated for that fiscal year subject to change based on funds appropriated, estimated collections, usage, the severity index of enrolled veterans, and changes in cost. Accordingly, VA recognizes the medical care expenses in the period the medical care services are provided. For the fiscal years 2005 through 2009, the average medical care cost per year was \$33.1 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 on active duty.

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

The liability for veterans' compensation and burial benefits payable decreased by \$149.2 billion in fiscal year 2009, and increased by \$339.0 billion in fiscal year 2008. The impact of lower estimated COLA rates used to calculate the 2009 liability was a reduction of \$287 billion. That reduction was due in part (\$150 billion) to the decrease in inflation expectations that occurred during 2009 and in part (\$137 billion) due to a change in methodology which aligned the assumption for future COLA rates with the assumption for future discount rates.

**Veterans Compensation and Burial Benefits Payable as of September 30**

(In billions of dollars)	2009	2008
<b>Compensation:</b>		
Veterans .....	1,130.7	1,231.9
Survivors .....	183.2	230.1
Burial benefits .....	3.6	4.7
Total veterans compensation and burial benefits payable.....	<u>1,317.5</u>	<u>1,466.7</u>

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

	2009	2008
Rate of interest .....	3.17%	3.97%
Rate of inflation.....	1.30%	2.45%

**Life Insurance Benefits**

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

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

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

**Veterans Life Insurance Liability as of September 30**

(In billions of dollars)	2009	2008
<b>Insurance death benefits:</b>		
NSLI .....	7.3	7.8
VSLI .....	1.6	1.6
VRI .....	0.3	0.3
Other .....	0.4	0.4
Total death benefits.....	<u>9.6</u>	<u>10.1</u>
Death benefit annuities.....	0.1	0.1
Disability income and waiver .....	0.6	0.5
Insurance dividends payable.....	1.8	1.9
Total veterans life insurance liability.....	<u>12.1</u>	<u>12.6</u>

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 non-exchange transaction and is not required to be recorded on the Balance Sheet. The projected amounts of future payments for pension benefits (presented for informational purposes only) as of September 30, 2009, and 2008, were \$91.4 billion and \$97.3 billion, respectively.

## Note 16. Environmental and Disposal Liabilities

### Environmental and Disposal Liabilities as of September 30

(In billions of dollars)	2009	2008
<b>Department of Energy:</b>		
Environmental management program.....	180.0	185.4
Legacy environmental liabilities - other.....	57.7	51.2
Active and Surplus Facilities.....	29.9	29.4
Total Department of Energy.....	<u>267.6</u>	<u>266.0</u>
<b>Department of Defense:</b>		
Environmental restoration.....	30.2	32.0
Disposal of weapon systems program.....	25.3	28.8
Environmental corrective other.....	5.7	4.5
Base realignment and closure.....	5.1	5.2
Total Department of Defense.....	<u>66.3</u>	<u>70.5</u>
<b>All other agencies</b> .....	<u>7.9</u>	<u>6.3</u>
Total environmental and disposal liabilities.....	<u><u>341.8</u></u>	<u><u>342.8</u></u>

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

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

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

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

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

DOE is also required to recognize closure and post-closure costs for its active and surplus facilities and environmental corrective action costs for current operations. The cleanup cost associated with active and surplus facilities that is allocated to operating periods beyond the balance sheet date is identified as the unrecognized portion. For facilities newly contaminated since fiscal year 1997, cleanup costs allocated to future periods and not included in the liability amounted to \$627.0 million and \$698.0 million for fiscal years 2009 and 2008, respectively. The unrecognized portion of the cleanup cost is recognized over a predetermined period of time.

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

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

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

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

DOD expenses associated environmental costs systematically over the life of the asset using two methods: physical capacity for operating landfills and life expectancy in years for all other assets. The Department expenses the full cost to clean up contamination for stewardship property, plant, and equipment at the time the asset is placed into service. DOD has expensed the costs for cleanup associated with general property, plant, and equipment placed into service before October 1, 1997, except for costs intended to be recovered through user charges; for those costs, DOD has expensed cleanup costs associated with that portion of the asset life that has passed since it was placed into service. DOD systematically recognizes the remaining cost over the remaining life of the asset. The unrecognized portion of the cleanup cost associated with general property, plant, and equipment is \$2.1 billion and \$2.0 billion for fiscal years 2009 and 2008, respectively. Not all components of DOD are able to compile the necessary information for this disclosure, thus the amount reported may not accurately reflect DOD's total unrecognized costs associated with general property, plant, and equipment. DOD is implementing procedures to address these deficiencies.

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

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

## Note 17. Benefits Due and Payable

### Benefits Due and Payable as of September 30

(In billions of dollars)

	2009	2008
Federal Old-Age and Survivors Insurance .....	50.2	46.4
Grants to States for Medicaid .....	25.0	20.4
Federal Supplementary Medical Insurance (Medicare Parts B and D) ...	24.4	24.0
Federal Disability Insurance .....	24.3	22.2
Federal Hospital Insurance (Medicare Part A) .....	22.4	21.0
Supplemental Security Income .....	5.3	4.5
Unemployment Insurance .....	4.5	1.6
All other benefit programs.....	4.7	4.3
Total benefits due and payable.....	<u>160.8</u>	<u>144.4</u>

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

## Note 18. Insurance and Guarantee Program Liabilities

### Insurance and Guarantee Program Liabilities as of September 30

(In billions of dollars)

	2009	2008
<b>Insurance and Guarantee Program Liabilities:</b>		
Pension Benefit Guaranty Corporation - Benefit Pension Plans .....	83.1	60.0
Federal Deposit Insurance Corporation Funds .....	70.5	12.1
All other insurance and guarantee programs .....	12.6	13.0
Total insurance and guarantee program liabilities .....	<u>166.2</u>	<u>85.1</u>

PBGC insures pension benefits for participants in covered defined benefit pension plans. As a wholly owned corporation of the U.S. Government, PBGC's financial activity and balances are included in the consolidated financial statements of the U.S. Government. However, under current law, PBGC's liabilities may be paid only from PBGC's assets and not from the General Fund of the Treasury or assets of the Government in general. As of September 30, 2009, PBGC had total liabilities of \$92.1 billion, and its total liabilities exceeded its total assets by \$21.9 billion. In addition, as discussed in Note 22—Contingencies, PBGC reported reasonably possible contingent losses of about \$168.2 billion.

Of the total FDIC amount as of September 30, 2009, \$38.9 billion represents the recorded contingent liability and loss provision for institutions insured by the Deposit Insurance Fund that are likely to fail. In addition, \$20.1 billion pertains to liabilities due to resolutions of failed or failing institutions and to pending depositor claims. Another \$10.3 billion pertains to the Temporary Liquidity Guarantee Program, which guarantees certain newly issued debt and certain noninterest-bearing transaction accounts in an effort to counter the system-wide crisis in the nation's financial sector. The remaining amounts represent contingent liabilities for litigation.

Of the \$12.6 billion under all other insurance and guarantee programs as of September 30, 2009, \$5.9 billion pertains to the USDA's Federal Crop Insurance Program. The Federal Crop Insurance Program is administered by the Federal Crop Insurance Corporation, whose mission is to provide an actuarially sound risk management program to reduce agricultural producers' economic losses due to natural disasters. Also, \$5.3 billion represents National Credit Union Administration's Temporary Corporate Credit Union Liquidity Guarantee Program. This Program guarantees the timely payment of principal and interest on certain unsecured debt of participating credit unions.

Of the \$13.0 billion under all other insurance and guarantee programs as of September 30, 2008, \$7.3 billion pertains to USDA's Federal Crop Insurance Program. These amounts were reclassified from the Farm and Other Subsidies line of Note 19—Other Liabilities to conform to the fiscal year 2009 presentation.

## Note 19. Other Liabilities

<b>Other Liabilities as of September 30</b>	<b>2009</b>	<b>2008</b>
(In billions of dollars)		
<b>Unearned revenue and assets held for others:</b>		
DOE's unearned fees for nuclear waste disposal and other unearned revenue .....	39.8	53.3
Assets held on behalf of others .....	<u>56.6</u>	<u>46.2</u>
Subtotal .....	<u>96.4</u>	<u>99.5</u>
<b>Employee-related liabilities:</b>		
Accrued Federal employees wages and benefits .....	38.9	35.1
Selected DOE contractors' and D.C. employees' pension benefits .....	<u>41.8</u>	<u>29.2</u>
Subtotal .....	<u>80.7</u>	<u>64.3</u>
<b>Subsidies and grants:</b>		
Farm and other subsidies .....	13.9	14.1
Grant payments due to State and local governments and others .....	<u>16.5</u>	<u>14.6</u>
Subtotal .....	<u>30.4</u>	<u>28.7</u>
<b>International monetary liabilities and gold certificates (Note 2) .....</b>	<b>72.2</b>	<b>18.7</b>
<b>Miscellaneous liabilities:</b>		
Legal and other contingencies .....	26.1	26.6
Bonneville Power Administration non-Federal power projects and capital lease liabilities, and disposal liabilities .....	10.2	10.2
Other miscellaneous .....	<u>38.1</u>	<u>42.8</u>
Subtotal .....	<u>74.4</u>	<u>79.6</u>
Total other liabilities .....	<u><u>354.1</u></u>	<u><u>290.8</u></u>

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



## Unearned Revenue and Assets Held for Others

The Government recognizes a liability when it receives money in advance of providing goods and services or assumes custody of money belonging to others. The Government's unearned revenue from fees DOE has collected from utility companies for the future cost of managing the disposal of nuclear waste is about \$26.2 billion and \$25.5 billion as of September 30, 2009, and 2008, respectively. The Federal Communications Commission (FCC) includes deferred revenue of \$17.1 billion as of September 30, 2008, for proceeds received from its competitive bidding system for the recovered analog spectrum relating to licenses that have not been granted. Other unearned revenue includes U.S.P.S. 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. The Foreign Military Sales program holds \$47.0 billion and \$36.0 billion as of September 30, 2009, and 2008, respectively for articles and services for future delivery to foreign governments.

## Employee-Related Liabilities

This category includes amounts owed to employees at yearend and actuarial liabilities for certain non-Federal employees. Actuarial liabilities for Federal employees and veteran benefits are included in Note 15 and are reported on another line on the balance sheet. The largest liability in the employee-related liabilities category is the amount owed at the end of the fiscal year to Federal employees for wages and benefits (including accrued annual leave). In addition, DOE is liable to certain contractors such as the University of California, which operates the Lawrence Livermore National Laboratory, for contractor employee pension and postretirement benefits, which is about \$24.4 billion and \$12.3 billion as of September 30, 2009, and 2008, respectively. Also, the Government owed about \$9.0 billion and \$8.8 billion as of September 30, 2009, and 2008, respectively, for estimated future pension benefits of the District of Columbia's judges, police, firefighters, and teachers.

## Subsidies and Grants

The Government supports the public good through a wide variety of subsidy and grant programs in such areas as agriculture, medical and scientific research, education, and transportation. USDA programs such as the Conservation Reserve, Tobacco Transition Payment, and Direct and Counter-Cyclical Payment programs account for the majority of the subsidies due, about \$11.3 billion, and \$12.2 billion as of September 30, 2009, and 2008, respectively.

The Government awards hundreds of billions of dollars in grants annually. These include project grants that are competitively awarded for agency-specific projects, such as HHS grants to fund projects to "enhance the independence, productivity, integration and inclusion into the community of people with developmental disabilities." Other grants are formula grants, such as matching grants. Formula grants go to State governments for such things as education and transportation programs. These grants are paid in accordance with distribution formulas that have been provided by law or administrative regulations. Of the total liability reported for grants as of September 30, 2009, and 2008, the Department of Transportation (DOT), Education, and HHS collectively owed their grantees about \$13.8 billion and \$11.9 billion, respectively. Refer to the financial statements and footnotes of the respective agencies for additional information.

## Miscellaneous Liabilities

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

## Note 20. Collections and Refunds of Federal Revenue

### Collections of Federal Revenue for the Year Ended September 30, 2009

(In billions of dollars)	Federal Revenue Collections	Tax Year to Which Collections Relate			
		2009	2008	2007	Prior Years
Individual income and tax withholdings .....	2,036.6	1,296.4	702.6	22.3	15.3
Corporation income taxes .....	225.5	138.2	69.0	1.7	16.6
Unemployment taxes .....	38.2	21.1	9.7	7.3	0.1
Excise taxes .....	69.8	57.1	12.5	0.1	0.1
Estate and gift taxes .....	24.7	0.1	4.0	0.8	19.8
Railroad retirement taxes .....	4.7	3.6	1.1	-	-
Federal Reserve earnings .....	34.3	24.5	9.8	-	-
Fines, penalties, interest, and other revenue .....	6.0	5.8	0.1	0.1	-
Customs duties .....	23.0	23.0	-	-	-
Subtotal .....	<u>2,462.8</u>	<u>1,569.8</u>	<u>808.8</u>	<u>32.3</u>	<u>51.9</u>
Less: amounts collected for non-Federal entities .....	<u>(0.2)</u>				
Total .....	<u><u>2,462.6</u></u>				

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

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

**Federal Tax Refunds Disbursed for the Year Ended September 30, 2009**

(In billions of dollars)	Refunds Disbursed	Tax Year to Which Refunds Relate			
		2009	2008	2007	Prior Years
Individual income and tax withholdings .....	339.6	1.1	293.8	30.4	14.3
Corporation income taxes .....	95.2	6.6	32.6	17.4	38.6
Unemployment taxes .....	0.1	-	0.1	-	-
Excise taxes .....	1.8	0.5	0.6	0.1	0.6
Estate and gift taxes .....	1.2	-	0.3	0.5	0.4
Customs duties .....	1.4	0.7	0.2	0.1	0.4
Total.....	<u>439.3</u>	<u>8.9</u>	<u>327.6</u>	<u>48.5</u>	<u>54.3</u>

**Reconciliation of Revenue to Collections for the Year Ended September 30**

(In billions of dollars)	2009	2008
Consolidated revenue per the Statements of Operations and Changes in Net Position .....	2,198.4	2,661.4
Tax refunds .....	439.3	427.3
ARRA and Stimulus Act Recovery Rebate Payments .....	(2.0)	(94.3)
First-time Homebuyers Tax Credit.....	(9.4)	-
Earned income tax credit and child tax credit imputed revenue .....	(66.7)	(59.2)
Beneficial Interest in Trust .....	(23.5)	-
Nontax-related fines and penalties reported by agencies .....	(18.7)	(40.7)
Nontax-related earned revenue .....	<u>(54.8)</u>	<u>(35.7)</u>
Collections of Federal revenue .....	<u>2,462.6</u>	<u>2,858.8</u>

Consolidated revenue in the Statements of Operations and Changes in Net Position is presented on a modified cash basis, is net of tax refunds, and includes other nontax related revenue. ARRA and Stimulus Act Recovery Rebate Payments, First-time Homebuyer Credit and Earned Income Tax Credit and Child Tax Credit amounts (unaudited) are included in gross cost in the Statements of Net Cost as a component of Treasury. Beneficial Interest in Trust is presented as an asset on the Balance Sheet. The ARRA of 2009 was signed into law on February 17, 2009. Payments since then are \$2.0 billion as of September 30, 2009. The payments under the Economic Stimulus Act of 2008 are \$94.3 billion as of September 30, 2009.

On the other hand, collections of Federal revenue 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, 2008

(In billions of dollars)	Federal Revenue Collections	Tax Year to Which Collections Relate			
		2008	2007	2006	Prior Years
Individual income and tax withholdings .....	2,294.3	1,455.0	799.2	23.5	16.6
Corporation income taxes .....	354.0	222.0	114.0	2.0	16.0
Unemployment taxes .....	39.5	21.9	10.1	7.4	0.1
Excise taxes .....	68.4	50.2	17.9	0.1	0.2
Estate and gift taxes .....	29.8	-	19.2	1.3	9.3
Railroad retirement taxes .....	4.9	3.7	1.2	-	-
Federal Reserve earnings .....	33.6	25.9	7.7	-	-
Fines, penalties, interest, and other revenue .....	6.6	6.1	0.4	0.1	-
Customs duties .....	28.6	28.6	-	-	-
Subtotal .....	<u>2,859.7</u>	<u>1,813.4</u>	<u>969.7</u>	<u>34.4</u>	<u>42.2</u>
Less: amounts collected for non-Federal entities .....	<u>(0.9)</u>				
Total .....	<u>2,858.8</u>				

### Federal Tax Refunds Disbursed for the Year Ended September 30, 2008

(In billions of dollars)	Refunds Disbursed	Tax Year to Which Refunds Relate			
		2008	2007	2006	Prior Years
Individual income and tax withholdings .....	369.3	0.9	342.1	19.2	7.1
Corporation income taxes .....	54.3	2.2	19.6	10.4	22.1
Unemployment taxes .....	0.1	-	0.1	-	-
Excise taxes .....	1.3	0.5	0.5	0.1	0.2
Estate and gift taxes .....	1.0	-	0.3	0.4	0.3
Customs duties .....	1.3	0.7	0.2	0.1	0.3
Total .....	<u>427.3</u>	<u>4.3</u>	<u>362.8</u>	<u>30.2</u>	<u>30.0</u>

## Note 21. Prior Period Adjustments

(In billions of dollars)	Changes to Net Position	
	2009	2008
<b>Prior Period Adjustments</b>		
Department of Defense.....	1.6	-
Department of the Interior.....	(0.3)	-
Department of Agriculture.....	-	11.5
Other prior period adjustments.....	-	(0.1)
Total prior period adjustments.....	1.3	11.4

During fiscal year 2009, a DOD component implemented an Enterprise Resource Planning system, which provided a means to revalue inventory from LAC to moving average cost, which is the Department's current policy for reporting inventory. The result was a prior period adjustment due to a change in accounting principle that increased the 2009 beginning net position by \$1.6 billion. Additionally, DOI adopted SFFAS 31, Accounting for Fiduciary Activities, which resulted in the removal of net fiduciary assets and liabilities of \$(0.3) billion from its net position.

DHS deposits 30 percent of customs duties collected into an unavailable receipt account. USDA receives an amount annually from this account in accordance with 7 U.S.C. 612c to encourage exportation and domestic consumption of agricultural products. Treasury and OMB decided that USDA should be assigned responsibility for the unavailable receipt account to improve Governmentwide reporting. Consequently, the cumulative effect of this change on prior periods increased the 2008 beginning balance of Net Position by \$13.6 billion. Additionally, USDA implemented a reclassification of its road prism assets from General Property, Plant, and Equipment to Stewardship Property, Plant, and Equipment. This change removes a net book value of \$2.1 billion from the beginning balance of Net Position. The net value of these two numbers increased USDA's beginning balance of Net Position by \$11.5 billion.

## Note 22. Contingencies

### Financial Treatment of Loss Contingencies

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

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.
<b>Probable.</b> Future confirming event(s) are more likely to occur than not. <sup>2</sup>	Accrue the liability. Report on Balance Sheet and Statement of Net Cost.	Accrue liability of the best estimate or minimum amount in loss range if there is no best estimate, and disclose nature of contingency and range of estimated liability.	Disclose nature of contingency and include a statement that an estimate cannot be made.
<b>Reasonably possible.</b> 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.
<b>Remote.</b> Possibility of future event(s) occurring is slight.	No disclosure.	No disclosure.	No disclosure.

<sup>1</sup> In addition, a third condition must be met to be a loss contingency: a past event or an exchange transaction must occur.

<sup>2</sup> For loss contingencies related to litigation, probable is defined as the future confirming event or events are more likely than not to occur, with the exception of pending or threatened litigation and unasserted claims. For the pending or threatened litigation and unasserted claims, the future confirming event or events are likely to occur.

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

### **Insurance Contingencies**

At the time an insurance policy is issued, a contingency arises. The contingency is the risk of loss assumed by the insurer, that is, the risk of loss from events that may occur during the term of the policy. The Government has insurance contingencies that are reasonably possible in the amount of \$198.7 billion as of September 30, 2009, and \$64.1 billion as of September 30, 2008. The major programs are identified below:

- PBGC reported \$168.2 billion and \$46.8 billion as of September 30, 2009, and 2008, respectively, for the estimated aggregate unfunded vested benefits exposure to the PBGC for private-sector single-employer and multiemployer defined pension plans that are classified as a reasonably possible exposure to loss.
- FDIC reported \$30.5 billion and \$17.2 billion as of September 30, 2009, and 2008, respectively, for identified additional risk in the financial services industry that could result in additional loss to the Deposit Insurance Fund should potentially vulnerable insured institutions ultimately fail. Actual losses, if any, will largely depend on future economic and market conditions.

### **Insurance in Force**

Insurance in Force is the accumulation of policy limits for all policies issued and outstanding at a point in time. The Government has Insurance in Force in the amount of \$1,252.2 billion as of September 30, 2009, and \$1,660.1 billion as of September 30, 2008. These amounts represent estimated maximum exposure to insurance claims and guarantee programs. The major programs are identified below:

- The DHS reported \$1,190.0 billion and \$1,600.0 billion as of September 30, 2009, and 2008, respectively, for the National Flood Insurance Program (NFIP).
- The Export-Import Bank of the United States reported \$42.2 billion and \$39.9 billion as of September 30, 2009, and 2008, respectively, for export credit insurance.

### **Deposit Insurance**

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

- FDIC has estimated insured deposits of \$5,309.0 billion as of September 30, 2009, and \$4,462.0 billion as of June 30, 2008, the most recent information available at the time of issuance of the 2008 Financial Report for the Deposit Insurance Fund.
- NCUA has estimated insured shares of \$713.6 billion as of September 30, 2009, and \$601.6 billion as of September 30, 2008, for the National Credit Union Share Insurance Fund.

## Legal Contingencies

Legal contingencies as of September 30, 2009, and 2008, are summarized in the table below:

(In billions of dollars)	Accrued Liabilities <sup>1</sup>	2009 Estimated Range of Loss for Certain Cases <sup>2</sup>		Accrued Liabilities <sup>1</sup>	2008 Estimated Range of Loss for Certain Cases <sup>2</sup>	
		Lower End	Upper End		Lower End	Upper End
Legal contingencies						
Probable.....	3.4	3.4	3.9	6.6	5.8	7.8
Reasonably possible .....		10.2	22.3		8.0	21.4
<sup>1</sup> Accrued liabilities are recorded and presented in the related line items of the balance sheet. <sup>2</sup> Does not reflect the total range of loss; many cases assessed as reasonably possible of an unfavorable outcome did not include estimated losses that could be determined.						

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

Management and legal counsel have determined that it is “probable” that some of these actions will result in a loss to the Government and the loss amounts are reasonably measurable. The estimated liabilities for these cases are \$3.4 billion and \$6.6 billion as of September 30, 2009, and 2008, respectively, and are reflected in the Balance Sheet as “Other Liabilities.” For example, USDA is subject to various claims and contingencies related to lawsuits. For cases in which payment has been deemed probable and for which the amount of potential liability has been estimated, about \$1.3 billion and \$0.1 billion has been accrued in the financial statements as of September 30, 2009 and 2008, respectively.

There are also administrative claims and legal actions pending where adverse decisions are considered by management and legal counsel as “reasonably possible” with an estimate of potential loss or a range of potential loss. The estimated potential losses for such claims and actions range from \$10.2 billion to \$22.3 billion as of September 30, 2009, and from \$8.0 billion to \$21.4 billion as of September 30, 2008. For example, DHS has pending administrative claims and 30 class action lawsuits with a “reasonably possible” likelihood of loss. The claims and lawsuits are related to claims against the Federal Emergency Management Agency (FEMA) for personal injuries allegedly resulting from exposure to formaldehyde in temporary housing units (i.e., travel trailers, and mobile homes) issued by FEMA in response to Hurricanes Katrina and Rita.

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

- Cobell et al. versus Salazar et al.—Native Americans allege that DOI and Treasury have breached trust obligations with respect to the management of the plaintiffs’ individual Indian monies. On August 7, 2008, the Federal District Court issued an opinion awarding \$455 million to the plaintiffs. This decision was overturned on appeal in July 2009. The appellate court found that the Government owes a cost-effective accounting, in scale with available funds. On December 8, 2009, the parties announced they have settled the claims raised in this lawsuit as well as other claims for the mismanagement of trust assets. The settlement is contingent on the passage of new legislation to authorize the settlement terms and court approval, which would not occur until March 2010 at the earliest. It is probable that an unfavorable outcome will occur with a \$3.412 billion estimated amount of potential loss (See Note 28—Subsequent Events, for additional information).



- Tribal Trust Fund Cases—Numerous cases have been filed in U.S. District Court in which Native American Tribes seek a declaration that the U.S. has not provided the tribes with a full and complete accounting of their trust funds, and seek an order requiring the government to provide such an accounting. It is not possible at this time to determine the likelihood of an unfavorable outcome or an estimate of the amount or range of any potential loss.
- Various parties filed administrative claims and lawsuits against the U.S. Army Corps of Engineers (USACE) as a result of Hurricane Katrina in 2005. Most of the Hurricane Katrina tort actions that have been filed are consolidated before a single judge sitting in the Eastern District of Louisiana. The court has classified the individual cases that have been consolidated into seven categories: Levee, MRGO, Insurance, Responder, Dredging Limitations, St. Rita Nursing Home and Barge. Approximately 490,000 administrative claims related to the allegations in this consolidated action have been filed. There is a reasonably possible chance of an unfavorable outcome that was previously unspecified. (See Note 28—Subsequent Events, for additional information).

**Environmental and Disposal Contingencies**

Environmental and disposal contingencies as of September 30, 2009, and 2008, are summarized in the table below:

(In billions of dollars)	Accrued Liabilities <sup>1</sup>	2009 Estimated Range of Loss for Certain Cases <sup>2</sup>		Accrued Liabilities <sup>1</sup>	2008 Estimated Range of Loss for Certain Cases <sup>2</sup>	
		Lower End	Upper End		Lower End	Upper End
Environmental and disposal contingencies						
Probable .....	13.5	13.5	13.7	12.7	12.7	13.0
Reasonably possible ....		0.4	0.4		0.4	0.4

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

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

Management and legal counsel have determined that it is “probable” that some of these actions will result in a loss to the Government and the loss amounts are reasonably measurable. The estimated liabilities for these cases are \$13.5 billion and \$12.7 billion as of September 30, 2009, and 2008, respectively, and are reflected on the Balance Sheet as “Other Liabilities.” DOE is subject to Spent Nuclear Fuel litigation for damages suffered by all utilities as a result of the delay in beginning disposal of spent nuclear fuel and also damages for alleged exposures to radioactive and/or toxic substances. Significant claims for partial breach of contract and a large number of class action and/or multiple plaintiff tort suits have been filed with estimated liability amounts of \$13.2 billion and \$12.4 billion as of September 30, 2009, and 2008, respectively. However, DOE reported that several developments have made it difficult to predict the amount of the Government’s likely liability, which at this time is undetermined.

## Other Contingencies

DOT reported the following other contingencies:

- The Federal Highway Administration (FHWA) reimburses states for construction costs on projects related to the Federal Highway System of roads. FHWA has pre-authorized \$41.0 billion and \$46.2 billion to the states to establish budgets for its construction projects for fiscal years ending September 30, 2009, and 2008, respectively. Congress has not provided appropriations for these projects and no liability is accrued in the consolidated financial statements.
- The Federal Transit Administration (FTA) provides grants to state and local transit authorities and agencies. FTA executes Full Funding Grant Agreements authorizing transit authorities to establish project budgets and incur costs with their own funds in advance of annual appropriations by Congress. Under these agreements, FTA has committed approximately \$4.2 billion and \$1.7 billion for fiscal years ending September 30, 2009, and 2008, respectively. Congress has not provided appropriations for these commitments and no liability is reflected in the consolidated financial statements.

## Treaties

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

## Note 23. Commitments

### Long-Term Operating Leases as of September 30

(In billions of dollars)

	2009	2008
General Services Administration.....	24.8	23.9
U.S. Postal Service .....	7.6	8.3
Department of Health and Human Services ..	1.5	1.5
Department of State .....	1.0	1.0
Department of Homeland Security.....	0.9	2.3
Department of Agriculture .....	0.9	0.8
Securities and Exchange Commission .....	0.6	0.7
Other Operating Leases.....	4.4	8.2
Total long-term operating leases.....	<u>41.7</u>	<u>46.7</u>

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

The Government has other contractual commitments that may require future use of financial resources. For example, the Government has callable subscriptions in certain Multilateral Development Banks (MDBs), which are autonomous international financial entities that finance economic and social development projects in developing countries. Callable capital stock shares in the MDB, serve as a supplement pool of resources that maybe called, and converted into ordinary paid in shares, if the MDB cannot otherwise meet certain obligations through its other available resources. MDBs are able to use callable capital as backing to obtain very favorable financing terms when borrowing from world capital markets. To date, there has never been a call on this capital for any of the major MDBs and none is anticipated.

### Undelivered Orders and Other Commitments as of September 30

(In billions of dollars)	2009	2008 (Restated)
<b>Undelivered Orders:</b>		
Department of Defense .....	342.9	336.3
Department of Education .....	224.5	87.8
Department of the Treasury .....	156.4	57.1
EOP Foreign Military Sales Program .....	103.0	85.6
Department of Transportation .....	97.6	71.7
Department of Health and Human Services .....	89.4	69.4
Department of Housing and Urban Development .....	68.2	56.8
Department of Agriculture .....	44.3	37.8
Department of Energy .....	42.4	13.6
Department of Homeland Security .....	35.6	33.6
Department of State .....	15.0	13.6
Environmental Protection Agency .....	12.6	7.8
Agency for International Development .....	12.4	11.6
Department of Justice .....	11.4	8.9
National Science Foundation .....	11.0	8.0
Department of Labor .....	10.4	5.6
All other agencies .....	42.9	37.0
Total undelivered orders.....	<u>1,320.0</u>	<u>942.2</u>
<b>Other Commitments:</b>		
Senior GSE Preferred Stock Purchase Agreement .....	289.4	186.2
Callable capital subscriptions for multilateral development banks.....	62.2	62.3
Contract options and negotiations.....	10.2	3.7
Fuel purchase obligations .....	8.6	4.2
Power purchase obligations.....	7.4	7.2
Agriculture direct loans and guarantees.....	6.1	3.8
Long-term satellite and systems.....	4.7	4.8
Conservation reserve program.....	1.8	1.9
All other commitments.....	4.5	2.8
Total other commitments .....	<u>394.9</u>	<u>276.9</u>

## Other Commitments and Risks

Treasury announced on December 9, 2009, that it will start to wind down programs that were established during the crisis and are no longer critical to financial stability. As authorized by HERA, P.L. 110-289, enacted on July 30, 2008, the Secretary of the Treasury entered into SPSPAs with Fannie Mae and Freddie Mac on September 7, 2008, and began providing substantial financial support to the enterprises; thereby minimizing potential systemic financial risks associated with the deteriorating financial condition of Fannie Mae and Freddie Mac. These agreements, which have no expiration date, provide that Treasury will make funding advances to the GSEs if, at the end of any quarter FHFA determines that the liabilities of either GSE exceed its assets. As of September 30, 2009, the maximum amount available to each GSE under this agreement was \$200 billion. See Note 28—Subsequent Events regarding modification to the amount available to each GSE under the SPSPAs authorized by HERA.

In addition, the U. S. Government has entered into other agreements that could potentially require claims on Government resources in the future. For an example, The Terrorism Risk Insurance Act of 2002 (TRIA or the Act) was signed into law on November 26, 2002. This law was enacted to address market disruptions resulting from terrorist attacks on September 11, 2001. The Act helps to ensure available and affordable commercial property and casualty insurance for terrorism risk, and simultaneously allows private markets to stabilize. The Terrorism Risk Insurance Program is activated upon the certification of an “act of terrorism” by the Secretary of the Treasury in concurrence with the Secretary of State and the Attorney General. If a certified act of terrorism occurs, insurers may be eligible to receive reimbursement from the Government for insured losses above a designated deductible amount. Insured losses above this amount will be shared between insurance companies and the Government. The Act also gives Treasury authority to recoup Federal payments made under the Program through policyholder surcharges under certain circumstances and contains provisions designed to manage litigation arising from or relating to a certified act of terrorism.

## Restatements

As of September 30, 2008, the following restatements were made: Due to correction of errors by DOD, Education, Executive Office of the President (EOP) Foreign Military Sales, and the FCC undelivered orders increased by \$72.1 billion. The restatement had no impact on the assets or liabilities reported on the balance sheet and the 2008 net position as reported.

In addition, due to correction of an error by DOE, \$32.8 billion was removed from commitments. During 2009, DOE determined that its surplus power sales activity did not meet the definition of a commitment. The restatement had no impact on the assets or liabilities reported on the balance sheet and the 2008 net position as reported.

## Note 24. Earmarked Funds

### Earmarked Funds as of September 30, 2009 <sup>1</sup>

(In billions of dollars)	Federal Old-Age and Survivors Insurance Trust Fund	Military Retirement Fund	Civil Service Retirement and Disability Fund	Medicare- Eligible Retiree Health Care Fund (MERHCF)	Federal Hospital Insurance Trust Fund (Medicare Part A)	Civil Service Health Benefits Program Trust Funds
<b>Assets:</b>						
Cash and other monetary assets.....	-	-	-	-	0.1	-
Fund balance with Treasury .....	(0.2)	-	-	-	0.4	1.0
Investments in U.S. Treasury securities, net of unamortized premiums/discounts .....	2,296.3	275.5	754.2	146.8	309.7	50.5
Other Federal assets.....	26.8	2.9	10.2	1.6	28.5	1.2
Non-Federal assets.....	2.3	-	0.4	0.4	0.7	0.9
Total assets.....	<u>2,325.2</u>	<u>278.4</u>	<u>764.8</u>	<u>148.8</u>	<u>339.4</u>	<u>53.6</u>
<b>Liabilities:</b>						
Liabilities due and payable to beneficiaries .....	50.3	3.7	5.3	0.7	22.4	3.8
Other Federal liabilities.....	4.7	-	0.1	0.1	24.4	0.3
Other non-Federal liabilities .....	-	1,173.5	1,455.4	509.4	0.2	340.3
Total liabilities.....	55.0	1,177.2	1,460.8	510.2	47.0	344.4
Total net position .....	<u>2,270.2</u>	<u>(898.8)</u>	<u>(696.0)</u>	<u>(361.4)</u>	<u>292.4</u>	<u>(290.8)</u>
Total liabilities and net position .....	<u>2,325.2</u>	<u>278.4</u>	<u>764.8</u>	<u>148.8</u>	<u>339.4</u>	<u>53.6</u>
<b>Change in net position:</b>						
Beginning net position.....	2,128.7	(901.1)	(653.6)	(366.7)	302.9	(285.5)
Prior period adjustment .....	-	-	-	-	-	-
Beginning net position, adjusted.....	2,128.7	(901.1)	(653.6)	(366.7)	302.9	(285.5)
Investment revenue.....	107.7	2.8	37.1	1.1	15.6	1.9
Individual income taxes.....	571.2	-	-	-	194.1	-
Unemployment and excise taxes...	-	-	-	-	-	-
Other taxes and receipts .....	-	-	-	-	0.5	-
Miscellaneous earned revenues..	-	-	-	-	-	-
Other changes in fund balance (e.g., appropriations, transfers).....	12.1	72.5	31.4	21.4	14.5	9.1
Non-program expenses.....	-	-	-	-	-	-
Program net cost.....	549.5	73.0	110.9	17.2	235.2	16.3
Ending net position.....	<u>2,270.2</u>	<u>(898.8)</u>	<u>(696.0)</u>	<u>(361.4)</u>	<u>292.4</u>	<u>(290.8)</u>

<sup>1</sup> 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, 2009 <sup>1</sup>**

(In billions of dollars)	Federal Disability Insurance Trust Fund	Federal Supplementary Medical Insurance Trust Fund (Medicare Parts B and D)	Exchange Stabilization Fund	All Other Earmarked Funds	Intra- Earmarked Fund Eliminations	Total Earmarked Funds
<b>Assets:</b>						
Cash and other monetary assets .....	-	0.3	71.7	0.1	-	72.2
Fund balance with Treasury ..	(0.3)	2.9	-	103.3	-	107.1
Investments in U.S. Treasury securities, net of unamortized premiums/discounts.....	207.9	61.8	19.8	185.9	-	4,308.4
Other Federal assets.....	2.6	27.9	-	19.6	(57.0)	64.3
Non-Federal assets .....	3.2	4.3	13.5	81.4	-	107.1
Total assets .....	<u>213.4</u>	<u>97.2</u>	<u>105.0</u>	<u>390.3</u>	<u>(57.0)</u>	<u>4,659.1</u>
<b>Liabilities:</b>						
Liabilities due and payable to beneficiaries .....	25.5	24.4	-	6.4	-	142.5
Other Federal liabilities.....	1.3	28.5	-	57.3	(57.0)	59.7
Other non-Federal liabilities ...	-	0.3	61.2	163.9	-	3,704.2
Total liabilities .....	26.8	53.2	61.2	227.6	(57.0)	3,906.4
Total net position .....	186.6	44.0	43.8	162.7	-	752.7
Total liabilities and net position .....	<u>213.4</u>	<u>97.2</u>	<u>105.0</u>	<u>390.3</u>	<u>(57.0)</u>	<u>4,659.1</u>
<b>Change in net position:</b>						
Beginning net position .....	196.7	52.0	39.8	191.4	-	704.6
Prior period adjustment .....	-	-	-	(0.3)	-	(0.3)
Beginning net position, adjusted.....	196.7	52.0	39.8	191.1	-	704.3
Investment revenue.....	10.6	3.0	-	4.8	-	184.6
Individual income taxes .....	97.0	-	-	-	-	862.3
Unemployment and excise taxes .....	-	-	-	87.0	-	87.0
Other taxes and receipts .....	-	-	0.2	51.8	(0.3)	52.2
Miscellaneous earned revenues.....	-	-	-	4.4	-	4.4
Other changes in fund balance (e.g., appropriations, transfers)..	(1.3)	183.8	-	42.5	-	386.0
Non-program expenses.....	-	-	-	2.8	-	2.8
Program net cost .....	116.4	194.8	(3.8)	216.1	(0.3)	1,525.3
Ending net position .....	<u>186.6</u>	<u>44.0</u>	<u>43.8</u>	<u>162.7</u>	<u>-</u>	<u>752.7</u>

<sup>1</sup> 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, 2008 <sup>1</sup>**

(In billions of dollars)	Federal Old-Age and Survivors Insurance Trust Fund	Military Retirement Fund	Civil Service Retirement and Disability Fund	Medicare- Eligible Retiree Health Care Fund (MERHCF)	Federal Hospital Insurance Trust Fund (Medicare Part A)	Civil Service Health Benefits Program Trust Funds
<b>Assets:</b>						
Cash and other monetary assets .....	-	-	-	-	-	-
Fund balance with Treasury .....	(0.3)	-	-	-	0.2	0.9
Investments in U.S. Treasury Securities, net of unamortized premiums/discounts .....	2,150.7	250.3	728.9	132.8	318.7	47.8
Other Federal assets .....	26.4	2.7	10.1	1.5	26.8	1.1
Non-Federal assets .....	2.5	-	0.3	-	1.1	0.9
Total assets .....	<u>2,179.3</u>	<u>253.0</u>	<u>739.3</u>	<u>134.3</u>	<u>346.8</u>	<u>50.7</u>
<b>Liabilities and net position:</b>						
Liabilities due and payable to beneficiaries .....	46.4	3.4	5.0	0.6	21.0	4.1
Other Federal liabilities .....	4.2	-	0.1	0.1	22.5	0.3
Other non-Federal liabilities .....	-	1,150.7	1,387.8	500.3	0.4	331.8
Total liabilities .....	50.6	1,154.1	1,392.9	501.0	43.9	336.2
Total net position .....	<u>2,128.7</u>	<u>(901.1)</u>	<u>(653.6)</u>	<u>(366.7)</u>	<u>302.9</u>	<u>(285.5)</u>
Total liabilities and net position .....	<u>2,179.3</u>	<u>253.0</u>	<u>739.3</u>	<u>134.3</u>	<u>346.8</u>	<u>50.7</u>
<b>Change in net position:</b>						
Beginning net position .....	1,946.7	(810.6)	(613.6)	(407.9)	295.0	(262.8)
Prior period adjustment .....	-	-	-	-	-	-
Beginning net position, adjusted .....	1,946.7	(810.6)	(613.6)	(407.9)	295.0	(262.8)
Investment revenue .....	104.1	15.5	37.3	8.2	16.6	1.9
Individual income taxes .....	573.8	-	-	-	197.2	-
Unemployment and excise taxes .....	-	-	-	-	-	-
Other taxes and receipts .....	-	-	-	-	0.6	-
Miscellaneous earned revenue .....	-	-	-	-	-	-
Other changes in fund balance (e.g., appropriations, transfers) .....	10.0	65.1	30.9	24.4	11.2	8.7
Non-program expenses .....	-	-	-	-	-	-
Program net cost .....	505.9	171.1	108.2	(8.6)	217.7	33.3
Ending net position .....	<u>2,128.7</u>	<u>(901.1)</u>	<u>(653.6)</u>	<u>(366.7)</u>	<u>302.9</u>	<u>(285.5)</u>

<sup>1</sup> 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, 2008 <sup>1</sup>**

(In billions of dollars)	Federal Disability Insurance Trust Fund	Federal Supplementary Medical Insurance Trust Fund (Medicare Parts B and D)	Exchange Stabilization Fund	All Other Earmarked Funds (Restated)	Intra- Earmarked Fund Eliminations	Total Earmarked Funds (Restated)
<b>Assets:</b>						
Cash and other monetary assets .....	-	0.3	22.2	0.1	-	22.6
Fund balance with Treasury .....	(0.4)	12.3	0.1	77.3	-	90.1
Investments in U.S. Treasury Securities, net of unamortized premiums/discounts.....	216.5	59.1	16.8	233.2	-	4,154.8
Other Federal assets .....	2.7	26.5	-	19.5	(53.5)	63.8
Non-Federal assets .....	3.0	5.0	10.8	79.8	-	103.4
Total assets .....	<u>221.8</u>	<u>103.2</u>	<u>49.9</u>	<u>409.9</u>	<u>(53.5)</u>	<u>4,434.7</u>
<b>Liabilities and net position:</b>						
Liabilities due and payable to beneficiaries .....	24.1	24.0	-	3.6	-	132.2
Other Federal liabilities .....	1.0	26.9	-	50.4	(53.5)	52.0
Other non-Federal liabilities...	-	0.3	10.1	164.5	-	3,545.9
Total liabilities .....	<u>25.1</u>	<u>51.2</u>	<u>10.1</u>	<u>218.5</u>	<u>(53.5)</u>	<u>3,730.1</u>
Total net position .....	<u>196.7</u>	<u>52.0</u>	<u>39.8</u>	<u>191.4</u>	<u>-</u>	<u>704.6</u>
Total liabilities and net position .....	<u>221.8</u>	<u>103.2</u>	<u>49.9</u>	<u>409.9</u>	<u>(53.5)</u>	<u>4,434.7</u>
<b>Change in net position:</b>						
Beginning net position .....	193.9	43.9	38.1	197.5	-	620.2
Prior period adjustment .....	-	-	-	-	-	-
Beginning net position, adjusted .....	193.9	43.9	38.1	197.5	-	620.2
Investment revenue .....	11.0	2.5	1.4	2.5	-	201.0
Individual income taxes .....	97.4	-	-	-	-	868.4
Unemployment and excise taxes .....	-	-	-	91.2	-	91.2
Other taxes and receipts .....	0.1	3.3	-	30.7	(0.4)	34.3
Miscellaneous earned revenue.....	-	-	-	5.8	-	5.8
Other changes in fund balance (e.g., appropriations, transfers) ..	(1.5)	179.6	-	9.6	-	338.0
Non-program expenses .....	-	-	-	1.9	-	1.9
Program net cost .....	<u>104.2</u>	<u>177.3</u>	<u>(0.3)</u>	<u>144.0</u>	<u>(0.4)</u>	<u>1,452.4</u>
Ending net position .....	<u>196.7</u>	<u>52.0</u>	<u>39.8</u>	<u>191.4</u>	<u>-</u>	<u>704.6</u>

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



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

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

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

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

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

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

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

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

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

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

## Federal Old-Age and Survivors Insurance Trust Fund

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

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

## **Military Retirement Fund**

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

## **Civil Service Retirement and Disability Fund**

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

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

## **Medicare-Eligible Retiree Health Care Fund**

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

## **Federal Hospital Insurance Trust Fund (Medicare Part A)**

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

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

## **Civil Service Health Benefits Program Trust Funds**

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

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

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

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

The laws establishing the PSRHB Fund and authorizing the depositing of amounts to the credit of the trust fund are set forth in 5 U.S.C. § 8909a. The Postal Civil Service Retirement and Health Benefits Funding Amendments of 2006 requires the USPS to make scheduled payment contributions to the PSRHB Fund ranging from \$5.4 billion to \$5.8 billion per year from fiscal year 2007 through fiscal year 2016. Thereafter, the USPS will make annual payments in the amount of the normal cost payment. The PSRHB Fund is also funded by interest earnings on Treasury securities. However, Public Law 111-68 made significant changes to the funding requirements of 5 U.S.C. § 8909a. Specifically, the law changed the USPS contribution for fiscal year 2009 to \$1.4 billion rather than \$5.4 billion.

## Federal Disability Insurance Trust Fund

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

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

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

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

Medicare Part D was created by the *Medicare Prescription Drug, Improvement, and Modernization Act of 2003* (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.

## Exchange Stabilization Fund (ESF)

The Exchange Stabilization Fund uses funds to purchase or sell foreign currencies, hold U.S. foreign exchange and SDR assets, and to provide financing to foreign governments. SDR assets in the International Monetary Fund, investments in Treasury securities, and investments in Foreign Currency Denominated assets are the sources of revenues or financing sources to the ESF. The Gold Reserve Act of 1934, the Bretton Woods Agreement Act of 1945, P.L. 95-147 and P.L. 94-564 established and authorized the use of the fund. The law establishing the ESF account and authorizing the depositing of amounts to the credit of the trust fund are set forth in 31 U.S.C. § 5302.

## All Other Earmarked Funds

The Government is responsible for the management of numerous earmarked funds that serve a wide variety of purposes. The earmarked funds presented on an individual basis in the table above represent the majority of the Government's net position attributable to earmarked funds. All other earmarked activity is aggregated in accordance with SFFAS No. 27. For the years ending September 30, 2009 and 2008, there were approximately 579 and 537 earmarked funds, respectively. The earmarked funds within the "all other" aggregate, along with the agencies that administer them, include the following:

- Unemployment Trust Fund—administered by DOL.
- Railroad Retirement Trust Fund—administered by RRB.
- Universal Service Fund—administered by FCC.
- Federal Crop Insurance Corporation Fund—administered by USDA.
- Superfund (Hazardous Substance) and Leaking Underground Storage Tanks—administered by Environmental Protection Agency (EPA).
- National Telecommunications and Information Administration (NTIA) Digital Television Transition and Public Safety Fund—administered by Department of Commerce (DOC).
- Land and Water Conservation Fund, Reclamation Fund, Water and Related Resources Fund, Lower Colorado River Basin Fund, and Historic Preservation Fund—administered by DOI.
- Decommissioning and Decontamination Fund—administered by DOE.
- Black Lung Disability Trust Fund (BLDTF)—administered by DOL.
- Federal Employees' Life Insurance—administered by OPM.
- Mass Transit—administered by DOT.
- Medical Care—administered by VA.
- Customs User Fees, and National Flood Insurance Program—administered by DHS.
- Government National Mortgage Association (Ginnie Mae)—administered by HUD.

## Unemployment Trust Fund (UTF) and Excise Taxes

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

The current economic recession has increased average unemployment from 5.3 percent in fiscal year 2008 to 8.6 percent in 2009. Additionally, new unemployment insurance benefit claims rose 70 percent, and payments rose 181 percent to \$119.2 billion. As a result, the UTF's total assets decreased from \$75.0 billion in 2008 to \$25.1 billion in 2009. The decrease in total assets was reflected in the investments held in the UTF. A portion of these investments was liquidated to pay unemployment benefits causing investments to decrease from \$73.3 billion in 2008 to \$19.8 billion in 2009. As a result, net position of the UTF dropped from \$72.1 billion in 2008 to \$10.5 billion in 2009.

Employer taxes provide the primary funding source for the UTF and constitute all the earmarked unemployment tax revenues as shown on the consolidated Statement of Operations and Changes in Net Position. For the years ending September 30, 2009, and 2008, UTF unemployment tax revenues were \$38.1 billion and \$39.4 billion, respectively. However, interest earnings on Treasury securities also provide income to the fund. Appropriations have supplemented the fund's income during periods of high and extended unemployment. The law establishing the UTF and authorizing the depositing of amounts to the credit of the trust fund is set forth in 42 U.S.C. § 1104.

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

The Highway Trust Fund was established to promote domestic interstate transportation and to move people and goods. The fund provides Federal grants to States for highway construction, certain transit programs, and related transportation purposes. The law establishing the Highway Trust Fund and authorizing the depositing of amounts to the credit of the trust fund is set forth in 26 U.S.C. § 9503. Funding sources include earmarked excise taxes on gasoline and other fuels, certain tires, the initial sale of heavy trucks, and highway use by commercial motor vehicles. For the years ending September 30, 2009, and 2008, Highway Trust Fund excise tax revenues were \$35.0 billion and \$36.4 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. The law establishing the Airport and Airway Trust Fund and authorizing the depositing of amounts to the credit of the trust fund is set forth in 26 U.S.C. § 9502. Funding sources include:

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

For the years ending September 30, 2009, and 2008, Airport and Airway Trust Fund excise tax revenues were \$10.6 billion and \$11.8 billion, respectively. These revenue amounts do not reflect any transfers from the Highway Trust Fund to the Airport and Airway Trust Fund for fuel which was used in aviation, but which was taxed at highway rates under P.L. 109-59 (SAFETEA-LU).

## Miscellaneous Earned Revenues

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

## Intra-Earmarked Fund Eliminations

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

## Restatements

As of September 30, 2008, the following restatements were made:

Due to a correction of an error by VA, other Federal liabilities were decreased and other non-Federal liabilities were increased by \$12.8 billion. This restatement had no impact on liabilities reported on the balance sheet and no impact on 2008 net position as reported.

In addition, due to a correction of an error by the DOT Highway Trust Fund, both other non-Federal assets and other non-Federal liabilities were decreased by \$27.1 billion to remove an intra-DOT elimination. The restatement had no impact on the assets or liabilities reported on the balance sheet and no impact on the 2008 net position as reported.

## Note 25. Fiduciary Activities

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

### Schedule of Fiduciary Net Assets as of September 30, 2009

(In billions of dollars)

FRTIB-Thrift Savings Plan .....	234.0
Department of the Interior .....	3.6
All other .....	<u>5.0</u>
Total fiduciary net assets.....	<u>242.6</u>

In accordance with the requirements of SFFAS 31, fiduciary investments in Treasury securities and fund balance with Treasury held by fiduciary funds are to be recognized on the Governmentwide Balance Sheet as debt held by the public and as liability for fiduciary fund balance with Treasury, respectively.

As of September 30, 2009, total fiduciary investments in Treasury securities and in non-Treasury securities are \$116.9 billion and \$124.8 billion, respectively. As of September 30, 2009, the total fiduciary fund balance with Treasury is \$0.9 billion. A liability for this fiduciary fund balance with Treasury is reflected as other miscellaneous liabilities in Note 19—Other Liabilities.

Collectively, the fiduciary investments in Treasury securities and fiduciary fund balance with Treasury held by all Government entities represent \$3.1 billion of unrestricted cash included within cash held by Treasury for Governmentwide Operations shown in Note 2—Cash and Other Monetary Assets.

### FRTIB-Thrift Savings Plan

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

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

As of September 30, 2009, the TSP held \$234.0 billion in net assets, which included \$113.0 billion of U.S. Government Securities (amounts are unaudited). The most recent audited financial statements for the TSP are as of December 31, 2008. As of December 31, 2008, the TSP held \$202.8 billion in net assets, which included \$108.2 billion of U.S. Government Securities. The unaudited amounts above are included to enhance comparability of the TSP net assets with the remainder of the Government's fiduciary net assets as of September 30, 2009.

Federal employees, who are participants of FERS, the CSRS, or equivalent retirement systems, as provided by statute, and members of the uniformed services, are eligible to join the Plan immediately upon being hired. Generally, FERS employees are those employees hired on or after January 1, 1984, while CSRS employees are employees hired before January 1, 1984, who have not elected to convert to FERS. Each group has different rules that govern contribution rates. As of December 31, 2008, there were approximately 4.0 million participants in the

TSP, with approximately 2.7 million contributing their own money. For further information about FRTIB and the TSP, please refer to the FRTIB website at <http://www.ftib.gov>.

## DOI–Indian Trust Funds

As stated above, DOI has responsibility for the assets held in trust on behalf of American Indian tribes and individuals, and these account for all of DOI's fiduciary net assets. DOI maintains accounts for Tribal and Other Trust Funds (including the Alaska Native Escrow Fund and Individual Indian Money Trust Funds) in accordance with the American Indian Trust Fund Management Reform Act of 1994. The fiduciary balances that have accumulated in these funds have resulted from land use agreements, royalties on natural resource depletion, other proceeds derived directly from trust resources, judgment awards, settlements of claims, and investment income. These funds are maintained for the benefit of individual Native Americans as well as for designated Indian tribes. For further information related to these assets, see the financial statements of the DOI.

## All Other Entities with Fiduciary Activities

The Government is responsible for the management of other fiduciary net assets on behalf of various non-Federal entities. The component agencies presented individually in the table above represent the vast majority of the Government's fiduciary net assets. All other component entities with fiduciary net assets are aggregated in accordance with SFFAS No. 31. As of September 30, 2009, including FRTIB and DOI, there are a total of 13 Federal entities with fiduciary activities with a grand total of 55 fiduciary funds. For further information relating to the fiduciary activities of the 11 remaining component entities within the "all other" aggregate, please refer to the financial statements for:

- Small Business Administration
- Library of Congress
- Department of the Treasury
- Department of State
- Department of Defense
- Department of Transportation
- Department of Labor
- Department of Agriculture
- Smithsonian Institution
- Department of Commerce
- National Labor Relations Board.

## Note 26. Social Insurance

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



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

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

The present values of future expenditures in excess of future revenue are the current amounts of funds needed to cover projected shortfalls, excluding the starting trust fund balances, over the projection period. They are calculated by subtracting the actuarial present values of future scheduled contributions and dedicated tax income by and on behalf of current and future participants from the actuarial present value of the future scheduled benefit payments to them or on their behalf.

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

<b>Social Insurance Programs Trust Fund Balances <sup>1</sup></b>					<u>UNAUDITED</u>
(In billions of dollars)	<b>2009</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>
Social Security.....	2,419	2,238	2,048	1,859	1,687
Medicare:					
HI .....	321	312	300	285	268
SMI Part B .....	59	53	38	23	19
SMI Part D .....	1	3	1	-	-
Railroad Retirement .....	22	33	32	30	28
Black Lung.....	(6)	(10)	(10)	(10)	(9)

<sup>1</sup> As of the valuation date of the respective programs.

## Social Security

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

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

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

## Medicare

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

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

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

## SMI Part B Physician Payments

The projected Part B expenditure growth reflected in the accompanying 2009 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 (and before the definitional change described below), this structure would result in multiple years of significant reductions in physician payments, totaling an estimated 38 percent over the next 6 years. Reductions of this magnitude are very unlikely to occur fully. For example, Congress has overridden scheduled negative updates for each of the years 2003 through 2009.<sup>1</sup> However, since such reductions are required in the future under the

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<sup>1</sup> Per Public Law 111-118, which was enacted on December 19, 2009, the negative update scheduled for 2010 was made zero for services furnished between January 1, 2010, and February 28, 2010. This provision has no impact on the calculation of the conversion factor for the remainder of 2010 and subsequent years.

current-law payment system, they are reflected in the accompanying 2009 Statement of Social Insurance as required under GAAP. Consequently, the projected actuarial present values of Part B expenditures shown in the accompanying 2009 Statement of Social Insurance, are 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. Also, the illustrations do not reflect the change in the definition of “physician-related services” described below. 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 \$23.2 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 \$23.7 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 \$25.7 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 of 2005 and the Medicare Improvements for Patients and Providers Act of 2008 (MIPPA)). 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.

Subsequent to September 30, 2009, HHS revised the definition of “physician-related services” under Part B to exclude physician-administered drugs in the determination of Medicare payment updates for physicians. The change in the definition of physician-related services increases estimated future Part B expenditures throughout the long-range SOSI projection period. The total increase for fiscal years 2010 through 2019 is estimated to be approximately \$125 billion; the amount of increase in the long range is not reasonably estimable at this time. The Part B projections prepared for the 2010 Medicare Trustees Report and the 2010 Statement of Social Insurance will reflect this change in policy.

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.

## **Social Security and Medicare—Demographic and Economic Assumptions**

The Boards of Trustees<sup>2</sup> 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 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.

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

**Table 1A**  
**Social Security – Demographic and Economic Assumptions**

Demographic Assumptions					
Year	Total Fertility Rate <sup>1</sup>	Age-Sex Adjusted Death Rate <sup>2</sup> (per 100,000)	Net Immigration <sup>3</sup> (persons)	Period Life Expectancy at Birth <sup>4</sup>	
				Male	Female
2009	2.08	811.4	1,210,000	75.5	80.0
2010	2.08	806.4	1,190,000	75.7	80.1
2020	2.04	743.2	1,130,000	77.0	81.0
2030	2.01	679.5	1,085,000	78.1	81.9
2040	2.00	622.9	1,050,000	79.2	82.9
2050	2.00	573.5	1,035,000	80.1	83.7
2060	2.00	530.2	1,030,000	81.1	84.5
2070	2.00	492.0	1,025,000	81.9	85.3
2080	2.00	458.2	1,025,000	82.7	86.0

Economic Assumptions						
Year	Real Wage Differential <sup>5</sup> (percent)	Average Annual Wage in Covered Employment <sup>6</sup> (percent change)	CPI <sup>7</sup> (percent change)	Real GDP <sup>8</sup> (percent change)	Total Employment <sup>9</sup> (percent change)	Average Annual Interest Rate <sup>10</sup> (percent)
2010	1.8	3.4	1.7	2.4	(0.4)	4.0
2020	1.1	3.9	2.8	2.1	0.5	5.7
2030	1.1	3.9	2.8	2.2	0.5	5.7
2040	1.1	3.9	2.8	2.2	0.5	5.7
2050	1.1	3.9	2.8	2.1	0.5	5.7
2060	1.1	3.9	2.8	2.1	0.4	5.7
2070	1.1	3.9	2.8	2.1	0.4	5.7
2080	1.1	3.9	2.8	2.1	0.4	5.7

<sup>1</sup> 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 2033.

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

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

<sup>4</sup> The period life expectancy for a group of persons born in the selected year is the average that would be attained by such persons if the group were to experience in succeeding years the death rates by age assumed for the given year. It is a summary measure and not a basic assumption; it summarizes the effects of the basic assumptions from which it is derived.

<sup>5</sup> 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.

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

<sup>7</sup> The CPI is the annual average value for the calendar year of the CPI for urban wage earners and clerical workers.

<sup>8</sup> The real GDP is the value of total output of goods and services produced in the U.S., 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.

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

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

**Table 1B  
Medicare – Demographic and Economic Assumptions**

Demographic Assumptions								
Year	Total Fertility Rate <sup>1</sup>	Age-Sex		Net Immigration <sup>3</sup> (persons)				
		Adjusted Death Rate <sup>2</sup> (per 100,000)						
2009	2.08	811.4		1,210,000				
2010	2.08	806.4		1,190,000				
2020	2.04	743.2		1,130,000				
2030	2.01	679.5		1,085,000				
2040	2.00	622.9		1,050,000				
2050	2.00	573.5		1,035,000				
2060	2.00	530.2		1,030,000				
2070	2.00	492.0		1,025,000				
2080	2.00	458.2		1,025,000				

Economic Assumptions								
Year	Real Wage Differential <sup>4</sup> (percent)	Average Annual Wage in Covered Employment (percent change)	CPI <sup>5</sup> (percent change)	Real GDP <sup>6</sup> (percent change)	Per Beneficiary Cost (percent change) <sup>7</sup>			Real Interest Rate <sup>8</sup> (percent)
					HI	SMI		
						Part B	Part D	
2009	1.8	0.7	(1.0)	(2.2)	5.8	10.0	6.1	4.7
2010	1.8	3.4	1.7	2.4	1.4	(2.9)	5.4	1.3
2020	1.1	3.9	2.8	2.1	4.3	6.4	7.2	2.9
2030	1.1	3.9	2.8	2.2	5.7	6.0	5.8	2.9
2040	1.1	3.9	2.8	2.2	5.9	5.5	5.3	2.9
2050	1.1	3.9	2.8	2.1	5.0	4.9	5.0	2.9
2060	1.1	3.9	2.8	2.1	4.7	4.8	4.7	2.9
2070	1.1	3.9	2.8	2.1	4.6	4.5	4.5	2.9
2080	1.1	3.9	2.8	2.1	4.4	4.3	4.3	2.9

<sup>1</sup> 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 2033.

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

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

<sup>4</sup> 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.

<sup>5</sup> The CPI is the annual average value for the calendar year of the CPI for urban wage earners and clerical workers.

<sup>6</sup> The real GDP is the value of total output of goods and services produced in the U.S., 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.

<sup>7</sup> 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.

<sup>8</sup> The average annual interest rate earned on new trust fund securities, above and beyond the rate of inflation.

## Railroad Retirement

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

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

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

Other sources of program income include: financial transactions with the Social Security and Medicare Trust Funds, earnings on investments, Federal income taxes on railroad retirement benefits, and appropriations (provided after 1974 as part of a phase out of certain vested dual benefits). The financial 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 eliminated in consolidation.

## Railroad Retirement—Employment, Demographic and Economic Assumptions

The most recent set of projections are prepared using employment, demographic and economic assumptions and reflect the Board Members' 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 230,000 in 2009 under the moderate employment assumption. This employment assumption, based on a model developed by the Association of American Railroads, assumes that (1) passenger service employment will remain at the level of 43,000 and (2) the employment base, excluding passenger service employment, will decline at a constant 2.0 percent annual rate for 23 years, at a falling rate over the next 25 years, and remain level thereafter. All the projections are based on an open group (i.e., future entrants) population.

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

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

<b>Table 2 Railroad Retirement Demographic Actuarial Assumptions (Sources)</b>		
<b>Mortality Rates<sup>1</sup></b>	Mortality after age retirement	2007 RRB Annuitants Mortality Table
	Mortality after disability retirement	2007 RRB Disabled Mortality Table for Annuitants with Disability Freeze
		2007 RRB Disabled Mortality Table for Annuitants without Disability Freeze
	Mortality during active service	2003 RRB Active Service Mortality Table
	Mortality of widow annuitants	1995 RRB Mortality Table for Widows
<b>Total Termination Rates<sup>2</sup></b>	Termination for spouses	2007 RRB Spouse Total Termination Table
	Termination for disabled children	2004 RRB Total Termination Table for Disabled Children
<b>Widow Remarriage Rate<sup>3</sup></b>	1997 RRB Remarriage Table	
<b>Retirement Rates<sup>4</sup></b>	Age retirement	See the Valuation Report
	Disability retirement	See the Valuation Report
<b>Withdrawal Rates<sup>5</sup></b>	See the Valuation Report	
<p><sup>1</sup> These mortality tables are used to project the termination of eligible employee benefit payments within the population.</p> <p><sup>2</sup> Total termination rates are used to project the termination of dependent benefits to spouses and disabled children.</p> <p><sup>3</sup> This rate is used to project the termination of spousal survivor benefits.</p> <p><sup>4</sup> 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.</p> <p><sup>5</sup> 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.</p>		

**Black Lung Disability Benefit Program**

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

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

## Black Lung—Demographic and Economic Assumptions

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

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

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

OMB supplies assumptions for future monthly benefit rate increases based on increases in the Federal pay scale and future medical cost inflation based on increases in the CPIM, which are used to calculate future benefit costs. During the current projection period, future benefit rate increases 4.6 percent in 2010 and 3.6 percent in each year thereafter and medical cost increases 3.4 percent in 2010, and ranges from 3.3 percent to 3.8 percent thereafter. Estimates for administrative costs for the first 11 years of the projection are supplied by DOL's Budget Office, based on current year enacted amounts, while later years are based on the number of projected beneficiaries.

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

## Note 27. Stewardship Land and Heritage Assets

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

The majority of public lands that are under the management of DOI were acquired by the Government during the first century of the Nation's existence between 1781 and 1867. Stewardship land accounts for 28 percent of the current U.S. landmass.

DOI uses units as a measure to more accurately reflect the major categories of uses of stewardship land. As of September 30, 2009, they have 550 national wildlife refuges, 378 park units, 134 geographic management areas, 66 fish hatcheries, and many other categories. At the end of fiscal year 2009, DOD had 706 thousand acres of public land and 16,057 thousand acres withdrawn public land, the USDA's Forest Service managed an estimated 155 national forests, while the DOC had 13 National Marine Sanctuaries, which included near-shore coral reefs and open ocean. This is just a sample of the types of stewardship lands reported.



Stewardship lands are used and managed in accordance with the statutes authorizing their acquisition or directing their use and management. Additional detailed information concerning stewardship land, such as agency stewardship policies, physical units by major categories, and the condition of stewardship land, can be obtained from the financial statements of DOI, DOC, DOD, and USDA.

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

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

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

Many laws and regulations govern the preservation and management of heritage assets. Established policies by individual Federal agencies for heritage assets ensure the proper care and handling of the assets under their control and preserve these assets for the benefit of the American public.

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

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

The discussion of the Government's heritage assets is not all-inclusive. Rather, it highlights significant heritage assets reported by Federal agencies. Please refer to the individual financial statements of the DOC, the DOD, the National Archives and Records Administration, and the websites for the Library of Congress (<http://www.loc.gov/index.html>) and the Smithsonian Institution (<http://www.si.edu>), for additional information on multi-use heritage assets, agency stewardship policies, and physical units by major categories and conditions.

## Note 28. Subsequent Events

### A. DOI Minerals Management Service (MMS) versus Kerr McGee

Under the 1995 Outer Continental Shelf Deep Water Royalty Relief Act (the Act), the DOI Minerals Management Service (MMS) implemented a royalty relief program that relieves eligible leases from paying royalties on defined amounts of deep water petroleum production over Federal Outer Continental Shelf lands. MMS interpreted the Act to include price thresholds in leases. The thresholds required royalty payments to MMS if market prices exceeded price thresholds established in the leases. Kerr McGee challenged the inclusion of price thresholds, arguing that MMS did not have the authority to impose such thresholds.

On January 15, 2009, the district court decided in favor of Kerr McGee. DOJ filed an appeal in June 2008, and the Fifth Circuit court also ruled in favor of Kerr McGee. DOJ then filed a petition for certiorari with the Supreme Court. On October 5, 2009, MMS was notified that the Supreme Court denied the petition for certiorari. As a result, MMS must issue refunds for payments previously made by payers on the subject leases. The estimated amount to be refunded including estimated interest is approximately \$2.1 billion.

## **B. Cobell versus Salazar**

On December 8, 2009, DOI proposed a settlement to the class-action lawsuit that suspected DOI in the mistreatment of accounts that dealt with the American Indian Trust Funds. This lawsuit was first filed in 1996 and both parties have been trying to settle ever since. A fund totaling \$1.4 billion will be distributed to more than 300,000 individual Indians to compensate them for their claims. The settlement will also establish a land program that will provide individual Indians with an opportunity to obtain cash payments for land interests and free up land for tribal communities. This fund will include an additional \$2 billion fund for the buy-back and consolidation of fractionated land interests.

## **C. Katrina Canal Breaches Litigation**

On November 18, 2009, the United States District Court held U.S. Army Corps of Engineers (USACE) liable for damages from Hurricane Katrina. The Department of Justice and USACE Office of Chief Counsel have reviewed the opinion and intend to appeal the decision to the U.S. Court of Appeals for the Fifth Circuit. The Government is unable to estimate the amount of any loss that may result, however, and the Government has not recorded a provision for Katrina-related matters in the consolidated financial statements.

## **D. Public Debt Limit**

Gross Federal debt (with some adjustments) is subject to a statutory ceiling (i.e., the debt limit). To permit continued financing of the Government, Public Law 111-123 was signed into law December 28, 2009, which increased the statutory debt limit from \$12,104 billion to \$12,394 billion. On February 12, 2010, President Obama signed into law the statutory Pay-As-You-Go Act of 2010, which increases the public debt limit from \$12,394 billion to \$14,294 billion.

## **E. Troubled Asset Relief Program (TARP)**

On December 9, 2009, the Secretary of the Treasury, pursuant to Section 120(b) of EESA, certified that he was extending the spending authority provided under the Act to October 3, 2010. The spending authority was originally set to expire on December 31, 2009. This extension was deemed necessary to assist American families and stabilize financial markets because it will, among other things, enable the Department of the Treasury to continue to implement programs that address housing markets and the needs of small businesses, and to maintain the capacity to respond to unforeseen threats to the economy stemming from financial instability.

A number of banks that received funds from the TARP also had activity subsequent to September 30, 2009. Certain TARP participants, including Bank of America (\$45 billion), Citigroup (\$20 billion), and Wells Fargo (\$25 billion) and other smaller institutions, had repaid approximately \$90 billion to Treasury subsequent to September 30, 2009.

Conversely, there have been a few financial institutions that have declared bankruptcy or were closed by regulators subsequent to September 30, 2009. Most notably on November 1, 2009, CIT Group, a CPP participant, filed for Chapter 11 Bankruptcy. Treasury had invested \$2.3 billion in senior preferred shares of CIT Group and received a warrant for the purchase of common shares. Treasury does not expect a significant recovery of its preferred stock investment. As such, this investment has been reduced to zero. The ultimate amount received, if any, from this investment will depend on the outcome of the bankruptcy proceedings.

In December 2009, Treasury entered into a termination agreement with Citigroup, the FDIC and FRBNY, which terminated the Citigroup guarantee under the AGP.

In December 2009, Treasury invested an additional \$3.8 billion in GMAC (\$2.5 billion in Trust Preferred securities and \$1.3 billion in Mandatory Convertible Preferred Stock) and exchanged its non-convertible preferred stock purchased in December 2008, into Mandatory Convertible Preferred Stock (see Note 5—TARP Direct Loans and Equity Investments, Net). Also, in December 2009, Treasury converted \$3 billion of its Mandatory Convertible Preferred Stock into GMAC common equity, thereby increasing Treasury's GMAC common equity ownership from approximately 35 percent to approximately 56 percent.

**F. Treasury and the Housing and Economic Recovery Act (HERA)**

Treasury announced on December 9, 2009, that it would start to wind down programs that had been established during the crisis and were no longer critical to financial stability. The program Treasury established under HERA to support the mortgage market by purchasing GSE-guaranteed mortgage-backed securities (MBS) ended on December 31, 2009. The short-term credit facility Treasury established under HERA for Fannie Mae, Freddie Mac, and the Federal Home Loan Banks was also terminated on December 31, 2009. Treasury also amended the term of its agreements with Fannie Mae and Freddie Mac to support their ongoing stability.

At the time the FHFA placed Fannie Mae and Freddie Mac into conservatorship in September 2008, Treasury established SPSPAs to ensure that each firm maintained a positive net worth. On December 24, 2009, Treasury amended the SPSPAs to replace the existing fixed \$200 billion cap per GSE on Treasury advances, with a formulaic cap for the next 3 years that will adjust upwards quarterly by the cumulative amount of any losses realized by either Fannie Mae or Freddie Mac and downwards by the cumulative amount of any gains, but not below \$200 billion per GSE. At the conclusion of the three-year period, the remaining commitment will then be fixed and be available to be drawn per the terms of the agreements.

In October 2009, Treasury, together with the Fannie Mae, Freddie Mac, and the Department of Housing and Urban Development announced an initiative to provide support to state and local housing finance agencies (HFAs) using authority that Congress had given Treasury in HERA. HFAs have historically played a central role in providing a safe, sustainable path to homeownership for working families in all 50 states and many localities across the country. This initiative is designed to support low mortgage rates and expand resources for low and middle income borrowers to purchase or rent homes, making them more affordable over the long term. In December 2009, several transactions closed as part of the HFA Initiative's two separate programs: (1) the Temporary Credit and Liquidity Program (TCLP) and (2) the New Issue Bond Program (NIBP). As part of the TCLP, Treasury has entered into participation interests with Fannie Mae and Freddie Mac supporting credit and liquidity facilities that the GSEs are providing to 12 states are part of the program. The liquidity facilities cover \$8.2 billion of single-family and multi-family variable-rate demand obligations. As of February 17, 2010, none of these bonds have been tendered to the GSEs, and Treasury accordingly has not disbursed any funds. In December, Treasury purchased \$15.3 billion of GSE obligations backed by a combination of HFA mortgage revenue bonds and escrowed funds from over 90 HFAs in 49 states.

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# United States Government Supplemental Information (Unaudited) for the Years Ended September 30, 2009, and 2008

## Social Insurance

The social insurance programs consisting of Social Security, Medicare, Railroad Retirement and Black Lung, were developed to provide income security and health care coverage to citizens under specific circumstances as a responsibility of the Government. Because taxpayers rely on these programs in their long-term planning, social insurance program information should indicate whether 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 OASI Trust Fund was established on January 1, 1940, as a separate account in the Treasury. The DI Trust Fund, another separate account in the Treasury, was established on August 1, 1956. OASI pays cash retirement benefits to eligible retirees and their eligible dependents and survivors, and the much smaller DI fund pays cash benefits to eligible individuals who are unable to work because of medical conditions and certain family members of such eligible individuals. Though the events that trigger benefit payments are quite different, both trust funds have the same earmarked financing structure: primarily payroll taxes and income taxes on benefits. All financial operations of the OASI and DI Programs are handled through these respective funds. The two funds are often referred to as simply the combined OASDI Trust Funds. At the end of calendar year 2008, OASDI benefits were paid to approximately 51 million beneficiaries.

The primary financing of these two funds are taxes paid by workers, their employers, and individuals with self-employment income, based on work covered by the OASDI Program. Since 1990, employers and employees have each paid 6.2 percent of taxable earnings. The self-employed pay 12.4 percent of taxable earnings. Payroll taxes are computed on wages and net earnings from self-employment up to a specified maximum annual amount, referred to as maximum taxable earnings (\$106,800 in 2009), that increases each year with economy-wide average wages.

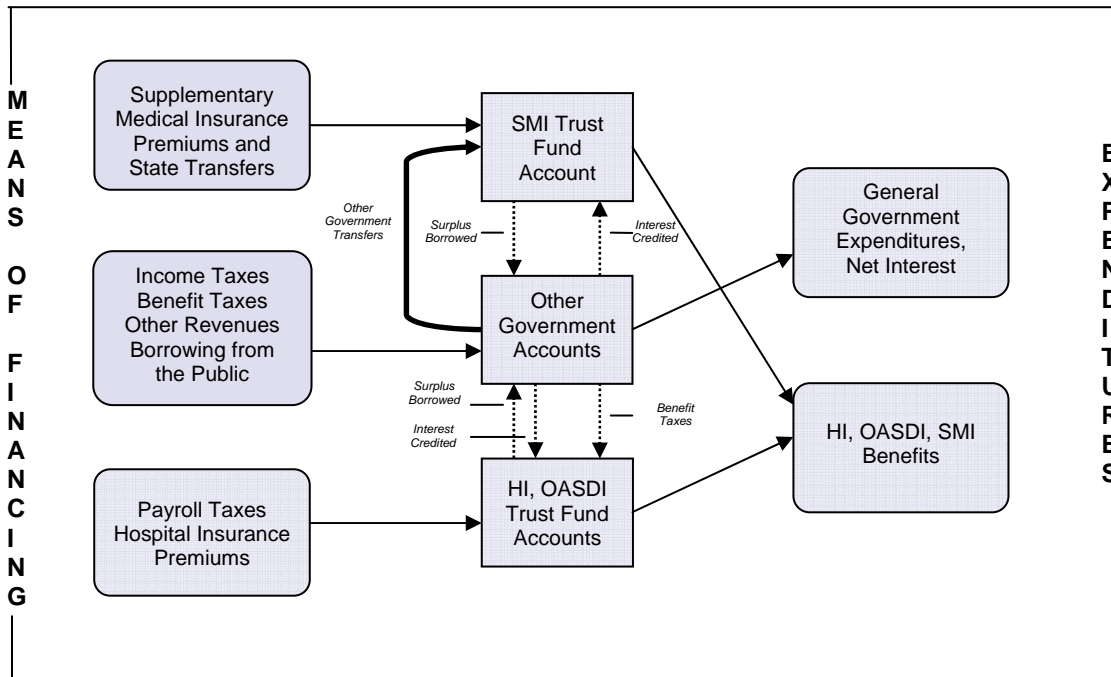
Legislation passed in 1984 subjected up to half of OASDI benefits to tax and allocated the revenue to the OASDI Trust Funds, and in 1993 legislation upped the potentially taxed portion of benefits to 85 percent and allocated the additional revenue to the Hospital Insurance Trust Fund.

**Medicare**

The Medicare Program, created in 1965, also has two separate trust funds: the Hospital Insurance (HI, Medicare Part A) and Supplementary Medical Insurance (SMI, Medicare Parts B and D) Trust Funds.<sup>1</sup> 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. 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. As is explained in the next section, these Treasury securities and related interest have no effect on the consolidated statement of Governmentwide finances.

For SMI, transfers from the General Fund of the Treasury represent the largest source of income covering about 74 percent and 77 percent of program costs for Parts B and D, respectively. Beneficiaries pay monthly premiums that finance approximately 26 percent and 23 percent of costs for Parts B and D, respectively. With the introduction of Part D drug coverage, Medicaid is no longer the primary payer of drug benefits for beneficiaries dually eligible for Medicare and Medicaid. For those beneficiaries, States must pay the Part D account a portion of their estimated foregone drug costs for this population (referred to as State transfers). As with HI, interest received on Treasury securities held in the SMI Trust Fund is credited to the fund. These Treasury securities and related interest have no effect on the consolidated statement of Governmentwide finances. See Note 26—Social Insurance, for additional information on Medicare program financing.

**Figure 1  
Social Security, Medicare, and Governmentwide Finances**



<sup>1</sup> 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.

## Social Security, Medicare, and Governmentwide Finances

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

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

Each of the trust funds has its own sources and types of revenue. With the exception of General Fund transfers to SMI, each of these revenue sources 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.<sup>3</sup> The arrows from the boxes on the left represent the flow of the revenues into the trust funds and other Government accounts.

The heavy line between the top two boxes in the middle of Figure 1 represents intragovernmental transfers 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. 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). However, the General Fund has to credit interest on the loans from the trust fund programs, just as if it borrowed the money from the public. The credits lead to future obligations for the General Fund (which is part of the other Government accounts). These transactions are indicated in Figure 1 by the vertical arrows labeled *Interest Credited*. The credits increase trust fund income exactly as much as they increase credits (future obligations) in the General Fund. From the standpoint of the Government as a whole, at least in an accounting sense, these interest credits are a wash.

<sup>2</sup> The Federal unified budget encompasses all Government financing and is synonymous with a Governmentwide perspective.

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

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.

Actual dollar amounts roughly corresponding to the flows presented in Figure 1 are shown in Table 1 for fiscal year 2009. 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 (\$196.2 billion) and interest credits (\$136.9 billion) received by the trust funds appear as negative entries under “Other Government” and are thus offsetting when summed for the total budget column. These two intragovernmental transfers are the key to the differences between the trust fund and budget perspectives.

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 (\$238.0 billion) and revenues (\$211.2 billion) was (\$26.8 billion) in 2009, 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 2009. The difference (\$194.9 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 (\$669.7 billion) and revenues from the public (\$689.0 billion) was \$19.4 billion in 2009, 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 expenditures exceeded total revenues by \$9.1 billion in 2009, as shown at the bottom of the first column. This cash deficit was made up by calling in past loans made to the General Fund (i.e., by redeeming Trust Fund assets). For SMI, total revenues of \$262.5 billion (\$65.3 + \$197.2), including \$194.3 billion transferred from other Government accounts (the General Fund), exceeded total expenditures by \$2.3 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 \$807.0 billion (\$689.0 + \$118.0), including interest and a small amount of other Government transfers, exceeded total expenditures of \$669.7 billion by \$137.3 billion.



**Table 1**  
**Revenues and Expenditures for Medicare and Social Security**  
**Trust Funds and the Total Federal Budget,**  
**for the Fiscal Year ended September 30, 2009**

(In billions of dollars)	Trust Funds					Total <sup>1</sup>
	HI	SMI	OASDI	Total	All Other	
<b>Revenues from the public and States:</b>						
Payroll and benefit taxes, State grants...	206.5	-	689.0	895.5	-	895.5
Premiums .....	4.7	57.8	-	62.5	-	62.5
Other taxes and fees .....	-	7.5	-	7.5	1,139.1	1,146.6
Total .....	211.2	65.3	689.0	965.5	1,139.1	2,104.6
Total expenditures to the public <sup>2</sup> .....	238.0	260.2	669.7	1,167.9	2,353.8	3,521.7
<b>Net results—budget perspective<sup>3</sup> .....</b>	<b>(26.8)</b>	<b>(194.9)</b>	<b>19.4</b>	<b>(202.4)</b>	<b>(1,214.7)</b>	<b>(1,417.1)</b>
<b>Revenues from other Government accounts:</b>						
Transfers .....	1.9	194.3	-	196.2	(196.2)	-
Interest credits .....	15.9	3.0	118.0	136.9	(136.9)	-
Total .....	17.7	197.2	118.0	333.1	(333.1)	-
<b>Net results—trust fund perspective (change in Trust Fund balance)<sup>3</sup> .....</b>	<b>(9.1)</b>	<b>2.3</b>	<b>137.3</b>	<b>130.7</b>	<b>N/A</b>	<b>N/A</b>

<sup>1</sup> This column is the sum of the preceding two columns and shows data for the total Federal budget. The figure \$1,417.1 billion was the total Federal deficit in fiscal year 2009.

<sup>2</sup> The OASDI figure includes \$4.1 billion transferred to the Railroad Retirement Board for benefit payments and is therefore an expenditure to the public.

<sup>3</sup> Net results are computed as revenues less expenditures.

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

## Cashflow Projections

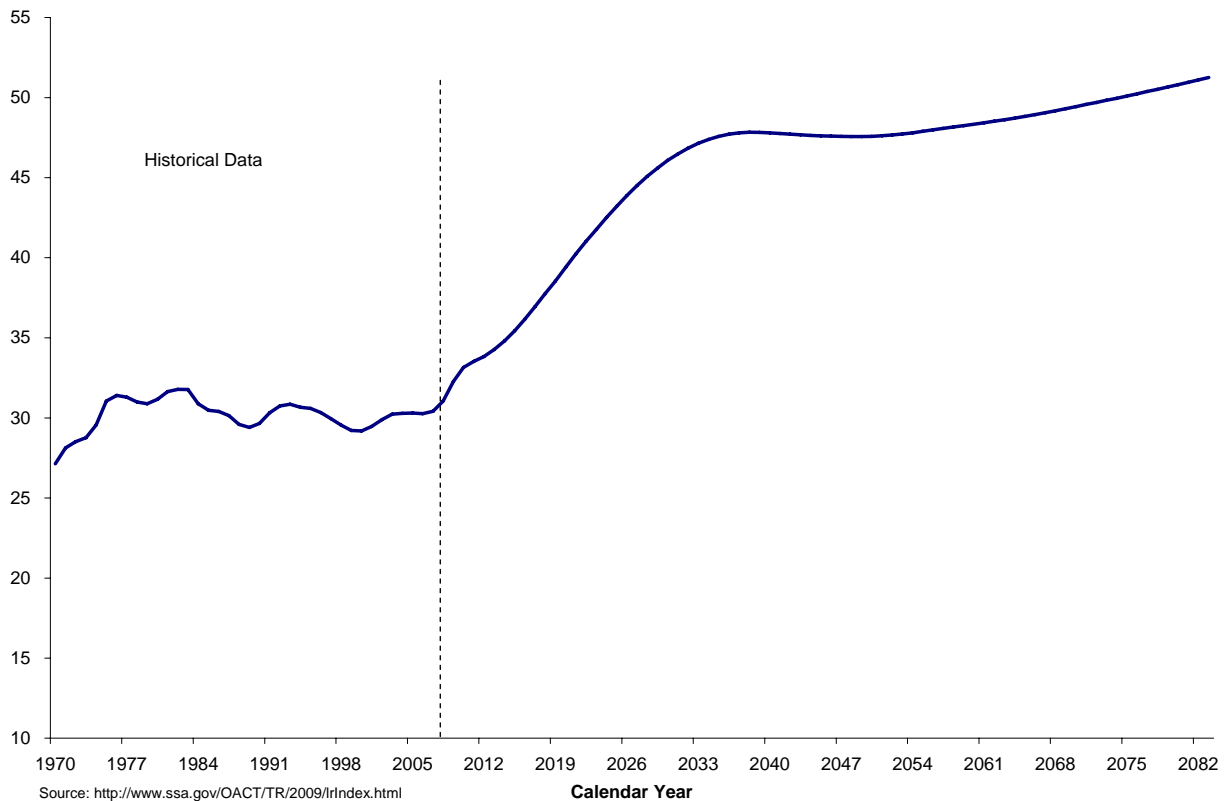
### Background

*Economic and Demographic Assumptions.* The Boards of Trustees<sup>4</sup> of the OASDI and Medicare Trust Funds provide in their annual reports to Congress short-range (10-year) and long-range (75-year) actuarial estimates of each trust fund. Because of the inherent uncertainty in estimates for 75 years into the future, the Boards use three alternative sets of economic and demographic assumptions to show a range of possibilities. The economic and demographic assumptions used for the most recent set of intermediate projections for Social Security and Medicare are shown in the "Social Security" and "Medicare" sections of Note 26—Social Insurance.

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

*Beneficiary-to-Worker Ratio.* Underlying the pattern of expenditure projections for both the OASDI and Medicare Programs is the impending demographic change that will occur as the large baby-boom generation, born in the years 1946 to 1964, retires or reaches eligibility age. The consequence is that the number of beneficiaries will increase much faster than the number of workers who pay taxes that are used to pay benefits. The pattern is illustrated in Chart 1 which shows the ratio of OASDI beneficiaries to 100 covered workers for the historical period and estimated for the next 75 years. In 2009, there were about 32 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 28 beneficiaries for every 100 workers in 2009; 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.

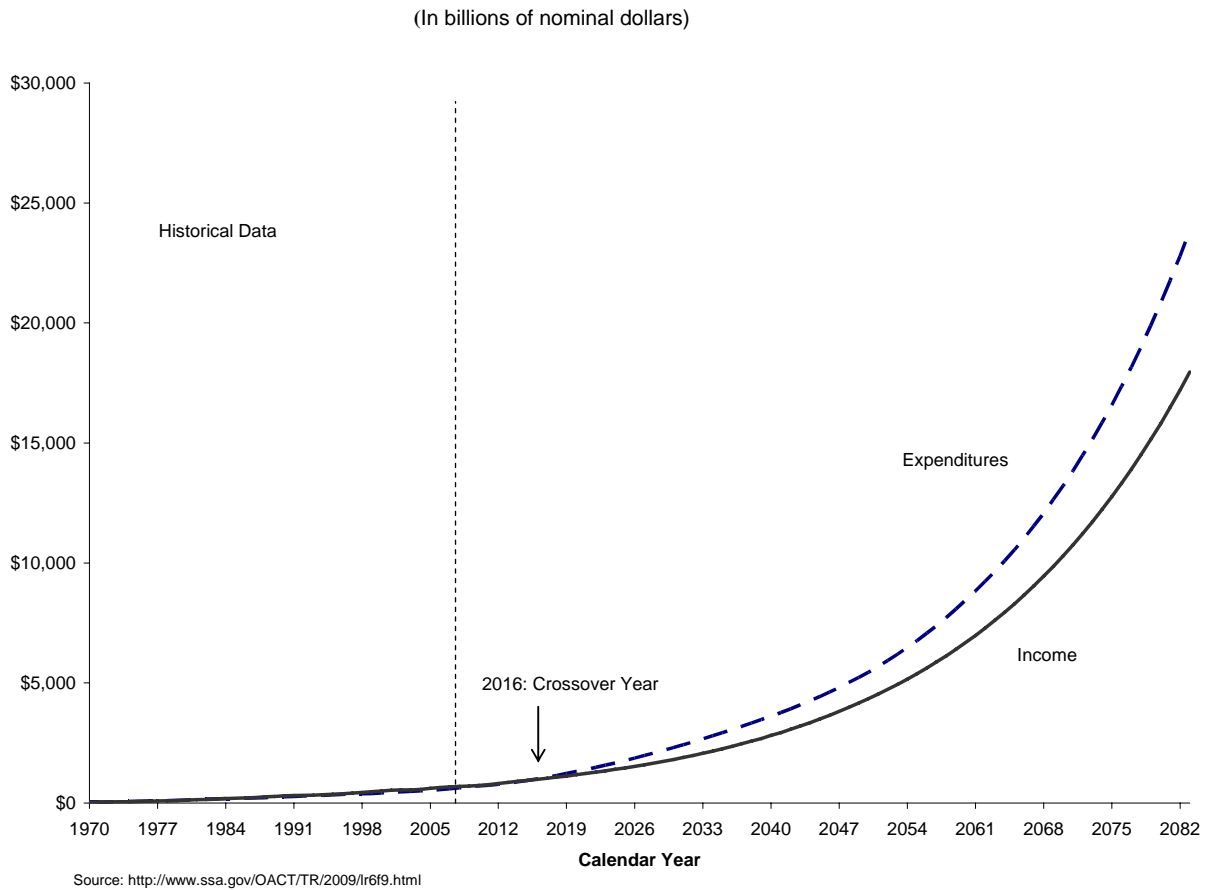
**Chart 1—OASDI Beneficiaries per 100 Covered Workers  
1970-2083**



### 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 1970-2083 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  
1970-2083**

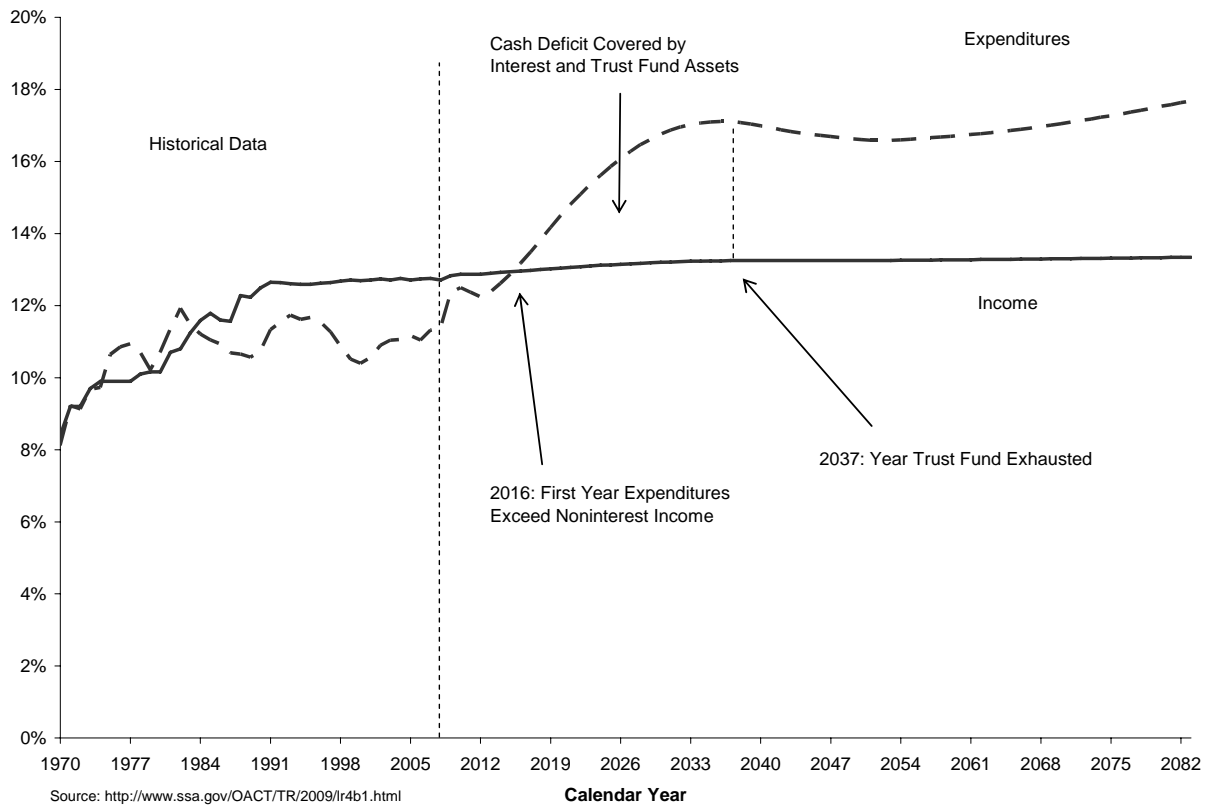


Currently, Social Security tax revenues exceed benefit payments and will continue to do so until 2016, when revenues are projected to fall below benefit payments, after which the gap between expenditures and revenues continues to widen.

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

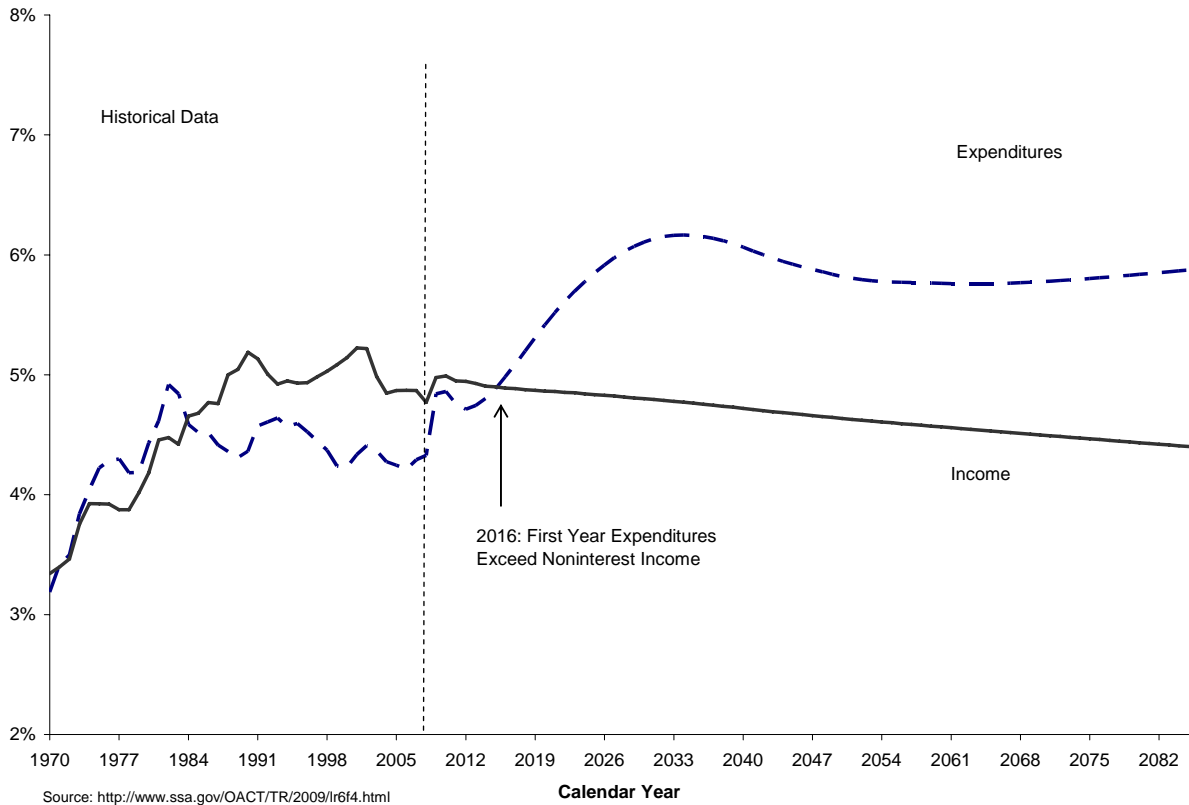
The OASDI cost rate is projected to increase rapidly and first exceeds the income rate in 2016, producing cashflow deficits thereafter. As described above, surpluses that occur prior to 2016 are “loaned” to the General Fund and accumulate, with interest, reserve spending authority for the trust fund. The reserve spending authority represents an obligation for the General Fund. Beginning in 2016, 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 2037, 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 76 percent of scheduled benefits after trust fund exhaustion in 2037 and 74 percent of scheduled benefits in 2083.

**Chart 3—OASDI Income (Excluding Interest) and Expenditures as a Percent of Taxable Payroll 1970-2083**



*Income and Expenditures as a Percent of GDP.* Chart 4 shows estimated annual income (excluding interest) and expenditures, expressed as percentages of GDP, the total value of goods and services produced in the United States. This alternative perspective shows the size of the OASDI Program in relation to the capacity of the national economy to sustain it. The gap between expenditures and income generally widens with expenditures generally growing as a share of GDP and income declining slightly relative to GDP. Social Security’s expenditures are projected to grow from 4.8 percent of GDP in 2009 to 5.9 percent in 2083. In 2083, expenditures are projected to exceed income by 1.5 percent of GDP.

**Chart 4—OASDI Income (Excluding Interest) and Expenditures as a Percent of GDP 1970-2083**



*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 consumer price index (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 0.79 percent. For the low cost alternative, a slower reduction rate (0.33 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 \$7,677 billion to \$5,864 billion, a 24 percent smaller shortfall. The high cost death rate assumption (1.32 percent) results in an increase in the shortfall, from \$7,677 billion to \$9,682 billion, a 26 percent increase in the shortfall. Clearly, alternative death rate assumptions have a substantial impact on estimated future cashflows in the OASDI Program.

A higher fertility rate means more workers relative to beneficiaries over the projection period, thereby lowering the shortfall relative to the intermediate assumption. An increase in the rate from 2.0 to 2.3 percent results in an 11 percent smaller shortfall (i.e., expenditures less income), from \$7,677 billion to \$6,826 billion.

Higher real wage growth results in faster income growth relative to expenditure growth. Table 2 shows that a real wage differential that is 0.6 greater than the intermediate assumption of 1.1 results in a drop in the shortfall from \$7,677 billion to \$5,914 billion, a 23 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 6 percent, from \$7,677 billion to \$8,161 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 6 percent drop in the shortfall, from \$7,677 billion to \$7,238 billion, relative to the intermediate case; and the high-cost assumption results in a 6 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 \$6,067 billion is 21 percent lower when the real interest rate is 3.6 percent rather than 2.9 percent, and 34 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, 2009-2083**

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

Assumption	Financing Shortfall Range		
	Low	Intermediate	High
Average annual reduction in death rates ..	5,864 (0.33)	7,677 (0.79)	9,682 (1.32)
Total fertility rate .....	6,826 (2.3)	7,677 (2.0)	8,572 (1.7)
Real wage differential .....	5,914 (1.7)	7,677 (1.1)	8,873 (0.5)
CPI change .....	7,189 (3.8)	7,677 (2.8)	8,161 (1.8)
Net immigration .....	7,238 (1,370,000) <sup>1</sup>	7,677 (1,065,000) <sup>1</sup>	8,126 (785,000) <sup>1</sup>
Real interest rate .....	6,067 (3.6)	7,677 (2.9)	10,249 (2.1)

<sup>1</sup> Amounts represent the average annual net immigration over the 75-year projection period.

Source: 2009 OASDI Trustees Report and SSA.

## Medicare Projections

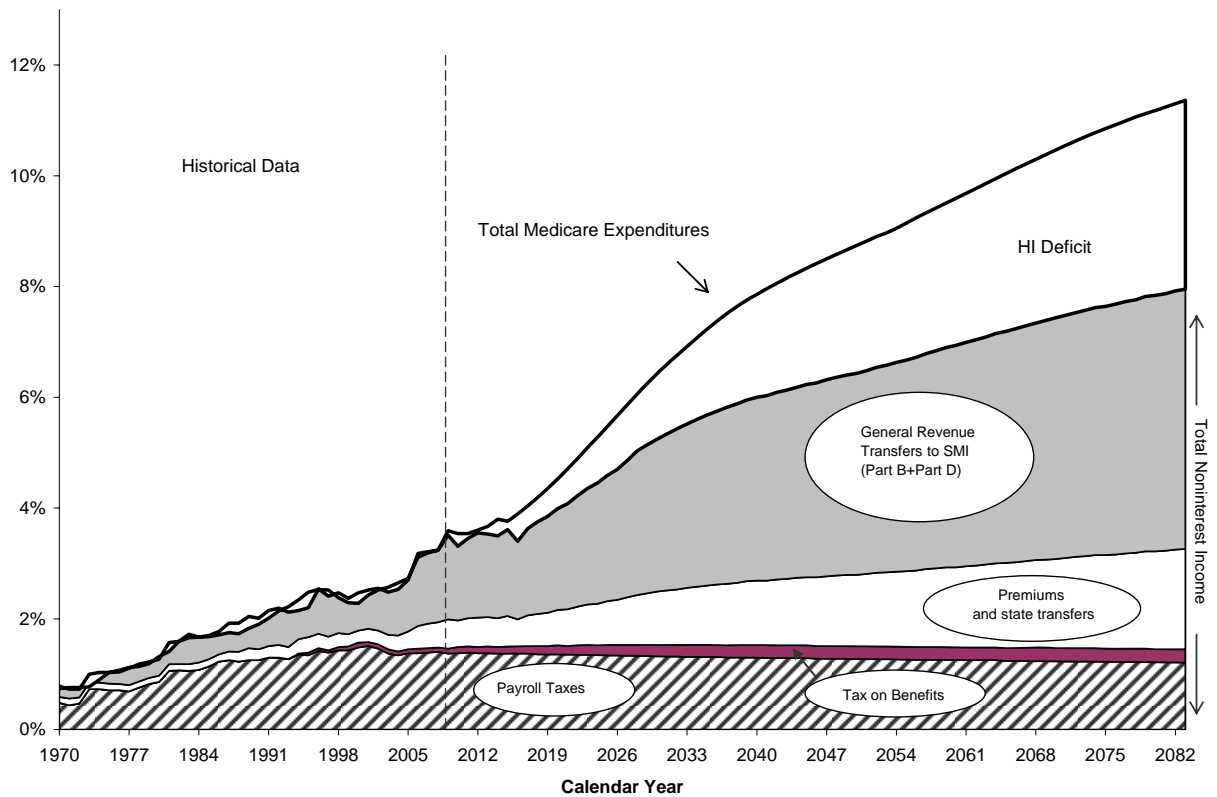
*Medicare Legislation.* On December 8, 2003, President Bush signed into law the Medicare Prescription Drug, Improvement, and Modernization Act of 2003. The 2003 law has a major impact on the operations and finances of Medicare. The law added a prescription drug benefit to Medicare beginning in 2006 and a new prescription drug account in the SMI Trust Fund. The benefit can be obtained through a private drug-only plan, a PPO or HMO, 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 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 that is driven in large by new technology. 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. The combination of more beneficiaries per worker and rapid growth in real expenditures per beneficiary causes projected Medicare expenditures to grow substantially more rapidly than GDP.

*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 11.4 percent of GDP by 2083. Revenues from taxes and premiums (including State transfers under Part D) are expected to increase from 2.0 percent of GDP in 2009 to 3.3 percent of GDP in 2083. 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 1.5 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 57 percent in 2009 to 41 percent in 2083) while general revenues will rise (from 43 percent to 59 percent). The gap between total noninterest Medicare income (including general revenue contributions) and expenditures begins around 2009 and then steadily continues to widen, reaching 3.4 percent of GDP by 2083.

**Chart 5—Total Medicare (HI and SMI) Expenditures and Noninterest Income as a Percent of GDP 1970-2083**



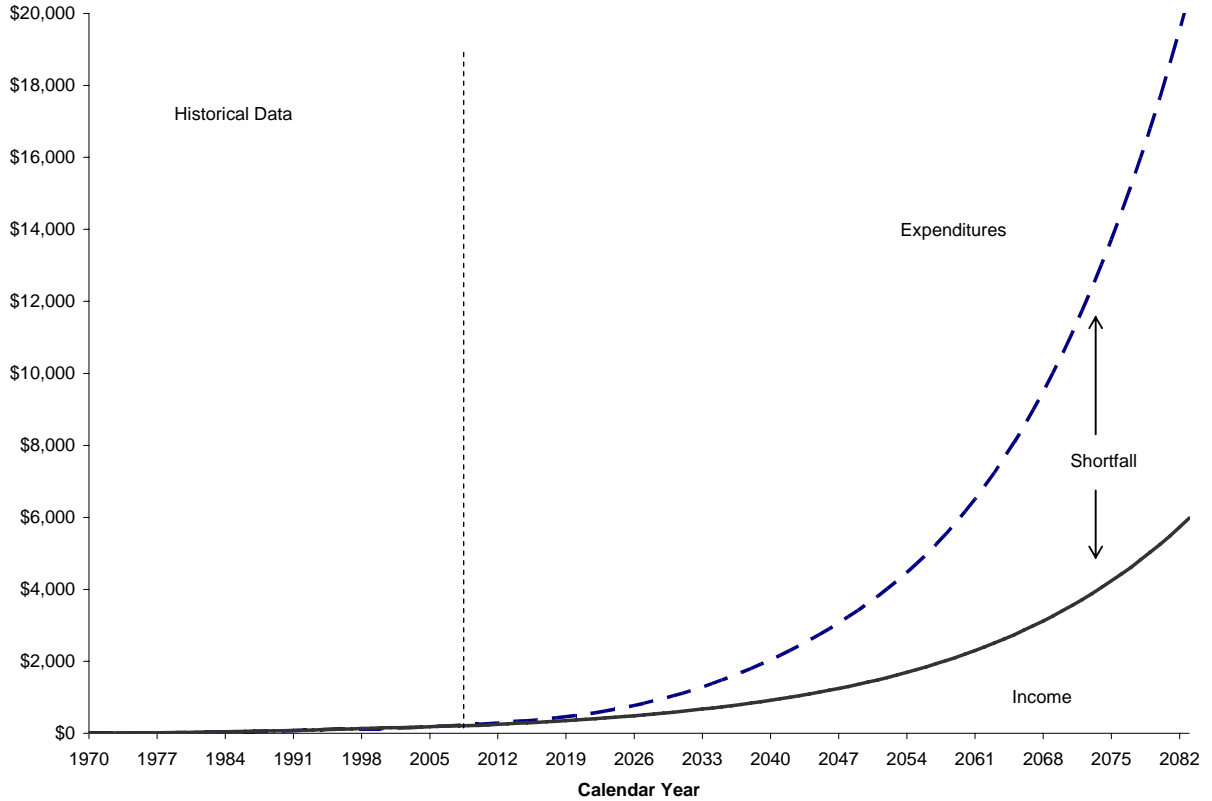
Source: [http://www.ssa.gov/OACT/TRSUM/images/LD\\_ChartD.html](http://www.ssa.gov/OACT/TRSUM/images/LD_ChartD.html)



*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 1970-2083 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 1970-2083**

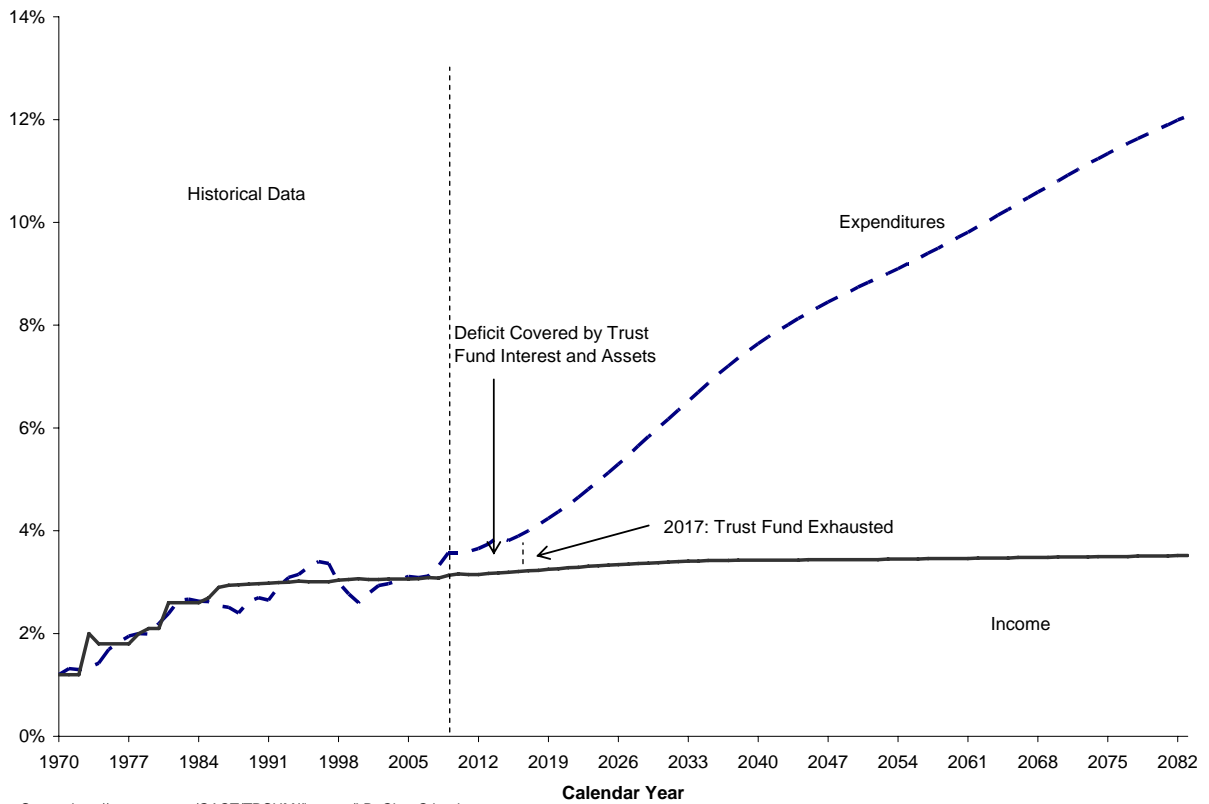
(In billions of nominal dollars)



Source: [http://www.ssa.gov/OACT/TRSUM/images/LD\\_ChartC.html](http://www.ssa.gov/OACT/TRSUM/images/LD_ChartC.html)

*Medicare, Part A Income and Expenditures as a Percent of Taxable Payroll.* Chart 7 illustrates income (excluding interest) and expenditures as a percentage of taxable payroll over the next 75 years. The chart shows that the expenditure rate exceeds the income rate in 2007, and cash deficits continue thereafter. Trust fund interest earnings and assets provide enough resources to pay full benefit payments until 2017 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 2017. Present tax rates would be sufficient to pay 81 percent of scheduled benefits after trust fund exhaustion in 2017 and 29 percent of scheduled benefits in 2083.

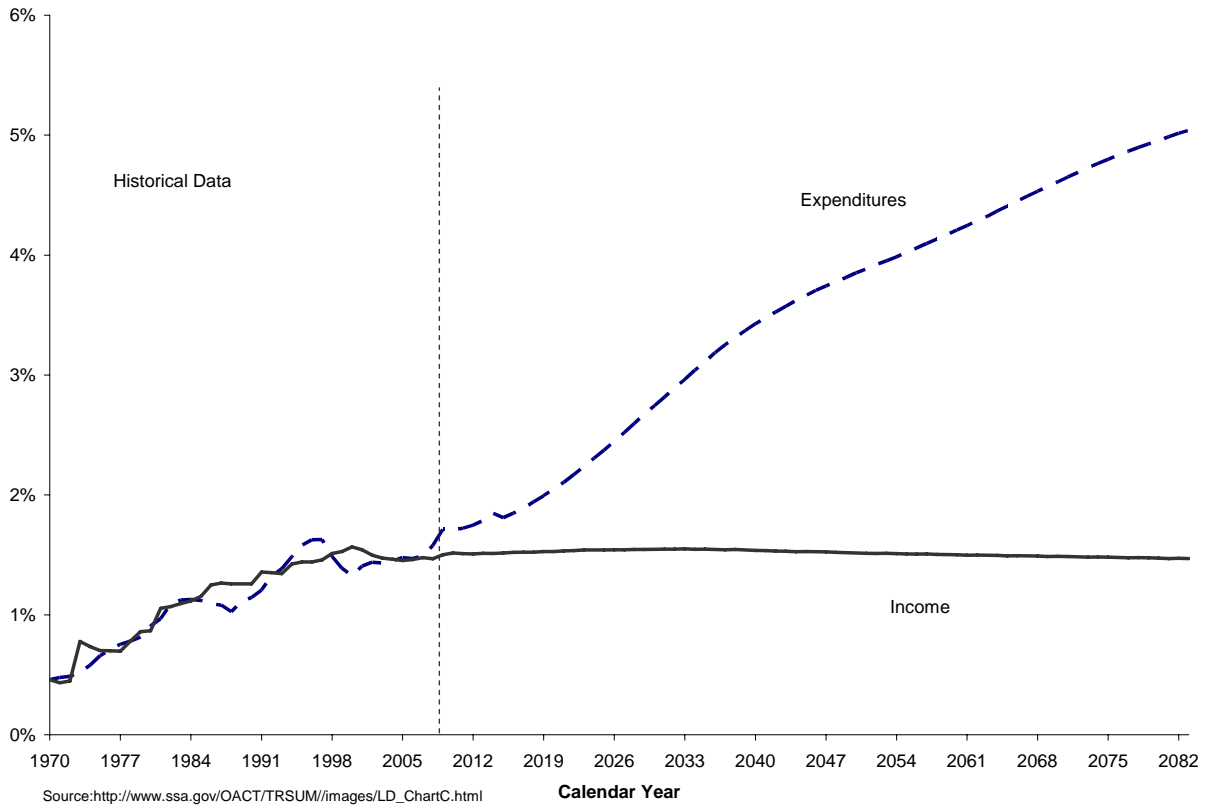
**Chart 7—Medicare Part A Income (Excluding Interest) and Expenditures as a Percent of Taxable Payroll 1970-2083**



Source: [http://www.ssa.gov/OACT/TRSUM//images/LD\\_ChartC.html](http://www.ssa.gov/OACT/TRSUM//images/LD_ChartC.html)

*Medicare Part A Income and Expenditures as a Percent of GDP.* Chart 8 shows estimated annual income (excluding interest) and expenditures, expressed as percentages of GDP, 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 1.7 percent of GDP in 2009, to 2.8 percent in 2030, and to 5.0 percent by 2083. The gap between expenditures and income widens continuously with expenditures growing as a share of GDP and income declining slightly relative to GDP. By 2083, expenditures are projected to exceed income by 3.6 percent of GDP.

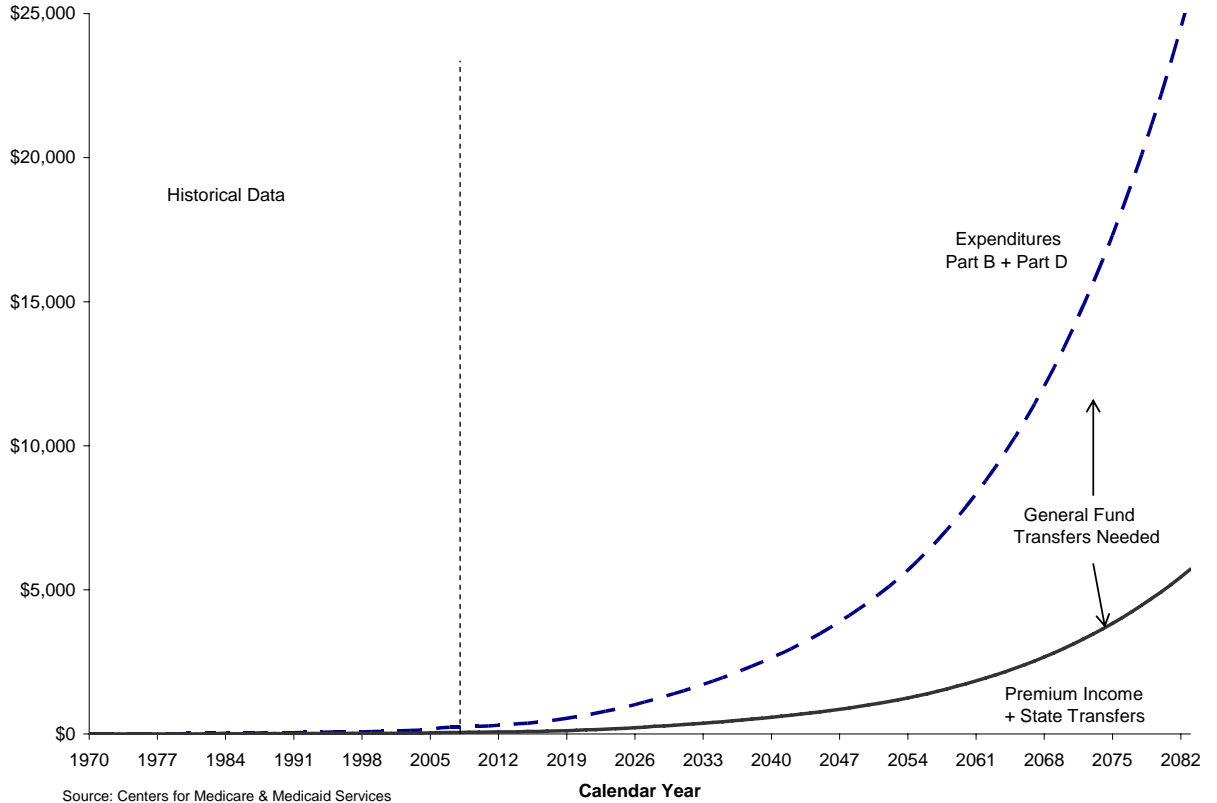
**Chart 8—Medicare Part A Income (Excluding Interest) and Expenditures as a Percent of GDP 1970-2083**



*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  
1970-2083**

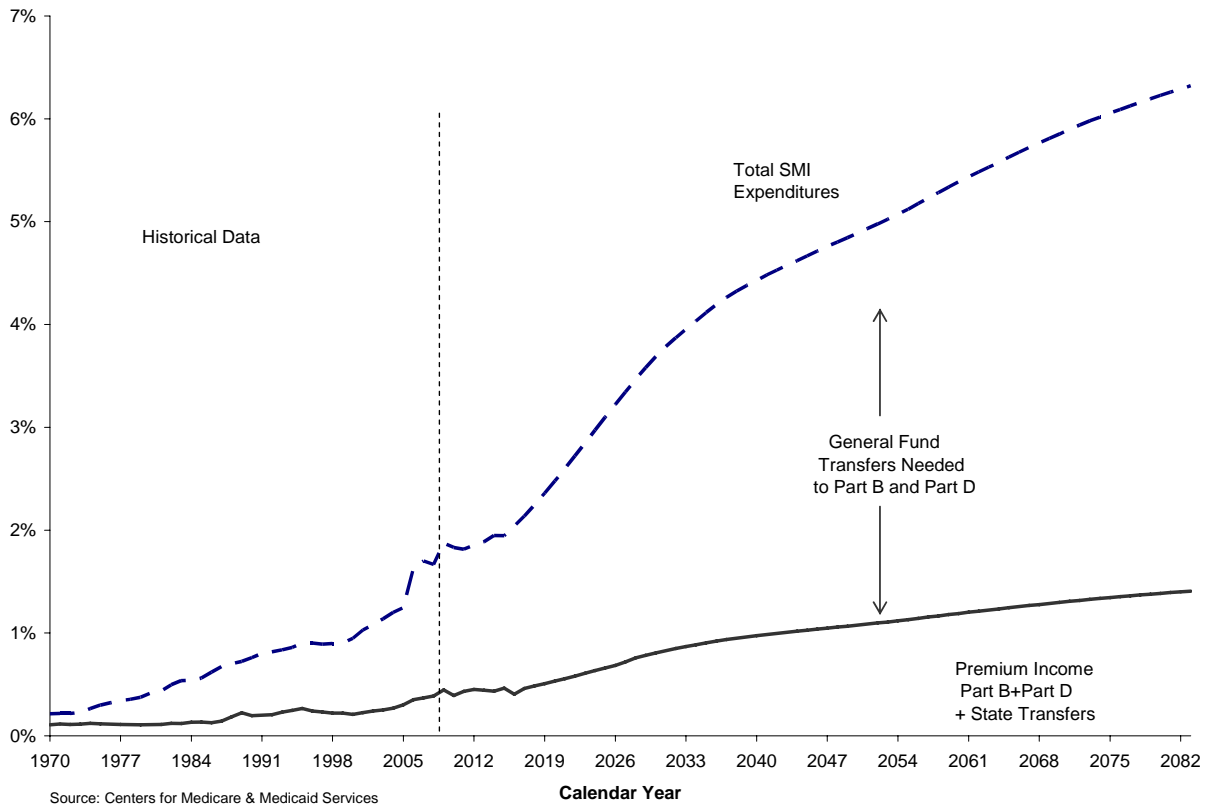
(In billions of nominal dollars)



*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 2009, SMI expenditures are expected to be \$264 billion or 1.9 percent of GDP. After 2009, this percentage is projected to increase steadily reaching 6.3 percent in 2083. 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 0.5 percent in 2009 to 1.6 percent of GDP in 2083, 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 1970-2083**



*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 \$13,770 billion to \$5,767 billion, a 58 percent smaller shortfall. The high cost assumption results in a near doubling of the shortfall, from \$13,770 billion to \$26,798 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 or lower real wage growth rate results in about a 10 percent change in the shortfall relative to the intermediate case. Wages are a key cost factor in the provision of health care. Higher wages also result in greater payroll tax income. HI expenditures exceed HI income by a wide and increasing margin in the future (Charts 6 to 8). CPI and net immigration changes have very little effect on net HI expenditures. Higher immigration 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 24 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, 2009-2083**

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

Assumption <sup>1</sup>	Financing Shortfall Range		
	Low	Intermediate	High
Average annual growth in health costs <sup>2</sup> .....	5,767 (3.1)	13,770 (4.1)	26,798 (5.1)
Total fertility rate <sup>3</sup> .....	13,535 (2.3)	13,770 (2.0)	14,017 (1.7)
Real wage differential .....	12,367 (0.5)	13,770 (1.1)	15,161 (1.7)
CPI change .....	13,677 (1.8)	13,770 (2.8)	13,822 (3.8)
Net immigration.....	13,652 (785,000) <sup>4</sup>	13,770 (1,065,000) <sup>4</sup>	14,149 (1,370,000) <sup>4</sup>
Real interest rate.....	10,425 (3.6)	13,770 (2.9)	19,238 (2.1)

<sup>1</sup> 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.

<sup>2</sup> 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*.

<sup>3</sup> 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.

<sup>4</sup> Amount represents the average annual net immigration over the 75-year projection period.

Table 4 shows the effects of various assumptions about the growth in health care costs on the present value of estimated SMI (Medicare Parts B and D) expenditures in excess of income. As with HI, net SMI expenditures are very sensitive to changes in the health care cost growth assumption. For the low cost alternative, the slower assumed growth in health costs reduces the Governmentwide resources needed for Part B from \$17,165 billion to \$11,989 billion and in Part D from \$7,172 billion to \$5,006 billion, about a 30 percent difference in each case. The high-cost assumption increases Governmentwide resources needed to \$25,402 billion for Part B and to \$10,613 billion for Part D, about a 48 percent difference 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, 2009-2083**

(In billions of dollars)

Medicare Program <sup>1</sup>	Governmentwide Resources Needed		
	Low (3.1)	Intermediate (4.1)	High (5.1)
Part B .....	11,989	17,165	25,402
Part D .....	5,006	7,172	10,613

<sup>1</sup> 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 2009 Medicare Trustees Report, the HI Trust Fund is projected to remain solvent until 2017 and, according to the 2009 Social Security Trustees Report, the OASDI Trust Funds are projected to remain solvent until 2037. In each case, some general revenues must be used to satisfy the authorization of full benefit payments until the year of exhaustion. This occurs when the trust fund balances accumulated during prior years are needed to pay benefits, which leads to a transfer from general revenues to the trust funds. Moreover, under current law, General Fund transfers to the SMI Trust Fund will occur into the indefinite future and will continue to grow with the growth in health care expenditures.

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

Table 5 shows the magnitudes of the primary expenditures and sources of financing for the three trust funds computed on an open-group basis for the next 75 years and expressed in present values. The data are consistent with the Statements of Social Insurance included in the principal financial statements. For HI, revenues from the public are projected to fall short of total expenditures by \$13,770 billion in present value terms which is the additional amount needed in order to pay scheduled benefits over the next 75 years.<sup>5</sup> From the trust fund perspective, the amount needed is \$13,449 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

<sup>5</sup> Interest income is not a factor in this table as dollar amounts are in present value terms.

public for Parts B and D combined are estimated to be \$24,337 billion<sup>6</sup> 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 program costs.<sup>7</sup> For OASDI, projected revenues from the public fall short of total expenditures by \$7,677 billion<sup>8</sup> in present value dollars, and, from the trust fund perspective, by \$5,258 billion.

From the Governmentwide perspective, the present value of the total resources needed for the Social Security and Medicare Programs equals \$45,784 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 \$18,647 billion in present value terms are needed, beyond the \$24,337 billion in present value of required general revenue transfers already scheduled for the SMI Program and the \$2,800 billion to honor the trust fund investments in Treasury securities.

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<sup>6</sup> For 2009, the actuarial present value of estimated future expenditures in excess of estimated future revenue for Medicare Parts A, B, and D reflected a total increase from \$36,312 billion in 2008 to \$38,107 billion in 2009. This increase is primarily attributable to (1) changes in demographic and near-term economic starting values and assumptions, (2) the normal annual level of increase including interest in moving the 75-year projection period forward from the prior year's valuation date (i.e., where much larger amounts of estimated future expenditures in excess of future revenue associated with the last year of the current year's projection period replaced smaller amounts of estimated future expenditures in excess of future revenue associated with the first year of the prior year's projection period), and (3) changes noted in Parts A, B, and D as follows:

For 2009, the present value of estimated future expenditures in excess of estimated future revenue for Part A increased by \$1,033 billion as compared to that reported in 2008. This growth is primarily attributable to a higher projection of beneficiary enrollment, which resulted from an improved mortality rate assumption for beneficiaries over age 65, and new immigration assumptions for the disabled population, which increased the number of working-age immigrants significantly.

For 2009, the present value of estimated future expenditures in excess of estimated future revenue for Part B increased \$1,445 billion as compared to that reported in 2008. This growth is attributable to (1) higher beneficiary enrollment, similar to that for Part A, (2) legislation that raised the physician fee schedule update for the second half of 2008 and all of 2009, and (3) increased historical data, coupled with legislated higher updates, lead to a different pattern of physician updates through the first 10 years of the projection period, as well as a higher starting point for the transition to the long-range growth rates, which were nearly the same as last year.

For 2009, the present value of estimated future expenditures in excess of estimated future revenue for Part D decreased by \$685 billion as compared to that reported in 2008. This reduction is primarily due to lower assumed growth rates for prescription drug expenditures in the U.S. overall, along with the change in beneficiary enrollment described above.

<sup>7</sup> The SMI Trust Fund also has a very small amount of existing assets.

<sup>8</sup> For 2009, the actuarial present value of estimated future expenditures in excess of estimated future revenue, increased from \$6,555 billion in 2008 to \$7,677 billion in 2009. This increase is primarily attributable to (1) projected lower levels of economic activity that reflect the recent economic downturn and updated data, (2) faster reductions in mortality assumed in the longer term, and (3) the normal annual level of increase including interest in moving the 75-year projection period forward from the prior year's valuation date (i.e., where much larger amounts of estimated future expenditures in excess of future revenue associated with the last year of the current year's projection period replaced smaller amounts of estimated future expenditures in excess of future revenue associated with the first year of the prior year's projection period).



**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, 2009)

	HI	SMI		OASDI	Total
		Part B	Part D		
<b>Revenues from the public:</b>					
Taxes.....	12,008	-	-	37,217	49,225
Premiums, State transfers.....	-	5,992	2,199	-	8,191
Total.....	12,008	5,992	2,199	37,217	57,416
<b>Total costs to the public.....</b>	<b>25,778</b>	<b>23,156</b>	<b>9,371</b>	<b>44,894</b>	<b>103,199</b>
<b>Net results — budget perspective*</b>					
.....	13,770	17,165	7,172	7,677	45,784
Revenues from other					
Government accounts.....	-	17,165	7,172	-	24,337
Trust fund balance as of 1/1/2009.....	321	59	1	2,419	2,800
<b>Net results — trust fund perspective*</b>					
.....	<u>13,449</u>	<u>(59)</u>	<u>(1)</u>	<u>5,258</u>	<u>18,647</u>

\*Net results are computed as costs less revenues.

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

Source: 2009 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 \$7.7 trillion in present value will be needed above currently scheduled taxes to pay for scheduled benefits (\$5.3 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 needed for all the programs sums to \$107 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 2009. 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 \$36.4 trillion and \$15.1 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 (\$37.1 trillion and \$15.6 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 2083, 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, 2009)

	HI	SMI		OASDI	Total
		Part B	Part D		
Present value of future costs less future taxes, premiums, and State transfers for current participants .....	14.5	13.7	5.2	18.7	52.1
Less current trust fund balance .....	0.3	0.1	-	2.4	2.8
Equals net obligations for past and current participants.....	14.2	13.6	5.2	16.3	49.3
Plus net obligations for future participants .....	22.2	23.5	10.4	(1.2)	54.9
Equals net obligations through the infinite future for all participants .....	<u>36.4</u>	<u>37.1</u>	<u>15.6</u>	<u>15.1</u>	<u>104.2</u>
Present value of future costs less the present values of future income over the infinite horizon .....	<u>36.7</u>	<u>37.2</u>	<u>15.6</u>	<u>17.5</u>	<u>107.0</u>

Details may not add to totals due to rounding.

Source: 2009 OASDI and Medicare Trustees' Reports.

## Railroad Retirement, Black Lung, and Unemployment Insurance

### Railroad Retirement

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

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

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

Other sources of program income include: financial interchanges with the Social Security and Medicare trust funds, earnings on investments, Federal income taxes on railroad retirement benefits, and appropriations (provided after 1974 as part of a phase out of certain vested dual benefits). See Note 26—Social Insurance, for additional information on railroad retirement program financing.

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

Since its inception, NRRIT has received \$21.3 billion from RRB (including \$19.2 billion in fiscal year 2003, pursuant to RRSIA) and returned \$7.9 billion. During fiscal year 2009, the NRRIT made net transfers of \$1.6 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, 2009, and 2008, of non-Federal securities and investments of the NRRIT are disclosed in Note 9—Securities and Investments.

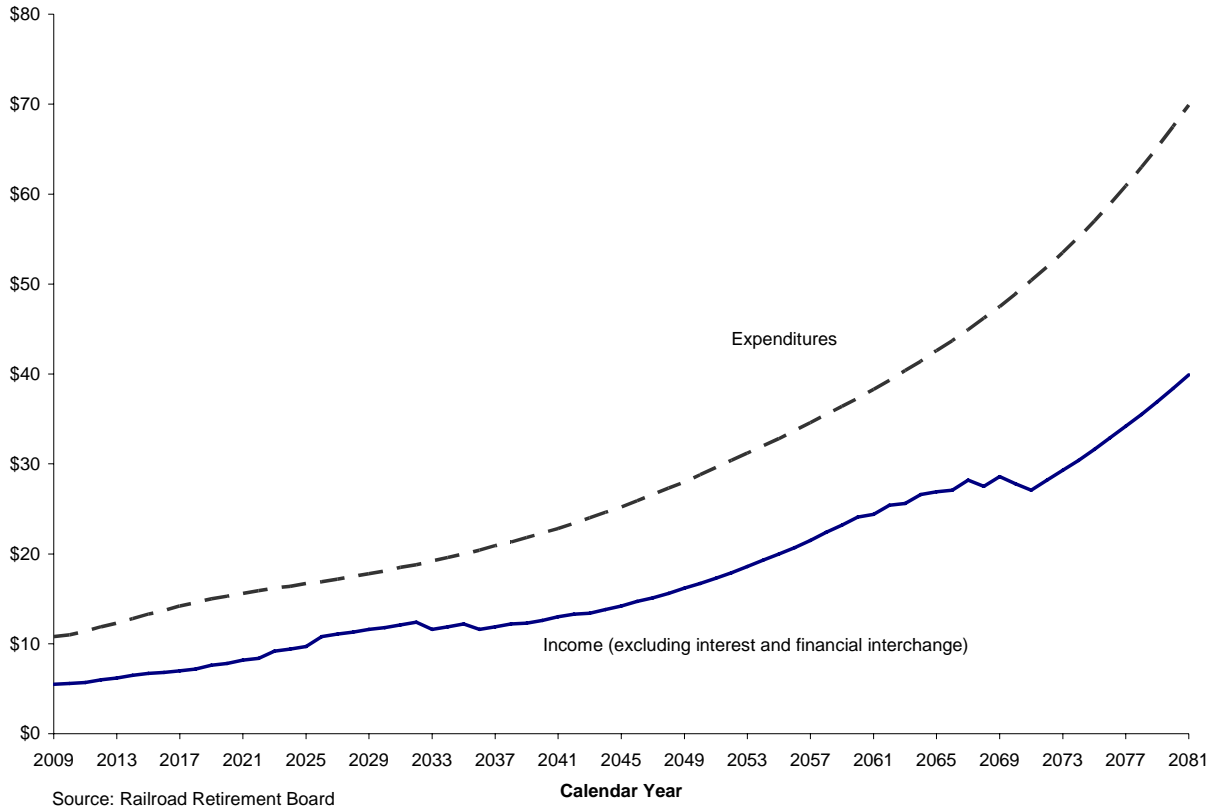
### Cashflow Projections

*Economic and Demographic Assumptions.* The economic and demographic assumptions used for the most recent set of projections are shown in the "Railroad Retirement" section of Note 26—Social Insurance.

*Nominal Income and Expenditures.* Chart 11 shows, in nominal dollars, estimated railroad retirement income (excluding interest and financial interchange income) and expenditures for the period 2009-2083 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  
2009-2083**

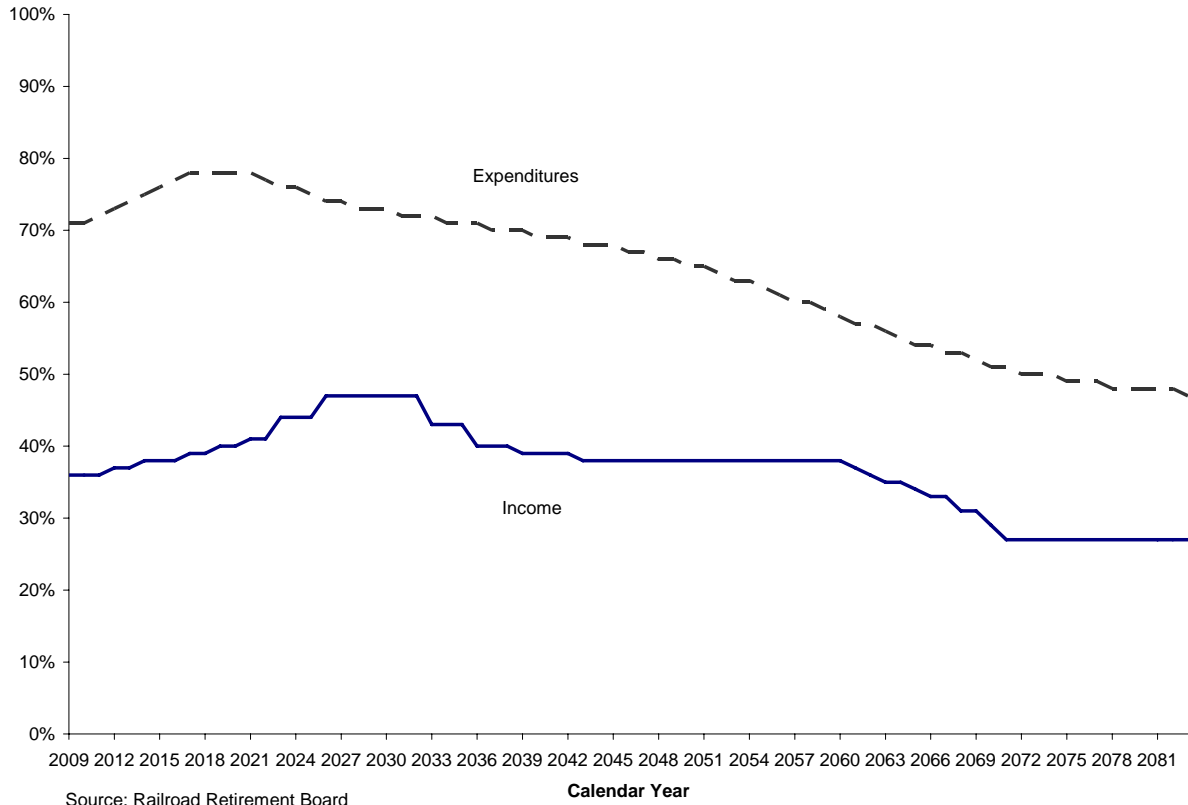
(In billions of nominal dollars)



As Chart 11 shows, expenditures are expected to exceed tax income for the entire projection period. The imbalances continue to widen until about 2022, decrease slightly for next 10 years, and then begin to grow steadily after 2033.

*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 2018 but then begin to decrease somewhat steadily as expenditures fall. Tax rates begin to decline after 2032, stabilizing 2071 and after. Compared to last year, projected tax rates are higher, 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  
2009-2083**



*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 5.5 percent smaller shortfall of income to expenditures, and the high-cost scenario has a 5.2 percent higher shortfall. A higher discount rate reduces future values relative to a lower rate. As seen in the table, the shortfall is 30.6 percent lower if the interest rate is 11 percent rather than 7.5 percent and 85.6 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, 2009-2083**

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

<b>Assumption</b>	<b>Low</b>	<b>Middle</b>	<b>High</b>
Employment <sup>1</sup> .....	94.4 (-0.5%)	99.9 (-2.0%)	105.1 (-3.5%)
Interest rate.....	69.3 (11%)	99.9 (7.5%)	185.4 (4%)

<sup>1</sup> The low and middle employment scenarios have passenger service employment remaining at 43,000 workers per year and the remaining employment base declining at 0.5 percent and 2.0 percent, respectively, for the next 25 years. The high cost scenario has passenger service employment declining by 500 per workers per year until a level of 35,000 is reached with the remaining employment base declining by 3.5 percent per year for 25 years, at a reducing rate over the next 25 years, and remaining level thereafter.

Source: Railroad Retirement Board.

## Sustainability of Railroad Retirement

Table 8 shows the magnitudes of the primary expenditures and sources of financing for the Railroad Retirement Program computed on an open-group basis for the next 75 years and expressed in present values as of January 1, 2009. The data are consistent with the Statements of Social Insurance.

From a Governmentwide perspective, revenues are expected to fall short of expenditures by approximately \$99.9 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**<sup>1, 2</sup>

(In billions of present-value dollars as of January 1, 2009)

<b>Estimated future income (excluding interest)<sup>3</sup> received from or on behalf of:</b>	
Current participants who have attained retirement age.....	4.9
Current participants not yet having attained retirement age.....	48.4
Those expected to become participants.....	69.6
All participants.....	<u>122.9</u>
<b>Estimated future expenditures:<sup>4</sup></b>	
Current participants who have attained retirement age.....	102.1
Current participants not yet having attained retirement age.....	91.2
Those expected to become participants.....	29.5
All participants.....	<u>222.8</u>
<b>Net obligations from budget perspective (expenditures less income).....</b>	<b>99.9</b>
Railroad retirement program assets (mostly investments stated at market) <sup>5</sup> .....	21.8
Financial interchange from Social Security Trust.....	<u>79.2</u>
<b>Net obligations from trust fund perspective.....</b>	<b><u>(1.1)</u></b>

<sup>1</sup> Represents combined values for the Railroad Retirement Account, SSEB Account, and NRRIT, based on middle employment assumption.

<sup>2</sup> The data used reflect the provisions of RRSIA of 2001.

<sup>3</sup> Future income (excluding interest) includes tier I taxes, tier II taxes, and income taxes on benefits.

<sup>4</sup> Future expenditures include benefits and administrative expenditures.

<sup>5</sup> 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 1/1/2008 whereas present values are as of 1/1/2009.

## Black Lung

The Federal Coal Mine Health and Safety Act of 1969 created the Black Lung Disability Benefit Program to provide compensation, medical, and survivor benefits for eligible coal miners who are totally disabled due to pneumoconiosis (black lung disease) arising out of their coal mine employment. The survivor benefits are available only for eligible survivors of coal miners who died due to pneumoconiosis. DOL operates the Black Lung Disability Benefit Program. The BLDTF provides benefit payments to eligible coal miners totally disabled by pneumoconiosis and to eligible survivors when no responsible mine operator can be assigned the liability. The beneficiary population is a nearly closed universe in which attrition by death exceeds new entrants by a ratio of more than ten to one.

Excise taxes on coal mine operators, based on the sale of coal, are the primary source of financing black lung disability payments and related administrative costs. The Black Lung Benefits Revenue Act provided for repayable advances to the BLDTF from the General Fund of the Treasury, in the event that BLDTF resources were not adequate to meet program obligations. Prior to legislation enacted in 2008 that allowed for the restructuring of BLDTF debt, the trust fund had accumulated large liabilities from significant and growing shortfalls of excise taxes relative to benefit payments and interest expenses.

The Energy Improvement and Extension Act of 2008 (P.L. 110-343), enacted on October 3, 2008, contained several provisions that significantly improved the BLDTF's financial position, including:

- Continuation of a previously-enacted increase in coal excise tax rates for an additional 5 years, through December 2018;
- Provision for the restructuring of BLDTF debt by refinancing the outstanding repayable advances with proceeds from issuing new debt instruments with lower interest rates; and
- A one-time appropriation that significantly reduced the outstanding debt of the BLDTF.

The Act also allowed that any debt issued by the BLDTF subsequent to the refinancing may be used to make benefit payments, other authorized expenditures, or to repay debt and interest from the initial refinancing. All debt issued by the BLDTF was effected as borrowing from the Treasury's Bureau of Public Debt.

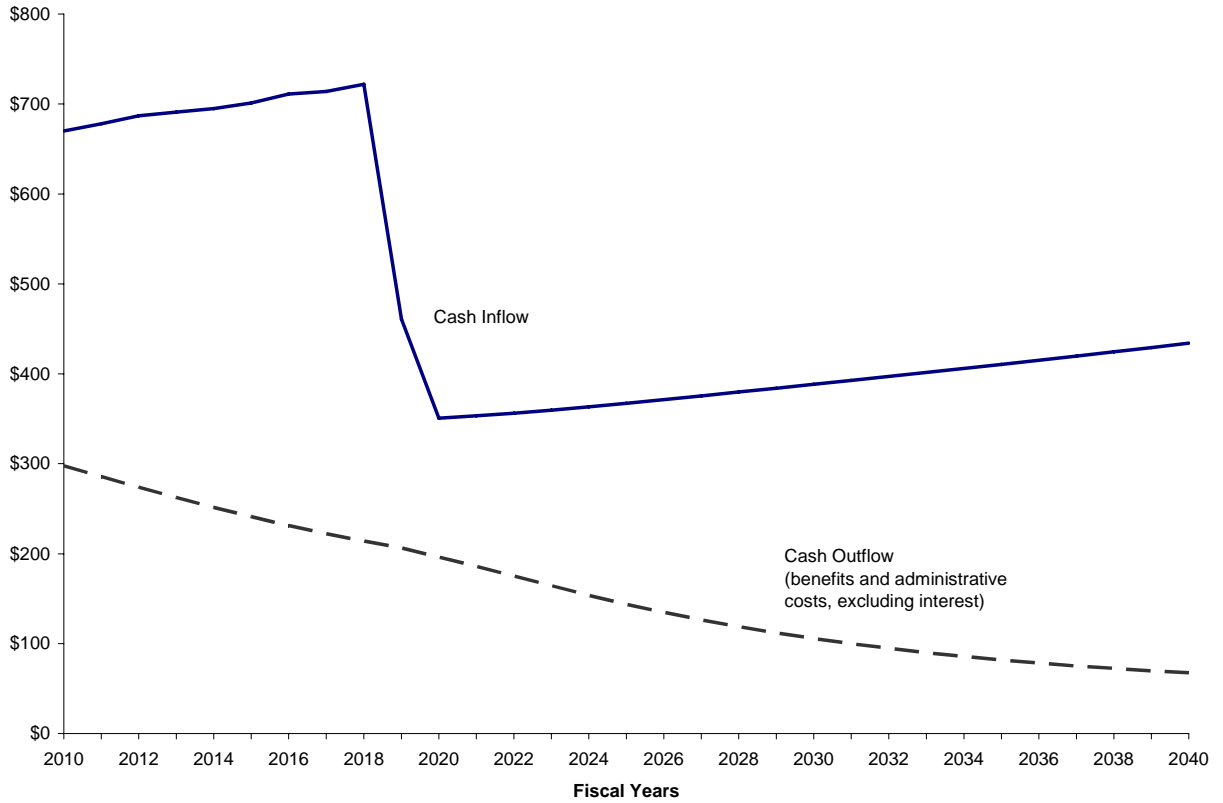
On September 30, 2009, total liabilities of the BLDTF exceeded assets by \$6.3 billion. Prior to the enactment of P.L. 110-343, this shortfall was funded by repayable advances to the BLDTF, which are repayable with interest. Pursuant to P.L. 110-343, any shortfall will be financed with debt instruments similar in form to zero-coupon bonds.

From the budget or consolidated financial perspective, Chart 13 shows projected black lung expenditures (excluding interest) and excise tax collections for the period 2010-2040. The significant assumptions used in the most recent set of projections are shown in the "Black Lung" section of Note 26—Social Insurance. The projected decrease in cash inflows in the year 2019 and thereafter is the result of a scheduled reduction in the tax rate on the sale of coal. This rate reduction is projected to result in a thirty-six percent decrease in the amount of excise taxes collected between the years 2018 and 2019.



**Chart 13—Estimated Black Lung Income and Expenditures (Excluding Interest)  
2010-2040**

(In millions of nominal dollars)



**Table 9**  
**Present Values of 31-Year Projections of Expenditures and Revenues**  
**for the Black Lung Disability Benefit Program**

(In billions of present value dollars, as of September 30, 2009)

Projected future expenditures .....	3.2
Projected future tax income .....	9.1
Net obligations from budget perspective (expenditures less income) .....	(5.8)
Accumulated balance due general fund .....	6.3
Net obligations from trust fund perspective .....	0.6

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

Source: Department of Labor projections and Treasury Department calculations.

Table 9 shows present values of 31-year projections of expenditures and revenues for the Black Lung Disability Benefit Program computed as of September 30, 2009. Cashflows were discounted using the rates on the debt in the BLDTF. From a Governmentwide (budget) perspective, the present value of expenditures is expected to be less than the present value of income by \$5.8 billion (a surplus). From a trust fund perspective, a large balance (\$6.3 billion) is owed to the General Fund. From that perspective, when that accumulated balance is combined with the cashflow surplus, the program has a shortfall of \$0.6 billion in present value dollars. This compares to a shortfall of \$6.4 billion reported in last year's *Financial Report*. This significant reduction in net future BLDTF obligations is due to the provisions of the Energy Improvement and Extension Act of 2008, discussed above.

## Unemployment Insurance

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

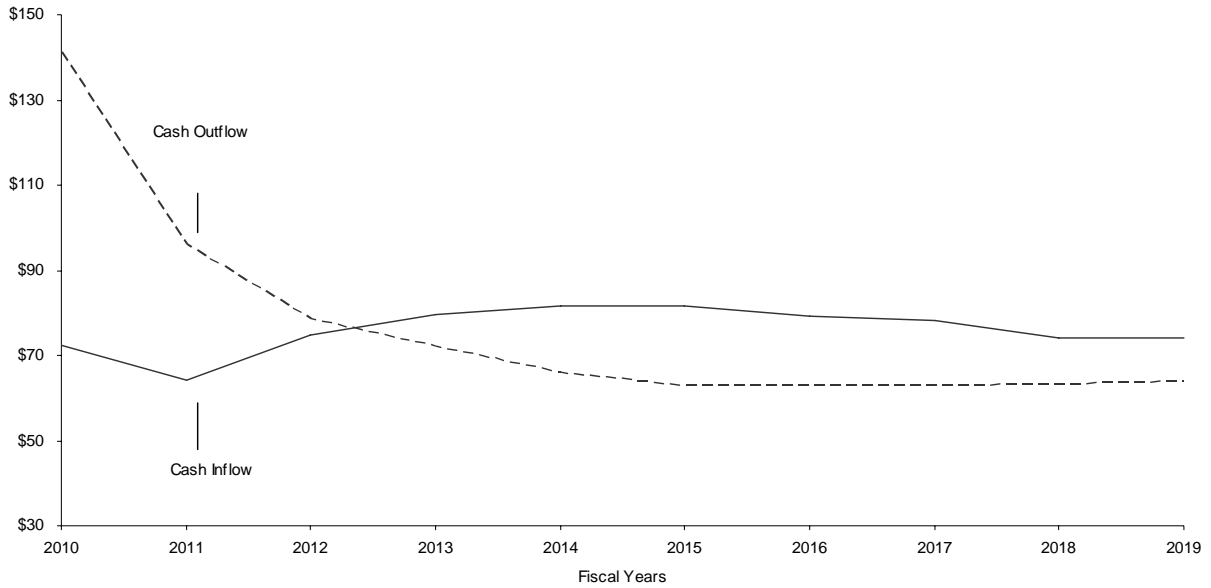
The program is financed through the collection of Federal and State unemployment taxes that are credited to the UTF and reported as Federal tax revenue. The fund was established to account for the receipt, investment, and disbursement of unemployment taxes. Federal unemployment taxes are used to pay for Federal and State administration of the Unemployment Insurance Program, veterans' employment services, State employment services, and the Federal share of extended unemployment insurance benefits. Federal unemployment taxes 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 14 shows the projected cash contributions and expenditures over the next 10 years under expected economic conditions (described below). The significant assumptions used in the projections include total unemployment rates, civilian labor force levels, percent of unemployed receiving benefits, total wages, distribution of benefit payments by State, State tax rate structures, State taxable wage bases, and interest rates on UTF investments. These projections, excluding interest earnings, indicate a negative net cashflow until 2012 followed by positive net cashflow for the remainder of the projection period.

The Worker, Homeownership, and Business Assistance Act of 2009 was enacted on November 6, 2009. The Act extended unemployment benefits to eligible recipients up to 14 additional weeks in all States. It also extended a total of up to 20 additional weeks in States with unemployment of 8.5 percent or greater. The Act also amended section 3301 of the Internal Revenue Code of 1986 to extend the 0.2 percent Federal Unemployment Tax Act (FUTA) surtax on covered employers through June 30, 2011. No benefits are payable for weeks of unemployment commencing before the date of enactment of the Act.

**Chart 14—Estimated Unemployment Trust Fund Cash Flow  
Using Expected Economic Conditions  
2010-2019**

(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 4.30 percent, the average of the interest rates underlying the 10-year projections. Three sets of numbers are presented in order to show the effects of varying economic conditions as reflected in different assumptions about the unemployment rate. For expected economic conditions, the estimates are based on an unemployment rate of 9.92 percent during fiscal year 2010, decreasing to below 6.0 percent in fiscal year 2015 and thereafter. Under Recovery Scenario One (decreasing unemployment rates), the unemployment rate decreases from 8.94 percent in fiscal year 2010 to 5.20 percent in fiscal year 2019. Under Recovery Scenario Two (higher than expected unemployment), the unemployment rate is assumed to reach 10.62 percent in fiscal year 2010 and gradually fall 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 the impact on the UTF projections of varying projected unemployment rates. For example, in Recovery Scenario Two, while tax income is projected to increase as higher layoffs result in higher employer taxes, benefit outlays increase even more. From the Governmentwide (budget) perspective, under expected conditions, the present value of expenditures exceeds the present value of income by \$29.4 billion. From the same perspective, under Recovery Scenario Two, the present value of expenditures exceeds the present value of income by \$42.9 billion. From a trust fund perspective, the program has \$13.6 billion in assets. When combined with the present value of net cash income under expected economic conditions, the program has a deficit of \$15.8 billion.

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

(In billions of present value dollars, as of September 30, 2009)

	Economic Conditions		
	Expected	Recovery Scenario One	Recovery Scenario Two
Projected future expenditures .....	635.0	581.6	666.1
Projected future cash income .....	605.6	577.3	623.3
Net obligations from budget perspective (expenditures less income) .....	29.4	4.2	42.9
Trust fund assets .....	13.6	13.6	13.6
Net obligations from trust fund perspective <sup>1</sup> .....	15.8	(9.3)	29.3

<sup>1</sup>Net obligations from the trust fund perspective equals net obligations from the budget perspective minus trust fund assets. The positive values in this line are indicative of deficits.

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

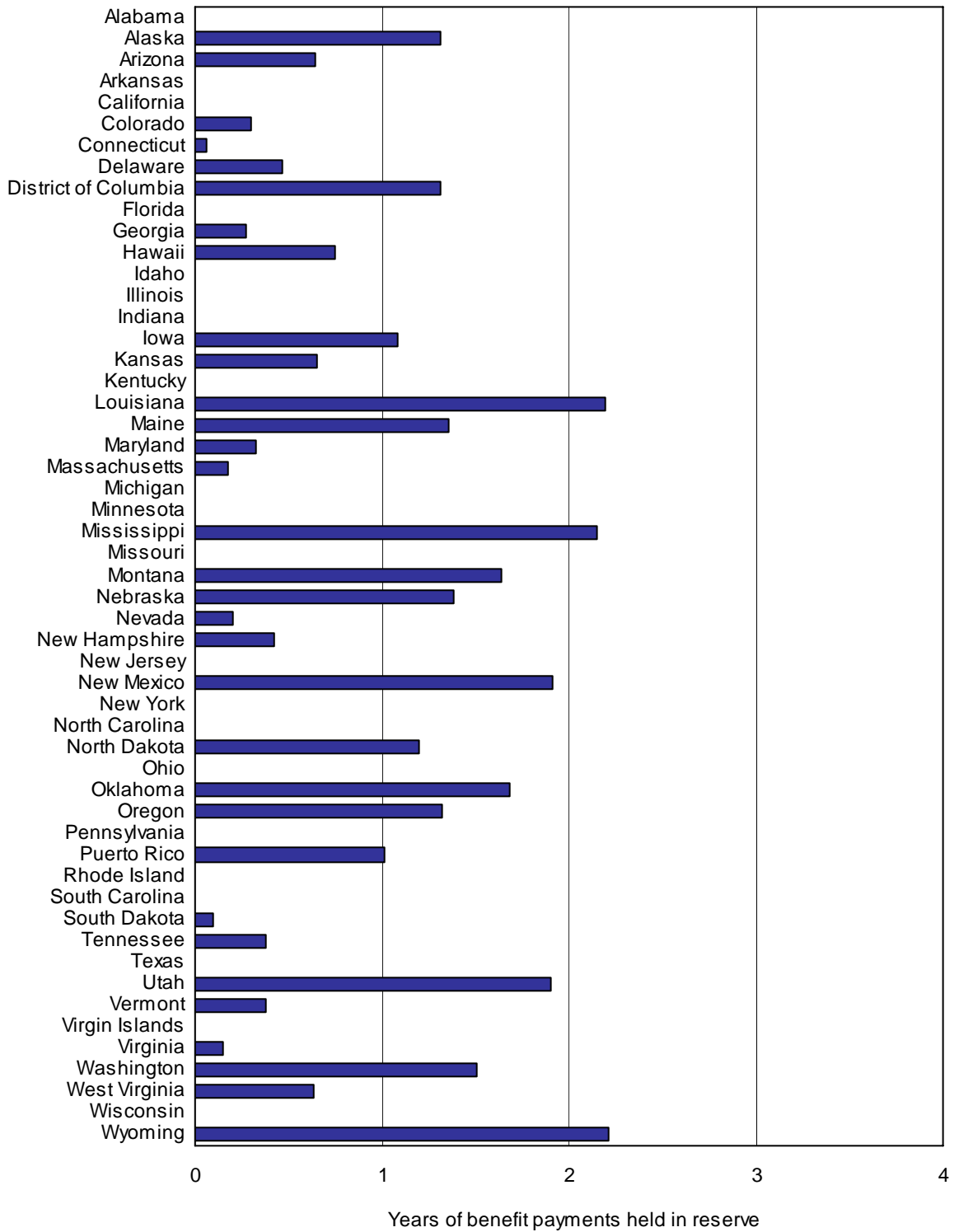
Source: Department of Labor.

### Unemployment Trust Fund Solvency

Each State's accumulated UTF net assets or reserve balance should provide a defined level of benefit payments over a defined period. To be minimally solvent, a State's reserve balance should provide for one year's projected benefit payment needs based on the highest levels of benefit payments experienced by the State over the last 20 years. A ratio of 1.0 or greater indicates a state is minimally solvent. States below this level are vulnerable to exhausting their funds in a recession. States exhausting their reserve balance borrow funds from the Federal Unemployment Account (FUA) to make benefit payments. During fiscal year 2009, the balances in the FUA were depleted and the FUA borrowed from the Treasury General Fund.

Chart 15 presents the State by State results of this analysis as of September 30, 2009. As the chart illustrates, 37 state funds were below the minimal solvency ratio of 1.0 at September 30, 2009.

**Chart 15—Unemployment Trust Fund Solvency as of September 30, 2009**



## Deferred Maintenance

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

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

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

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

Some deferred maintenance has been deemed critical. Such amounts and conditions are defined by the individual agencies with responsibility for the safekeeping of these assets. 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.

	<b>Deferred Maintenance as of September 30</b>					
	<b>Deferred Maintenance Cost Range</b>				<b>Critical Maintenance</b>	
	<b>Low Estimate</b>		<b>High Estimate</b>		<b>2009</b>	<b>2008</b>
(In billions of dollars)	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
<b>Asset category:</b>						
Buildings, structures and facilities .....	93.5	88.6	98.7	94.1	2.4	5.0
Furniture, fixtures and equipment .....	0.3	0.3	0.3	0.3	0.2	0.1
Other general property, plant, and equipment .....	12.9	11.9	12.9	12.0	0.2	0.2
Heritage assets.....	10.0	7.0	10.0	7.0	0.1	-
Stewardship land.....	3.1	2.2	4.5	3.2	-	-
Total deferred maintenance ....	<u>119.8</u>	<u>110.0</u>	<u>126.4</u>	<u>116.6</u>	<u>2.9</u>	<u>5.3</u>

The agencies material to property, plant, and equipment are the DOD, DOE, DOI, DHS, GSA, TVA, and USPS. These agencies comprise 89 percent of the Government's total reported net property, plant, and equipment of \$784.1 billion as of September 30, 2009.

Please refer to the individual financial statements of DOD, DOE, DOI, and DHS for detailed significant information on deferred maintenance, including the standards used for acceptable operating condition and changes in asset condition. As of the end of fiscal year 2009, GSA, TVA, and USPS had no material amounts of deferred maintenance cost.

## Unexpended Budget Balances

The Federal budget and budget process largely use obligational accounting—a distinct administrative control through which Federal Agencies control, monitor, and report on the status of funds at their disposal. Unexpended budget balances consist of the unobligated and obligated, but unliquidated, budget balances.

Unobligated budget balances, including amounts for trust funds, are the cumulative amount of budget balances that are not obligated and that remain available for obligation. In 1-year accounts, the unobligated balance is not available for new obligations after the end of the fiscal year. In multiyear accounts, the unobligated balance may be carried forward and remains available for obligation for the period specified. In no-year accounts, the unobligated balance is carried forward until specifically rescinded by law or the head of the agency concerned determines that the purposes for which it was provided have been accomplished and disbursements have not been made against the appropriation for 2 consecutive years. The total unobligated budget balances as of September 30, 2009, and 2008, are \$1,012.7 billion and \$688.9 billion, respectively.

Obligated budget balances are the cumulative budget balances that have been obligated but not liquidated. The obligated balance can be carried forward for a maximum of 5 years after the appropriation has expired. The total obligated budget balances as of September 30, 2009, and 2008, are \$1,418.1 billion and \$1,104.4 billion, respectively.

The President's Budget is located at [www.whitehouse.gov/omb](http://www.whitehouse.gov/omb); unexpended budget balances are shown in the supporting documentation section under "Balances of Budget Authority." The President's fiscal year 2011 Budget (issued on February 1, 2010), includes the actual amounts unobligated and obligated amounts for fiscal year 2009.

## 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 2007

Adjusted Gross Income (AGI)	Number of Taxable Returns (In thousands)	AGI (In millions of dollars)	Total Income Tax (In millions of dollars)	Average AGI per Return (In whole dollars)	Average Income Tax per Return (In whole dollars)	Income Tax as a Percentage of AGI
Under \$15,000 .....	37,597	186,000	3,022	4,947	80	1.6%
\$15,000 under \$30,000 .....	30,229	669,932	22,211	22,162	735	3.3%
\$30,000 under \$50,000 .....	25,978	1,015,283	61,396	39,082	2,363	6.0%
\$50,000 under \$100,000 .....	31,260	2,216,021	191,293	70,890	6,119	8.6%
\$100,000 under \$200,000 .....	13,463	1,793,835	229,415	133,242	17,040	12.8%
\$200,000 or more .....	4,503	2,650,325	585,572	588,569	130,040	22.1%
Total .....	<u>143,030</u>	<u>8,531,396</u>	<u>1,092,909</u>			

### Corporation Income Tax Liability for Tax Year 2006

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 .....	17,500	5,399	30.9%
\$1 under \$500 .....	9,519	1,787	18.8%
\$500 under \$1,000 .....	4,659	1,123	24.1%
\$1,000 under \$5,000 .....	16,790	4,933	29.4%
\$5,000 under \$10,000 .....	10,019	3,286	32.8%
\$10,000 under \$25,000 .....	16,070	5,321	33.1%
\$25,000 under \$50,000 .....	14,181	4,661	32.9%
\$50,000 under \$100,000 .....	16,626	5,457	32.8%
\$100,000 under \$250,000 .....	32,623	10,431	32.0%
\$250,000 or more .....	1,153,444	310,686	26.9%
Total .....	<u>1,291,431</u>	<u>353,084</u>	

## 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 the IRS detects it, and whether 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 \$4.7 billion and \$5.0 billion for fiscal years 2009 and 2008, respectively. For those under appeal, the estimated payout is \$6.3 billion and \$17.0 billion for fiscal years 2009 and 2008, respectively. There are also unasserted claims for refunds of certain excise taxes. Although these refund claims have been deemed to be probable, they do not meet the criteria in SFFAS No. 5 for reporting the amounts in the balance sheets or for disclosure in the Notes to the Financial Statements. However, they meet the criteria in SFFAS No. 7 for inclusion as supplemental information. To the extent judgments against the Government for these claims prompt other similarly situated taxpayers to file similar refund claims, these amounts could become significantly greater.

## Tax Assessments

The Government is authorized and required to make inquiries, determinations, and assessments of all taxes which have not been duly paid. Unpaid assessments result from taxpayers filing returns without sufficient payment, as well as enforcement programs such as examination, under-reporter, substitute for return and combined annual wage reporting. Assessments with little or no future collection potential are called write-offs. Although compliance assessments and write-offs are not considered receivables under Federal accounting standards, they represent legally enforceable claims of the Government. There is, however, a significant difference in the collection potential between compliance assessments and receivables.

Management's best estimate of additional revenues that may potentially be collected by agencies from compliance assessments and pre-assessment work in process are \$77.2 billion and \$69.0 billion for fiscal years 2009 and 2008, respectively. The amount of assessments that agencies have statutory authority to collect at the end of the period, but have been written off and excluded from accounts receivable are \$105.4 billion and \$99.3 billion for fiscal years 2009 and 2008, respectively.

## Risk Assumed

Risk assumed information is important for all Federal insurance and guarantee programs, except social insurance, life insurance and loan guarantee programs. Risk assumed is generally measured by the present value of unpaid expected losses net of associated premiums, based on the risk inherent in the insurance or guarantee coverage in force. In addition to the liability for unpaid insurance claims included in Note 18—Insurance and Guarantee Program Liabilities, for events that have already occurred, the Government 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 that include information and assumptions applicable to the economic, legal and policy environment in force at the time the assessments are made. Management has estimated the loss amounts based on the risk assumed as well as the periodic changes.

Please refer to the individual financial statements of the PBGC, USDA and NCUA for other significant detailed information.

**Risk Assumed Information as of September 30**

(In billions of dollars)

**2009****2008****Present value of unpaid expected losses,  
net of associated premiums:**

Pension Benefit Guaranty Corporation .....	168.2	46.8
Department of Agriculture .....	8.9	9.9
National Credit Union Administration .....	5.9	0.1
All other .....	1.6	1.3
Total .....	<u>184.6</u>	<u>58.1</u>

**Periodic changes in risk assumed amounts:**

Pension Benefit Guaranty Corporation .....	121.4	(19.0)
Department of Agriculture .....	(1.0)	3.3
All other .....	6.1	0.3
Total .....	<u>126.5</u>	<u>(15.4)</u>

## Unmatched Transactions and Balances

(In millions of dollars)	Fiscal Year 2009	Fiscal Year 2008
<b>Change in intra-Governmental unmatched balances:</b>		
Debt/investment .....	(1,202.7)	343.0
Interest payable/receivable .....	13.6	(35.1)
Loans payable/receivable .....	(6,396.5)	1,843.1
Benefit program contributions payable/receivable .....	(25.7)	(514.9)
Accounts payable/receivable .....	4,380.6	2,502.1
Advances from/to others and deferred credits/prepayments .....	1,121.7	3,877.2
Transfers payable/receivable .....	(61.2)	9.0
	(2,170.2)	8,024.4
<b>Unmatched intra-Governmental transactions:</b>		
Federal securities interest revenue/expense - investment exchange .....	40.1	570.2
Borrowings interest revenue/expense - exchange .....	55.9	1,532.4
Borrowings gains/losses .....	125.3	(54.7)
Nonexpenditure transfers-in/out .....	234.0	1,352.2
Expenditure transfers-in/out .....	20,357.0	5,279.5
Transfers-in/out without reimbursement .....	10,221.6	(2,974.0)
Imputed financing source/cost .....	(15.0)	(13.1)
Benefit program revenue/cost .....	(1,240.2)	1,551.8
	29,778.7	7,244.3
<b>General fund transactions:</b>		
Fund balance with Treasury .....	98,104.3	(38,370.7)
Appropriations of unavailable special or trust fund receipts - transfers out/in .....	94.4	1,776.1
Appropriations received/warrants .....	(5,454.1)	(31,000.7)
Other general fund transactions .....	(100,707.0)	82,826.6
	(7,962.4)	15,231.3
Net intra-agency reporting errors and restatements .....	(2,229.2)	(751.9)
Unmatched transactions and balances, net .....	17,416.9	29,748.1

( ) Parentheses indicate a decrease to Net Position.

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

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

# United States Government Stewardship Information (Unaudited) for the Years Ended September 30, 2009, and 2008

## Stewardship Investments

Stewardship investments focus on Government programs aimed at providing long-term benefits by improving the Nation's productivity and enhancing economic growth. These investments can be provided through direct Federal spending or grants to State and local governments for certain education and training programs, research and development, and federally financed but not Federally-owned property, such as bridges and roads. When incurred, these investments are included as expenses in determining the net cost of operations. Stewardship investments for the current year and for the immediately preceding 4 years are shown below in Table 11.

**Table 11**  
**Stewardship Investments**  
**for the Years Ended September 30**

(In billions of dollars)	Fiscal Year 2009	Fiscal Year 2008	Fiscal Year 2007	Fiscal Year 2006	Fiscal Year 2005
Investments in non-Federal physical property .....	65.1	57.8	56.2	54.4	51.9
Investments in human capital .....	60.3	77.2	76.1	107.4	88.2
<b>Research and development:</b>					
Investments in basic research.....	27.4	27.6	26.5	25.2	25.1
Investments in applied research.....	19.1	21.4	22.2	21.7	21.2
Investments in development.....	101.0	79.2	66.3	52.1	42.1
Total investments.....	<u>272.9</u>	<u>263.2</u>	<u>247.3</u>	<u>260.8</u>	<u>228.5</u>

## 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 EPA had \$55.5 billion (85 percent), \$4.2 billion (6 percent), and \$2.5 billion (4 percent), respectively, of the total non-Federal physical property investments in fiscal year 2009 as shown in Table 11. Within DOT, the Federal Highway Administration invested \$41.3 billion during fiscal year 2009, primarily via reimbursement from the Highway Trust Fund, for States' construction costs of interstate and national highways. The States' contribution is 10 percent for the Interstate System and 20 percent for most other programs.

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.

## 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 \$43.7 billion (72 percent), \$6.5 billion (11 percent), and \$4.9 billion (8 percent), respectively, of the total human capital investments in fiscal year 2009 as shown in Table 11. These same agencies also had similar investment percentage contributions with decreases in the investment amounts in each of the preceding 4 years, with the exception of Education in fiscal year 2006, where there was an increase in Federal Family Education Loan and Direct Loan subsidy re-estimates and subsidy transfers due to increased loan consolidation activity.

Education administers a wide variety of programs related to general public education and training programs that are intended to increase or maintain national economic productive capacity. The Office of Federal Student Aid administers need-based financial assistance programs for students pursuing postsecondary education and makes available federal grants, direct loans, guaranteed loans and work-study funding to eligible undergraduate and graduate students.

The significant human capital programs administered by DOL relate to grants for job training and employment programs. The significant human capital programs administered by VA also relate to grants for job training and rehabilitation programs for veterans.

## Research and Development

Federal investments in Research and Development (R&D) comprise those expenses for basic research, applied research, and development that are intended to increase or maintain national economic productive capacity or yield other future benefits.

- Investments in basic research are for systematic studies to gain knowledge or understanding of the fundamental aspects of phenomena and of observable facts without specific applications toward processes or products in mind.
- Investments in applied research are for systematic studies to gain knowledge or understanding necessary for determining the means by which a recognized and specific need may be met.
- Investments in development are the systematic use of the knowledge and understanding gained from research for the production of useful materials, devices, systems, or methods, including the design and development of prototypes and processes.

With regard to basic and applied research, the HHS had \$17.0 billion (62 percent) and \$12.0 billion (63 percent), of the total basic and applied research investments, respectively, in fiscal year 2009 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, the DOD and NASA had \$83.5 billion (83 percent) and \$11.8 billion (12 percent), respectively, of total development investments in fiscal year 2009, as shown in Table 11. Development is comprised of five stages: advanced technology development, advanced component development and prototypes, system development and demonstration, management support, and operational systems development. Major outputs of DOD development are:

- Hardware and software components, and complete weapon systems ready for operational and developmental testing and field use, and
- Weapon systems finalized for complete operational and developmental testing.

NASA development 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 competitiveness 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 and onto the surfaces of bodies about which we may know relatively little.
- The Fundamental Aeronautics Program conducts research to enable the design of vehicles that fly through any atmosphere at any speed. A key focus will be the development of physics-based, multidisciplinary design, analysis, and optimization tools to address the multiple design challenges in future aircraft.
- The James Webb Space Telescope is a large, deployable infrared astronomical space-based observatory. The mission is a logical successor to the Hubble Space Telescope, extending beyond Hubble's discoveries into the infrared, where the highly red shifted early universe must be observed, where cool objects like protostars and protoplanetary disks emit strongly, and where dust obscures shorter wavelengths.
- The study of the dynamic Earth system to trace effect to cause, connect variability and forcing with response, and vastly improve national capabilities to predict climate, weather, natural hazards, and conditions in the space environment.

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## Appendix A: Significant Government Entities

This appendix lists the organizations and agencies encompassed in the reporting entity for this publication as well as some organizations excluded from the reporting entity. The reporting entity is a specifically defined group of agencies, principally cabinet departments and other agencies of the executive branch, as stated in the law and accounting guidance.

The determination as to which organizations and agencies will be included in the reporting entity is governed by Federal laws and is also based on guidance issued by the Federal Accounting Standards Advisory Board in their Statement of Federal Financial Accounting Concept No. 2, Entity and Display, which provides criteria for determining what should be included in the reporting entity for a consolidated Governmentwide report. The Board is now considering more specific guidance on the reporting entity for this report.

There are a total of 142 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* and include entities from all three branches of Government.

### Twenty-Four Chief Financial Officer Act Agencies

Department of Agriculture <a href="http://www.usda.gov">www.usda.gov</a>	Department of Transportation <a href="http://www.dot.gov">www.dot.gov</a>
Department of Commerce <a href="http://www.doc.gov">www.doc.gov</a>	Department of the Treasury <a href="http://www.ustreas.gov">www.ustreas.gov</a>
Department of Defense <a href="http://www.defenselink.mil">www.defenselink.mil</a>	Department of Veterans Affairs <a href="http://www.va.gov">www.va.gov</a>
Department of Education <a href="http://www.ed.gov">www.ed.gov</a>	Environmental Protection Agency <a href="http://www.epa.gov">www.epa.gov</a>
Department of Energy <a href="http://www.doe.gov">www.doe.gov</a>	General Services Administration <a href="http://www.gsa.gov">www.gsa.gov</a>
Department of Health and Human Services <a href="http://www.hhs.gov">www.hhs.gov</a>	National Aeronautics and Space Administration <a href="http://www.nasa.gov">www.nasa.gov</a>
Department of Homeland Security <a href="http://www.dhs.gov">www.dhs.gov</a>	National Science Foundation <a href="http://www.nsf.gov">www.nsf.gov</a>
Department of Housing and Urban Development <a href="http://www.hud.gov">www.hud.gov</a>	Office of Personnel Management <a href="http://www.opm.gov">www.opm.gov</a>
Department of the Interior <a href="http://www.doi.gov">www.doi.gov</a>	Small Business Administration <a href="http://www.sba.gov">www.sba.gov</a>
Department of Justice <a href="http://www.usdoj.gov">www.usdoj.gov</a>	Social Security Administration <a href="http://www.ssa.gov">www.ssa.gov</a>
Department of Labor <a href="http://www.dol.gov">www.dol.gov</a>	U.S. Agency for International Development <a href="http://www.usaid.gov">www.usaid.gov</a>
Department of State <a href="http://www.state.gov">www.state.gov</a>	U.S. Nuclear Regulatory Commission <a href="http://www.nrc.gov">www.nrc.gov</a>

### Eleven Additional Significant Entities

Export-Import Bank of the United States

[www.exim.gov](http://www.exim.gov)

Farm Credit System Insurance Corporation

[www.fcsic.gov](http://www.fcsic.gov)

Federal Communications Commission

[www.fcc.gov](http://www.fcc.gov)

Federal Deposit Insurance Corporation

[www.fdic.gov](http://www.fdic.gov)

National Credit Union Administration

[www.ncua.gov](http://www.ncua.gov)

Pension Benefit Guaranty Corporation

[www.pbgc.gov](http://www.pbgc.gov)

Railroad Retirement Board

[www.rrb.gov](http://www.rrb.gov)

Securities and Exchange Commission

[www.sec.gov](http://www.sec.gov)

Smithsonian Institution

[www.si.edu](http://www.si.edu)

Tennessee Valley Authority

[www.tva.gov](http://www.tva.gov)

U.S. Postal Service

[www.usps.gov](http://www.usps.gov)

### One Hundred Seven Additional Entities

Abraham Lincoln Bicentennial Commission

Advisory Council on Historic Preservation

African Development Foundation

American Battle Monuments Commission

Appalachian Regional Commission

Appalachian Regional Development Fund

Architect of the Capitol

Architectural and Transportation Barriers Compliance Board

Armed Forces Retirement Home

Barry Goldwater Scholarship and Excellence in Education Foundation

Broadcasting Board of Governors

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 21<sup>st</sup> Century

Commission on Civil Rights

Commission on International Religious Freedom

Commission on Review of Overseas Military Facility Structure United States

Commission on Security and Cooperation–Europe

Commission on Weapons of Mass Destruction

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 and 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

Election Assistance Commission

Environmental Dispute Resolution Fund

Equal Employment Opportunity Commission

Executive Office of the President

Farm Credit Administration

Federal Election Commission

Federal Financial Institutions Examination Council Appraisal Subcommittee

Federal Housing Finance Agency

Federal 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 and Library Services

Interagency Council on the Homeless

Inter-American Foundation

International Trade Commission

James Madison Memorial Fellowship Foundation

Japan-United States Friendship Commission

John C. Stennis Center

John F. Kennedy Center for the Performing Arts

Library of Congress

Marine Mammal Commission

Medicare Payment Advisory Commission

Merit Systems Protection Board	Office of Government Ethics
Military Sales Program	Office of Navajo and Hopi Indian Relocation
Millennium Challenge Corporation	Office of Special Counsel
Morris K. Udall Scholarship Foundation	Office of the Federal Coordination for Alaska Natural Gas Transportation Projects
National Archives and Records Administration	Open World Leadership Center Funds
National Capital Planning Commission	Overseas Private Investment Corporation
National Commission on Libraries and Information Science	Peace Corps
National Commission on Terrorist Attacks upon the United States	Presidio Trust
National Council on Disability	Public Defender Service
National Endowment for the Arts	Selective Service System
National Endowment for the Humanities	Senate Preservation Fund
National Gallery of Art	St. Lawrence Seaway Development Corporation
National Labor Relations Board	State Justice Institute
National Mediation Board	U.S. Capital Preservation Commission
National Railroad Retirement Investment Trust	U.S. China Security Review Commission
National Transportation Safety Board	U.S. Holocaust Memorial Museum
National Veterans Business Development Corporation	U.S. Institute of Peace
Neighborhood Reinvestment Corporation	U.S. Trade and Development Agency
Nuclear Waste Technical Review Board	Vietnam Education Foundation
Occupational Safety and Health Review Commission	White House Commission on the National Moment of Remembrance
Office of Compliance	Woodrow Wilson International Center for Scholars

### Legislative and Judicial Branches

There are no legal or other requirements for the legislative 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 such entities as the U.S. Courts or the Congress. Some legislative branch entities voluntarily prepare and submit such information (e.g., Government Accountability Office, Government Printing Office, and Library of Congress). The President's Budget includes cash-based, outlay data for the legislative and judicial branches and, to a limited extent, this outlay data is also a part of the information contained in this report.

## Entities Excluded from these Statements

The following entities are not part of the Governmentwide reporting entity based on an assessment of these entities in accordance with the indicative criteria stated in SFFAC No. 2, Entity and Display. However, this list is not all inclusive of all entities excluded from these statements.

American International Group (AIG)	Thrift Savings Fund
Board of Governors of the Federal Reserve System (Including the Federal Reserve Banks)	Financing Corporation
Citigroup	GMAC Financial Services
Federal Home Loan Banks	Public-Private Investment Funds (PPIF)
Federal Home Loan Mortgage Corporation (Freddie Mac)	Resolution Funding Corporation
Federal National Mortgage Association (Fannie Mae)	Student Loan Marketing Association (SLMA or Sallie Mae)

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## Appendix B: Material Weaknesses Reported by Auditors and Federal Managers' Financial Integrity Act (FMFIA) Tables

OMB audit guidance requires auditors to disclose material weaknesses in internal control over financial reporting. The FMFIA and OMB guidance require the head of each executive agency to annually report whether there is reasonable assurance that the agency's controls are achieving the intended objectives and whether the agency's financial management systems conform to government-wide requirements.

Agency heads are required to identify material weaknesses related to agency programs and operations (pursuant to Section 2 of FMFIA) and non-conformances with government-wide financial systems requirements (pursuant to Section 4 of FMFIA). Reporting material weaknesses under FMFIA is not limited to weaknesses over financial reporting.

The following tables include: the number of material weaknesses reported by independent auditors, the number of material weaknesses reported by agency heads under Section 2 of FMFIA, and the number of financial system non-conformances reported by agency heads under Section 4 of FMFIA. The number of material weaknesses may differ from those identified by independent auditors and those identified by agency heads. This difference is primarily due to the more in-depth review that management is required to perform on its internal control environment over financial reporting, per OMB Circular A-123, which may result in more material weaknesses being identified.

### Table Definitions:

- **Beginning**—the number of material weaknesses (beginning balance) reported in the Independent Auditor's Report or FMFIA Report for the prior fiscal year.
- **New**—the number of new material weaknesses reported in the Independent Auditor's Report or FMFIA Report for the current fiscal year which could include reportable conditions/significant deficiencies reported from the prior fiscal year whose severity has risen to the level of a material weakness.
- **Resolved**—the number of material weaknesses reported in the Independent Auditor's Report or FMFIA Report for the current fiscal year that were reported as resolved or whose severity has been reduced so that it is no longer a material weakness.
- **Consolidated**—the number of material weaknesses reported in the Independent Auditor's Report or FMFIA Report that were combined with other repeat material weaknesses from a prior fiscal year or with a new material weakness from the current fiscal year.
- **Ending**—the number of material weaknesses (ending balance) reported in the Independent Auditor's Report or FMFIA Report for the current fiscal year. The number is calculated by adding the number of new material weaknesses reported from the current fiscal year to the number of material weaknesses reported the prior fiscal year and then subtracting the number of weaknesses resolved and consolidated weaknesses during the current fiscal year.

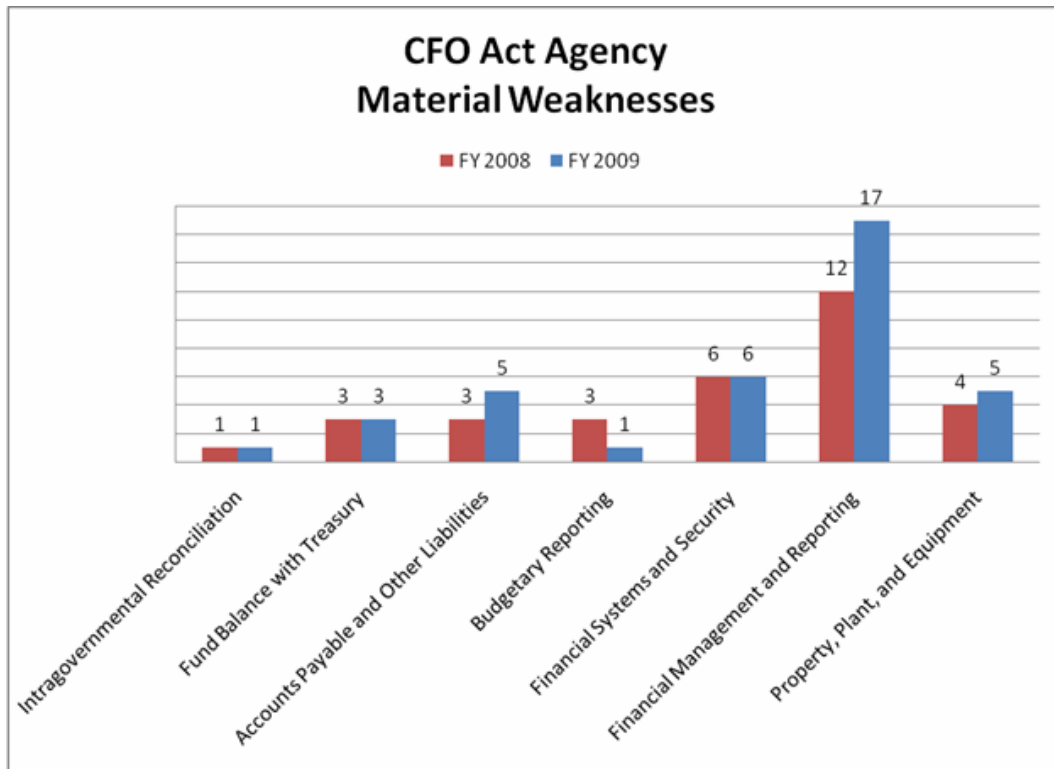
**Fiscal Year 2009: Auditor-Identified Material Weaknesses**

	<b>Beginning</b>	<b>New</b>	<b>Resolved</b>	<b>Consolidated</b>	<b>Ending</b>
Agriculture .....	2	0	0	0	2
Commerce .....	0	0	0	0	0
Defense .....	13	0	0	0	13
Education.....	0	0	0	0	0
Energy .....	0	0	0	0	0
HHS .....	2	0	0	0	2
Homeland .....	6	0	0	0	6
HUD .....	0	0	0	0	0
Interior.....	1	0	1	0	0
Justice.....	0	0	0	0	0
Labor.....	0	0	0	0	0
State .....	0	3	0	0	3
DOT .....	0	0	0	0	0
Treasury.....	1	1	0	0	2
VA.....	3	1	0	0	4
AID.....	1	0	0	0	1
EPA.....	0	3	0	0	3
GSA .....	1	0	1	0	0
NASA.....	2	0	1	0	1
NSF.....	0	0	0	0	0
NRC.....	0	0	0	0	0
OPM.....	0	0	0	0	0
SBA.....	0	1	0	0	1
SSA.....	0	0	0	0	0
<b>Total .....</b>	<b>32</b>	<b>9</b>	<b>3</b>	<b>0</b>	<b>38</b>

## Fiscal Year 2009 Auditor-Identified Material Weaknesses by Category

In the fall of 2008, when the financial market began to show signs of significant stress, the nation looked to the Government to stabilize the nation’s financial system while protecting the taxpayer. In response, the Government enacted both the Emergency Economic Stabilization Act of 2008 (EESA) and the American Recovery and Reinvestment Act of 2009 (ARRA). Implementing EESA and ARRA presented extraordinary challenges in financial management. Reporting under ARRA was unparalleled in the breadth and depth of transparency it provides to the American public. In addition, the Government made unprecedented investments in private entities. Despite these challenges the Government did not increase the number of repeat material weaknesses; however new material weaknesses were incurred.

A material weakness is a significant deficiency, or combination of significant deficiencies, that result in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected. The existence of material weaknesses does not necessarily mean the financial statements are unreliable. However, they are indicators and their existence suggests the likelihood that the financial statements include material misstatements has increased.



This year great strides were made in the area of Budgetary Reporting, which was reduced by over 50 percent. However, challenges still remain particularly in the area of Financial Management and Reporting, which increased by almost 50 percent. Financial Management and Reporting material weaknesses were found in nine agencies. Auditors found the controls over the financial statement preparation needed to be improved in various areas including oversight, data integrity, reconciliations, updating of policies and procedures, and training. By improving controls over the reporting process agencies are better positioned to prepare reliable, useful, and timely financial information for decision making.

## Fiscal Year 2009: FMFIA Section 2—Consolidated Totals

The agency head is responsible for submitting an annual assurance statement on the effectiveness of the agency's internal control. The OMB Circular A-123 requires the Agency Head to separately address the effectiveness of internal control over operations separately from the internal control over financial reporting. The assurance statement must take one of the following forms: a) Unqualified statement of assurance (no material weaknesses reported); b) Qualified statement of assurance, considering the exceptions explicitly noted (one or more material weaknesses reported); or c) Statement of no assurance (no processes in place or pervasive material weaknesses).

A material weakness over operations includes reportable conditions in which the agency head determines to be significant enough to report outside of the agency. A material weakness over financial reporting is a reportable condition, or a combination thereof which results in more than a remote<sup>1</sup> likelihood that a material misstatement of the financial statements, or other significant financial reports, will not be prevented or detected.

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<sup>1</sup> The term "remote" is defined in SFFAS No. 5, Accounting for Liabilities of the Federal Government, as the chance of the future event, or events, occurring is slight.



**Fiscal Year 2009: FMFIA Section 2--Consolidated Totals**

		Adequate and Effective Management Controls		Number of Material Weaknesses				
		Section 2 Operational	Section 2 Financial Reporting	Beginning	New	Resolved	Consolidated	Reassessed
Agriculture ..	Unqualified	Qualified	3	0	0	0	0	3
Commerce ..	Qualified	Unqualified	1	0	0	0	0	1
Defense .....	Qualified	No Assurance	16	1	1	0	0	16
Education.....	Unqualified	Unqualified	1	0	1	0	0	0
Energy .....	Unqualified	Unqualified	0	0	0	0	0	0
HHS .....	Qualified	Qualified	2	0	0	0	0	2
Homeland ...	Qualified	No Assurance	16	0	0	0	4	12
HUD .....	Unqualified	Unqualified	0	0	0	0	0	0
Interior.....	Qualified	Unqualified	1	1	1	0	0	1
Justice.....	Qualified	Unqualified	2	0	0	0	0	2
Labor.....	Unqualified	Unqualified	0	0	0	0	0	0
State .....	Unqualified	Unqualified	0	0	0	0	0	0
DOT .....	Unqualified	Unqualified	1	0	1	0	0	0
Treasury.....	Qualified	Qualified	4	1	0	0	0	5
VA .....	Qualified	Qualified	1	0	0	0	0	1
AID.....	Unqualified	Unqualified	0	0	0	0	0	0
EPA.....	Unqualified	Qualified	0	3	0	0	0	3
GSA .....	Unqualified	Unqualified	2	0	2	0	0	0
NASA .....	Unqualified	Qualified	2	0	1	0	0	1
NSF.....	Unqualified	Unqualified	0	0	0	0	0	0
NRC .....	Unqualified	Unqualified	0	0	0	0	0	0
OPM.....	Qualified	Unqualified	1	0	0	0	0	1
SBA.....	Qualified	Unqualified	0	1	0	0	0	1
SSA.....	Unqualified	Unqualified	0	0	0	0	0	0
Total .....			<u>53</u>	<u>7</u>	<u>7</u>	<u>0</u>	<u>4</u>	<u>49</u>

## Fiscal Year 2009: FMFIA Section 2–Operational

	Adequate and Effective Management Controls			Number of Material Weaknesses					
	Unqualified	Qualified	No Assurance	Beginning	New	Resolved	Consolidated	Reassessed	Ending
Agriculture.....	X			0	0	0	0	0	0
Commerce.....		X		1	0	0	0	0	1
Defense.....		X		4	1	1	0	0	4
Education.....	X			1	0	1	0	0	0
Energy.....	X			0	0	0	0	0	0
HHS.....		X		1	0	0	0	0	1
Homeland.....		X		10	0	0	0	4	6
HUD.....	X			0	0	0	0	0	0
Interior.....		X		0	1	0	0	0	1
Justice.....		X		2	0	0	0	0	2
Labor.....	X			0	0	0	0	0	0
State.....	X			0	0	0	0	0	0
DOT.....	X			1	0	1	0	0	0
Treasury.....		X		3	0	0	0	0	3
VA.....		X		1	0	0	0	0	1
AID.....	X			0	0	0	0	0	0
EPA.....	X			0	0	0	0	0	0
GSA.....	X			1	0	1	0	0	0
NASA.....	X			0	0	0	0	0	0
NSF.....	X			0	0	0	0	0	0
NRC.....	X			0	0	0	0	0	0
OPM.....		X		1	0	0	0	0	1
SBA.....		X		0	1	0	0	0	1
SSA.....	X			0	0	0	0	0	0
Total.....	14	10	0	26	3	4	0	4	21

**Fiscal Year 2009: FMFIA Section 2–Financial Reporting**

	Adequate and Effective Management Controls			Number of Material Weaknesses					
	Unqualified	Qualified	No	Beginning	New	Resolved	Consolidated	Reassessed	Ending
			Assurance						
Agriculture .....		X		3	0	0	0	0	3
Commerce .....	X			0	0	0	0	0	0
Defense.....			X	12	0	0	0	0	12
Education .....	X			0	0	0	0	0	0
Energy.....	X			0	0	0	0	0	0
HHS .....		X		1	0	0	0	0	1
Homeland.....			X	6	0	0	0	0	6
HUD .....	X			0	0	0	0	0	0
Interior.....	X			1	0	1	0	0	0
Justice.....	X			0	0	0	0	0	0
Labor.....	X			0	0	0	0	0	0
State.....	X			0	0	0	0	0	0
DOT .....	X			0	0	0	0	0	0
Treasury.....		X		1	1	0	0	0	2
VA .....		X		0	0	0	0	0	0
AID.....	X			0	0	0	0	0	0
EPA.....		X		0	3	0	0	0	3
GSA .....	X			1	0	1	0	0	0
NASA .....		X		2	0	1	0	0	1
NSF.....	X			0	0	0	0	0	0
NRC .....	X			0	0	0	0	0	0
OPM.....	X			0	0	0	0	0	0
SBA.....	X			0	0	0	0	0	0
SSA.....	X			0	0	0	0	0	0
<b>Total .....</b>	<b>16</b>	<b>6</b>	<b>2</b>	<b>27</b>	<b>4</b>	<b>3</b>	<b>0</b>	<b>0</b>	<b>28</b>

## Fiscal Year 2009: FMFIA Section 4—Financial Management Systems

	Systems Conform to Requirements		Number of Non-conformances						
	Yes, with Non-conformances		Beginning	New	Resolved	Consolidated	Reassessed	Ending	
	Yes	No							
Agriculture.....	X		1	0	0	0	0	1	
Commerce .....	X		0	0	0	0	0	0	
Defense .....		X	1	0	0	0	0	1	
Education.....	X		0	0	0	0	0	0	
Energy .....	X		0	0	0	0	0	0	
HHS .....		X	2	0	0	0	0	2	
Homeland .....		X	3	0	0	0	0	3	
HUD .....	X		0	0	0	0	0	0	
Interior.....	X		0	0	0	0	0	0	
Justice.....	X		0	0	0	0	0	0	
Labor.....	X		0	0	0	0	0	0	
State .....	X		0	0	0	0	0	0	
DOT .....	X		0	0	0	0	0	0	
Treasury.....	X		0	0	0	0	0	0	
VA.....		X	2	1	0	0	0	3	
AID.....	X		0	0	0	0	0	0	
EPA.....	X		0	0	0	0	0	0	
GSA.....	X		1	0	1	0	0	0	
NASA.....		X	1	0	1	0	0	0	
NSF.....	X		0	0	0	0	0	0	
NRC.....	X		0	0	0	0	0	0	
OPM.....	X		0	0	0	0	0	0	
SBA.....	X		0	0	0	0	0	0	
SSA.....	X		0	0	0	0	0	0	
Total.....	<u>18</u>	<u>2</u>	<u>4</u>	<u>11</u>	<u>1</u>	<u>2</u>	<u>0</u>	<u>0</u>	<u>10</u>

## Appendix C: Government Corporations Required to Submit Audited Financial Statements to OMB

Government Corporation	Fiscal Year 2009 Audit Opinion
Commodity Credit Corporation .....	Unqualified
Community Development Financial Institutions Fund .....	Unqualified
Corporation for National and Community Service .....	Unqualified
Export-Import Bank of the United States .....	Unqualified
Federal Crop Insurance Corporation .....	Unqualified
Federal Deposit Insurance Corporation .....	Not Received <sup>1</sup>
Federal Home Loan Banks .....	Not Received <sup>1</sup>
Federal Housing Administration .....	Unqualified
Federal Prison Industries, Incorporated .....	Unqualified
Financing Corporation .....	Not Received <sup>1</sup>
Government National Mortgage Association .....	Unqualified
Millennium Challenge Corporation .....	Unqualified
National Credit Union Administration Central Liquidity Facility .....	Not Received <sup>1</sup>
Overseas Private Investment Corporation .....	Unqualified
Pension Benefit Guaranty Corporation .....	Unqualified
Resolution Funding Corporation .....	Not Received <sup>1</sup>
Saint Lawrence Seaway Development Corporation .....	Unqualified
Tennessee Valley Authority .....	Unqualified

<sup>1</sup> The entity has a calendar yearend; the financial statements were not due as of the printing of this report.

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## Appendix D: Accountability of Tax Dollars Act Agencies Required to Submit Audited Financial Statements to OMB

The Accountability of Tax Dollars Act required executive agencies, not already required through separate legislation, to prepare and submit audited financial statements. The majority of these agencies are relatively small as compared to the CFO Act departments and agencies in both budgetary and human resources. This has contributed to several of the agencies having not yet submitted their audited financial statements. OMB continues to work with these agencies to meet this requirement.

Agency	Fiscal Year 2009 Audit Opinion
Advisory Council on Historic Preservation .....	Not Received
African Development Foundation .....	Unqualified
American Battle Monuments Commission .....	Not Received
Appalachian Regional Commission .....	Not Received
Architectural and Transportation Barriers Compliance Board .....	Unqualified
Armed Forces Retirement Home .....	Unqualified
Barry Goldwater Scholarship and Excellence in Education Fund.....	Not Received
Broadcasting Board of Governors.....	Unqualified
Christopher Columbus Fellowship Foundation .....	Unqualified
Central Intelligence Agency .....	Qualified
Chemical Safety and Hazard Investigation Board .....	Unqualified
Commission on Civil Rights .....	Unqualified
Commission of Fine Arts .....	Not Received
Commission for the Preservation of America's Heritage Abroad.....	Not Received
Committee for Purchase from People Who Are Blind or Severely .....	Not Received
Commodity Futures Trading Commission.....	Unqualified
Consumer Product Safety Commission .....	Unqualified
Court Services and Offender Supervision Agency for DC .....	Not Received <sup>1</sup>
Defense Nuclear Facilities Safety Board .....	Unqualified
Delta Regional Authority .....	Not Received
Denali Commission .....	Unqualified

Agency	Fiscal Year 2009 Audit Opinion
Election Assistance Commission .....	Unqualified
Equal Employment Opportunity Commission .....	Unqualified
Farm Credit Administration .....	Unqualified
Farm Credit System Insurance Corporation .....	Not Received <sup>1</sup>
Federal Communications Commission .....	Unqualified
Federal Election Commission .....	Unqualified
Federal Financial Institutions Examination Council Appraisal Subcommittee .....	Not Received
Federal Housing Finance Agency .....	Unqualified
Federal Labor Relations Authority.....	Unqualified
Federal Maritime Commission .....	Unqualified
Federal Mediation and Conciliation Service.....	Unqualified
Federal Mine Safety and Health Review Commission.....	Unqualified
Federal Retirement Thrift Investment Board.....	Not Received <sup>1</sup>
Federal Trade Commission.....	Unqualified
Harry S. Truman Scholarship Foundation.....	Not Received
Institute of American Indian and Alaska Native Culture and Arts Development.....	Not Received
Institute of Museum and Library Services .....	Unqualified
Inter-American Foundation.....	Unqualified
James Madison Memorial Fellowship Foundation .....	Not Received
Japan-U.S. Friendship Commission.....	Unqualified
Marine Mammal Commission.....	Unqualified
Merit Systems Protection Board.....	Unqualified
Morris K. Udall Scholarship and Excellence in National Environmental Policy Foundation .....	Unqualified
National Archives and Records Administration.....	Unqualified



Agency	Fiscal Year 2009 Audit Opinion
National Capital Planning Commission .....	Unqualified
National Commission on Libraries and Information Science .....	Not Received
National Council on Disability.....	Unqualified
National Credit Union Administration .....	Not Received <sup>1</sup>
National Endowment for the Arts .....	Unqualified
National Endowment for the Humanities.....	Unqualified
National Labor Relations Board .....	Unqualified
National Mediation Board.....	Unqualified
National Transportation Safety Board.....	Unqualified
Nuclear Waste Technical Review Board.....	Unqualified
Occupational Safety and Health Review Commission.....	Unqualified
Office of the Federal Coordinator for Alaska Natural Gas Transportation Projects.....	Unqualified
Office of Government Ethics .....	Unqualified
Office of Navajo and Hopi Indian Relocation Commission .....	Unqualified
Office of Special Counsel.....	Unqualified
Peace Corps.....	Unqualified
Postal Regulatory Commission .....	Not Received
Presidio Trust .....	Qualified
Railroad Retirement Board.....	Unqualified
Securities and Exchange Commission .....	Unqualified
Selective Service System.....	Unqualified
Smithsonian Institution .....	Unqualified
SI/John F. Kennedy Center for the Performing Arts .....	Unqualified
SI/National Gallery of Arts.....	Unqualified

Agency	Fiscal Year 2009 Audit Opinion
SI/Woodrow Wilson International Center for Scholars.....	Unqualified
Trade and Development Agency.....	Unqualified
U.S. Court of Appeals for Veterans Claims.....	Unqualified
U.S. Holocaust Memorial Museum .....	Unqualified
U.S. Interagency Council on Homelessness.....	Unqualified
U.S. International Trade Commission .....	Disclaimer
Vietnam Education Foundation .....	Unqualified
White House Commission on the National Moment of Remembrance.....	Unqualified
<sup>1</sup> The entity has a calendar yearend; the financial statements were not due as of the printing of this report.	

## Appendix E: Selected Components of CFO Act Agencies Required to Submit Audited Financial Statements to OMB

OMB designates those individual entity components that must prepare audited financial statements.

<b>Agency Components:</b>	<b>Fiscal Year 2009 Opinion</b>
Food and Nutrition Service (USDA).....	Unqualified
Forest Service (USDA) .....	Unqualified
Rural Development Mission Area (USDA).....	Unqualified
Department of Army General Funds (DOD) .....	Disclaimer
Department of Navy General Funds (DOD) .....	Disclaimer
Department of Air Force General Funds (DOD).....	Disclaimer
Military Retirement Trust Fund (DOD).....	Unqualified
U.S. Army Corp of Engineers Civil Works Program (DOD).....	Unqualified
Department of Army Working Capital Fund (DOD) .....	Disclaimer
Department of Navy Working Capital Fund (DOD) .....	Disclaimer
Department of Air Force Working Capital Fund (DOD) .....	Disclaimer
Centers for Medicare and Medicaid Services (HHS).....	Unqualified
Federal Aviation Administration (DOT).....	Unqualified
Internal Revenue Service (Treasury).....	Unqualified
Civil Service Retirement and Disability Fund (OPM).....	Unqualified
Federal Employees Health Benefits Program (OPM).....	Unqualified
Federal Employees Life Insurance Program (OPM) .....	Unqualified

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## Appendix F: Compliance with the Federal Financial Management Improvement Act of 1996

Under the FFMIA, the 24 CFO Act agencies listed below are required to maintain financial management systems that substantially comply with Federal financial management system requirements, applicable Federal accounting standards, and the U.S. Standard General Ledger at the transaction level. FFMIA provides that both the agency head and the independent auditor publish a determination of compliance on an annual basis.

The table below indicates the fiscal year 2009 compliance findings for each CFO Act agency.

	Agency Head	Auditor
Agriculture.....	No	No
Commerce.....	Yes	Yes
Defense.....	No	No
Education .....	Yes	No
Energy.....	Yes	Yes
HHS.....	No	No
Homeland.....	No	No
HUD .....	Yes	No
Interior .....	Yes	Yes
Justice .....	Yes	Yes
Labor .....	Yes	Yes
State.....	Yes	No
DOT.....	Yes	Yes
Treasury .....	No	No
VA .....	No	No
AID .....	Yes	Yes
EPA .....	Yes	Yes
GSA.....	Yes	Yes
NASA .....	No	No
NSF.....	Yes	Yes
NRC .....	Yes	Yes
OPM.....	Yes	Yes
SBA .....	Yes	Yes
SSA .....	Yes	Yes

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## Appendix G: Debt Collection Deficiencies and Corrective Actions

Agency	Deficiency	Corrective Actions to be Taken or Recently Completed
Agriculture (USDA)	A few small agencies within USDA, representing 0.02 percent of delinquent debt, have not been compliant with the requirement to write off delinquent debt greater than 2 years old if there are no estimated material collections.	USDA established a departmental waiver program and continues to coordinate write-off plans across the Department identifying agency-specific action items. Delinquent debt greater than 2 years old without waivers increased from \$257 thousand to \$594 thousand from fiscal year 2008 to fiscal year 2009.
Health and Human Services (HHS)	The Centers for Medicare and Medicaid Services have not been reporting all eligible discharged/ closed-out debt to the Internal Revenue Service (IRS).	HHS is currently making the systems changes necessary to the Healthcare Integrated General Ledger Accounting System (HIGLAS) in order to report in accordance with IRS regulations. Because system changes will not be complete until 2012, HHS receives support in the interim from Treasury's Financial Management Service.
Homeland Security (DHS)	DHS previously identified a need to develop comprehensive debt collection procedures.	Per the auditor's report, DHS achieved compliance with the Debt Collection Improvement Act this year, citing no deficiencies. DHS had developed a working group tasked with reviewing debt management policy and conducting periodic debt collection workshops. Department policy was finalized and issued in 2009.
State (DOS)	Procedures for recording the write-off of debts in the accounting system were found to be deficient in 2008.	The 2008 deficiency was resolved in 2009 and no new deficiencies were identified. Detailed instructions for recording the write-off of debts were implemented in 2009 and the write-offs have been processed. In 2010 the Department of State will be refining related policies and procedures if needed.
Labor (DOL)	Historically, the Mine Safety and Health Administration (MSHA) had not referred aged delinquent debt to Treasury for collection and DOL agencies had not complied with the requirement to write off delinquent debt greater than 2 years old if there were no estimated material collections.	MSHA has added human assets to that area and expect an increase in its referral rate during fiscal year 2010. OCFO will continue working with agencies to ensure that all delinquent debts will refer to Treasury for collections in 2010.
Defense (DOD)	<p>In 2006, DOD identified a deficiency in that the Taxpayer Identification Number (TIN) was not provided on all certified vouchers submitted to a disbursing office for payment.</p> <p>A new deficiency was identified; DOD has not referred all eligible debts less than \$100,000 to Treasury.</p>	<p>In 2009 DOD strengthened their policies related to vendors providing a TIN.</p> <p>To address the newly-identified deficiency, DOD is pursuing a reconciliation process to improve the referral of eligible debts to Treasury when 180 days delinquent.</p>

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## Appendix H: Acronyms

This appendix lists the acronyms used in the Financial Statements and Notes to the Financial Statements section of this *Financial Report*.

ABS	Asset-Backed Securities
AIG	American International Group, Inc.
AGP	Asset Guarantee Program
ASC	Accounting Standards Codification
BLDTF	Black Lung Disability Trust Fund
CCC	Commodity Credit Corporation
CDs	Certificates of Deposits
CERCLA	Comprehensive Environmental Response, Compensation, and Liability Act
COLA	Cost of Living Adjustments
CPI	Consumer Price Index
CPIM	Consumer Price Index–Medical
CPP	Capital Purchase Program
CSB	Career Status Bonus
CSRDF	Civil Service Retirement and Disability Fund
CSRS	Civil Service Retirement System
DHS	Department of Homeland Security
DI	Disability Insurance
DIP	Debtor-in-Possession
DOC	Department of Commerce
DOD	Department of Defense
DOE	Department of Energy
DOI	Department of the Interior
DOJ	Department of Justice
DOL	Department of Labor
DOT	Department of Transportation
ECASLA	Ensuring Continued Access to Student Loans Act of 2008
Education	Department of Education
EESA	Emergency Economic Stabilization Act of 2008
EOP	Executive Office of the President
EPA	Environmental Protection Agency
ESF	Exchange Stabilization Fund
Fannie Mae	Federal National Mortgage Association
FASB	Financial Accounting Standards Board
FCC	Federal Communication Commission
FCRA	Federal Credit Reform Act of 1991
FDIC	Federal Deposit Insurance Corporation
FECA	Federal Employees Compensation Act
FEGLI	Federal Employee Group Life Insurance
FEHB	Federal Employees Health Benefits Program
FEMA	Federal Emergency Management Agency
FERS	Federal Employees' Retirement System
FERSA	Federal Employees' Retirement System Act of 1986
FFAS	Farm and Foreign Agricultural Services
FFEL	Federal Family Education Loan
FHA	Federal Housing Administration
FHFA	Federal Housing Financing Agency
FHWA	Federal Highway Administration
FICA	Federal Insurance Contributions Act

FMFIA	Federal Managers' Financial Integrity Act
FRBNY	Federal Reserve Bank of New York
FRBs	Federal Reserve banks
Freddie Mac	Federal Home Loan Mortgage Corporation
FRTIB	Federal Retirement Thrift Investment Board
FSA	Farm Service Agency
FTA	Federal Transit Administration
FTCA	Federal Tort Claims Act
FUA	Federal Unemployment Account
GAAP	U.S. Generally Accepted Accounting Principles
GAO	Government Accountability Office
GDP	Gross Domestic Product
Ginnie Mae	Government National Mortgage Association
GM	General Motors
GSA	General Services Administration
GSE	Government Sponsored Enterprises
GSECF	GSE Credit Facility Program
HAMP	Home Affordable Modification Program
HBP	Health Benefits Program
HERA	Housing and Economic Recovery Act of 2008
HFA	Housing Financing Agencies
HHS	Department of Health and Human Services
HI	Hospital Insurance
HMO	Health Maintenance Organization
HUD	Department of Housing and Urban Development
IMF	International Monetary Fund
IRS	Internal Revenue Service
LAC	Latest acquisition cost
MAC	Moving average cost
MBS	Mortgage-Backed Securities
MDBs	Multilateral Development Banks
MERHCF	Medicare Eligible Retiree Health Care Fund
MIPPA	Medicare Improvements for Patients and Providers Act
MMA	Medicare Prescription Drug, Improvement, and Modernization Act
MMS	Minerals Management Service
MRADR	Market Risk Adjusted Discount Rate
MRF	Military Retirement Fund
NASA	National Aeronautics and Space Administration
NAV	Net Asset Value
NCUA	National Credit Union Administration
NFIP	National Flood Insurance Program
NIBP	New Issue Bond Program
NIH	National Institutes of Health
NRP	National Research Program
NRRIT	National Railroad Retirement Investment Trust
NSLI	National Service Life Insurance
NTIA	National Telecommunications and Information Administration
OASDI	Old-Age and Survivors Disability Insurance
OASI	Old-Age and Survivors Insurance
OMB	Office of Management and Budget
OPM	Office of Personnel Management
PBGC	Pension Benefit Guaranty Corporation
PMAAs	Power Marketing Authorities
PPIF	Public Private Investment Funds
PPIP	Public Private Investment Program
PPO	Preferred Provider Organization
PSRHB	Postal Service Retiree Health Benefits

QBP	Quarterly Banking Profile
QEO	Qualified Equity Offerings
QFI	Qualified Financial Institution
R&D	Research and Development
RACER	Remedial Action Cost Engineering Requirements
RCRA	Resource Conservation and Recovery Act
RD	Rural Development
REDUX	Military Retirement Reform Act of 1986
RRB	Railroad Retirement Board
RRSIA	Railroad Retirement and Survivors Improvement Act
SAFETEA-LU	Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users
Sallie Mae	Student Loan Marketing Association
SBA	Small Business Administration
SDRs	Special Drawing Rights
SDRCs	SDR Certificates
SECA	Self-Employment Contributions Act
SFAS	Statement of Financial Accounting Standards
SFFAC	Statement of Federal Financial Accounting Concept
SFFAS	Statement of Federal Financial Accounting Standards
SFP	Supplementary Financing Program
SLMA	Student Loan Marketing Association
SMI	Supplementary Medical Insurance
SOMA	System Open Market Account
SOSI	Statement of Social Insurance
SPSPA	Senior Preferred Stock Purchase Agreements
SSA	Social Security Administration
SSEB	Social Security Equivalent Benefit
SSP	Stable Share Price
TALF	Term Asset-Backed Loan Facility
TARP	Troubled Asset Relief Program
TCLP	Temporary Credit Liquidity Program
TFL	TRICARE for Life
TIP	Targeted Investment Program
TIPS	Treasury Inflation-Protected Securities
Treasury	Department of the Treasury
TRIA	Terrorism Risk Insurance Act
TSP	Thrift Savings Plan
TVA	Tennessee Valley Authority
TVARS	Tennessee Valley Authority Retirement System
USACE	U.S. Army Corps of Engineers
U.S.C.	United States Code
USDA	United States Department of Agriculture
USPS	United States Postal Service
UTF	Unemployment Trust Fund
VA	Department of Veterans Affairs
VRI	Veterans Reopened Insurance
VSLI	Veterans Special Life Insurance

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**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 to annually submit financial statements for the U.S. government to the President and the Congress. GAO is required to audit these statements.<sup>1</sup> This is (1) our report on the accompanying U.S. government's accrual-based consolidated financial statements for the fiscal years ended September 30, 2009 and 2008, and the 2009, 2008, 2007, and 2006 Statements of Social Insurance, and (2) our associated reports on internal control over financial reporting and on compliance with selected provisions of laws and regulations. As used in this report, accrual-based financial statements refer to all of the consolidated financial statements and notes, except for those related to the Statement of Social Insurance.<sup>2</sup>

The federal government is responsible for (1) preparing annual consolidated financial statements in conformity with U.S. generally accepted accounting principles (GAAP); (2) establishing, maintaining, and evaluating internal control to provide reasonable assurance that the control objectives of the Federal Managers' Financial Integrity Act (FMFIA)<sup>3</sup> are met; and (3) complying with laws and regulations. Also, the 24 Chief Financial Officers (CFO) Act agencies are responsible for implementing and maintaining financial management systems that substantially comply with the requirements of the Federal

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<sup>1</sup>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.

<sup>2</sup>The accrual-based consolidated financial statements for the fiscal years ended September 30, 2009 and 2008 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 2009, 2008, 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-based consolidated financial statements.

<sup>3</sup>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.

Financial Management Improvement Act of 1996 (FFMIA).<sup>4</sup> Our objective was to audit the consolidated financial statements for the fiscal years ended September 30, 2009 and 2008 (as well as 2007 and 2006 with respect to the Statements of Social Insurance). Appendix I discusses the scope and methodology of our work.

Material weaknesses<sup>5</sup> discussed later in our report continued to (1) hamper the federal government's ability to reliably report a significant portion of its assets, liabilities, costs, and other related information; (2) affect the federal government's ability to reliably measure the full cost as well as the financial and nonfinancial performance of certain programs and activities; (3) impair the federal government's ability to adequately safeguard significant assets and properly record various transactions; and (4) hinder the federal government from having reliable financial information to operate in an efficient and effective manner. We found the following:

- Certain material weaknesses in internal control over financial reporting and other limitations on the scope of our work<sup>6</sup> resulted in conditions that continued to prevent us from expressing an opinion on the accompanying accrual-based consolidated financial statements for the fiscal years ended September 30, 2009 and 2008.<sup>7</sup>
- The Statements of Social Insurance for 2009, 2008, and 2007<sup>8</sup> are presented fairly, in all material respects, in conformity with GAAP; we disclaim an opinion on the 2006 Statement of Social Insurance.<sup>9</sup>
- Material weaknesses resulted in ineffective internal control over financial reporting (including safeguarding of assets).

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<sup>4</sup>31 U.S.C. 3512 note (Federal Financial Management Improvement Act).

<sup>5</sup>A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis.

<sup>6</sup>Three major impediments continued to prevent us from rendering an opinion on the accrual-based consolidated financial statements: (1) serious financial management problems at the Department of Defense (DOD) that have prevented DOD's financial statements from being auditable, (2) the federal government's inability to adequately account for and reconcile intragovernmental activity and balances between federal entities, and (3) the federal government's ineffective process for preparing the consolidated financial statements. In addition, the financial statements of the Department of Homeland Security and the National Aeronautics and Space Administration for fiscal years 2009 and 2008 were not auditable or not subjected to audit by agency auditors.

<sup>7</sup>We previously reported that certain material weaknesses prevented us from expressing an opinion on the consolidated financial statements of the U.S. government for fiscal years 1997 through 2006 and on the accrual-based consolidated financial statements of the U.S. government for fiscal years 2007 and 2008.

<sup>8</sup>The valuation date is January 1 for all social insurance programs except the Black Lung program, which has a valuation date of September 30.

<sup>9</sup>We disclaimed an opinion on the fiscal year 2006 consolidated financial statements, including the Statement of Social Insurance.

- Our work to test compliance with selected provisions of laws and regulations in fiscal year 2009 was limited by the material weaknesses and other scope limitations discussed in this report.

### SIGNIFICANT MATTERS OF EMPHASIS

Before discussing our conclusions on the consolidated financial statements, the following key items deserve emphasis in order to put the information contained in the financial statements and the Management's Discussion and Analysis section of the *2009 Financial Report of the United States Government (2009 Financial Report)* into context.

#### The Federal Government's Actions to Stabilize Financial Markets and to Promote Economic Recovery

The economic recession and the federal government's unprecedented actions intended to stabilize the financial markets and to promote economic recovery have significantly affected the federal government's financial condition. The resulting substantial investments and increases in liabilities, net operating cost, the unified budget deficit, and debt held by the public, are reported in the accrual-based consolidated financial statements for fiscal year 2009. However, the ultimate cost of these actions and their impact on the federal government's financial condition will not be known for some time. Key actions that the federal government has taken to stabilize financial markets and to restore the availability of credit for Americans are discussed in the Management's Discussion and Analysis section of the *2009 Financial Report* and certain Notes to the consolidated financial statements.

#### Uncertainties Regarding Certain Asset and Liability Valuations

As of September 30, 2009, the federal government's actions to stabilize the financial markets and to promote economic recovery resulted in an increase in reported federal assets of over \$500 billion (e.g., Troubled Asset Relief Program (TARP) equity investments,<sup>10</sup> investments in the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), and mortgage-backed securities guaranteed by them),<sup>11</sup> which is net of about \$80 billion in valuation losses. In addition, the federal government reported incurring additional significant liabilities (e.g., liquidity guarantees to Fannie Mae and Freddie Mac) and related net cost resulting from these actions. In valuing these assets and liabilities, management considered and selected assumptions and data that it believed provided a reasonable basis for the estimated values reported in the accrual-based consolidated financial statements. However, as discussed in

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<sup>10</sup>TARP was established by the Department of the Treasury (Treasury) under authority provided in the Emergency Economic Stabilization Act of 2008 (Pub. L. No. 110-343). The Act requires the U.S. Comptroller General to audit TARP's financial statements as well as report every 60 days on a variety of areas associated with oversight of TARP. For the fiscal year 2009 audit and the 60-day reports, see GAO's Web site at [www.gao.gov](http://www.gao.gov).

<sup>11</sup>The Housing and Economic Recovery Act of 2008 (Pub. L. No. 110-289) authorized Treasury to purchase, until December 31, 2009, any amount of Fannie Mae or Freddie Mac securities, whether debt or equity.

Note 1 to the consolidated financial statements, there are many factors affecting these assumptions and estimates that are inherently subject to substantial uncertainty arising from the uniqueness of certain transactions and the likelihood of future changes in general economic, regulatory, and market conditions. As such, there will be differences between the estimated values as of September 30, 2009, and the actual results, and such differences may be material. These differences will also affect the ultimate cost of the federal government's actions.

### Long-Term Fiscal Challenges

The federal government faces even larger fiscal challenges in the long term. As discussed in this *2009 Financial Report*, the federal government is on an unsustainable long-term fiscal path driven primarily by rising health care costs and known demographic trends. The Statement of Social Insurance, for example, shows that the present value of projected scheduled benefits exceeds earmarked revenues for social insurance programs (e.g., Social Security and Medicare) by about \$46 trillion over the next 75-year period.<sup>12</sup> In addition, our most recent long-term simulations for all federal government programs show that absent policy changes, debt held by the public as a percentage of gross domestic product could exceed the historical high reached in the aftermath of World War II in a little over 10 years.<sup>13</sup> Absent a change in policy, under this scenario, the interest costs on the growing debt together with spending on major entitlement programs could absorb 92 cents of every dollar of federal revenue in 2019.<sup>14</sup> Clearly, this is not sustainable. The federal government faces increasing pressures yet a shrinking window of opportunity for making policy changes regarding these challenges.

### Equity Interests in Certain Financial Organizations and Commercial Entities

As discussed in Note 1, the consolidated financial statements do not include the assets, liabilities, or results of operations of any financial organizations or commercial entities in which Treasury holds either a direct, indirect, or beneficial equity interest. Treasury and the Office of Management and Budget (OMB) have determined that none of these entities meet the criteria for a federal entity. The investments in such entities, however, are valued and reported on the Balance Sheet.

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<sup>12</sup>On an open group basis (current and future participants).

<sup>13</sup>GAO, *The Federal Government's Long-Term Fiscal Outlook: Fall 2009 Update*, GAO-10-137SP (Washington, D.C.: October 2009). These simulations will be updated in a report forthcoming in early March 2010.

<sup>14</sup>GAO's Fall 2009 alternative simulation is based on the 2009 Trustees' assumptions for Social Security and Medicare. Discretionary spending other than the American Recovery and Reinvestment Act of 2009 (Recovery Act) provisions grows with gross domestic product (GDP) after 2009; and the Recovery Act provisions are included but assumed to be temporary. Expiring tax provisions are extended and the Alternative Minimum Tax exemption amount is indexed to inflation through 2019. After 2019, revenue as a share of GDP is brought to its 40-year historical average of 18.3 percent of GDP. Medicare spending is adjusted based on the assumption that physician payments are not reduced as specified under current law.



## DISCLAIMER OF OPINION ON THE ACCRUAL-BASED CONSOLIDATED FINANCIAL STATEMENTS

Because of the federal government's inability to demonstrate the reliability of significant portions of the U.S. government's accompanying accrual-based consolidated financial statements for fiscal years 2009 and 2008, principally resulting from limitations related to certain material weaknesses in internal control over financial reporting and other limitations on the scope of our work, we are unable to, and we do not, express an opinion on such accrual-based consolidated financial statements.

As a result of these limitations, readers are cautioned that amounts reported in the accrual-based consolidated financial statements and related notes may not be reliable. 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 federal government day-to-day and budget information reported by federal entities—that is taken from the same data sources as the accrual-based consolidated financial statements.

We have not audited and do not express an opinion on the Management's Discussion and Analysis, or on Stewardship Information, Supplemental Information, or other information that is not part of the accrual-based consolidated financial statements and related notes included in the *2009 Financial Report*.

### Other Limitations on the Scope of Our Work

For fiscal years 2009 and 2008, there were limitations on the scope of our work in addition to the material weaknesses that contributed to our disclaimer of opinion on the accrual-based consolidated financial statements. Treasury and OMB depend on representations from certain federal entities to provide their representations to us regarding the U.S. government's consolidated financial statements. Treasury and OMB were unable to provide us with adequate representations regarding the U.S. government's accrual-based consolidated financial statements for fiscal years 2009 and 2008. In addition, the federal government was unable to provide us with adequate legal representations regarding the U.S. government's accrual-based consolidated financial statements for fiscal year 2009.

### Material Weaknesses Contributing to Our Disclaimer of Opinion on the Accrual-based 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-based 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-based 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-based consolidated financial statements and on the management of federal government operations. The material weaknesses that contributed to our disclaimer of opinion on the accrual-based consolidated financial statements were the federal government's inability to

- satisfactorily determine that property, plant, and equipment and inventories and related property, primarily held by DOD, were properly reported in the accrual-based consolidated financial statements;
- 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 federal entities;
- adequately account for and reconcile intragovernmental activity and balances between federal entities;
- ensure that the federal government's accrual-based consolidated financial statements were (1) consistent with the underlying audited entities' financial statements, (2) properly balanced, and (3) in conformity with GAAP; and
- identify and either resolve or explain material differences between certain components of the budget deficit reported in Treasury's records, which are 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 entities' financial statements and underlying financial information and records.

Due to the material weaknesses and other limitations on the scope of our work discussed above, there may also be additional issues that could affect the accrual-based consolidated financial statements that were not identified.

## UNQUALIFIED OPINIONS ON THE STATEMENTS OF SOCIAL INSURANCE FOR 2009, 2008, AND 2007

In our opinion, the Statements of Social Insurance for 2009, 2008, and 2007 present fairly, in all material respects, the financial condition of the federal government's social insurance programs, in conformity with GAAP. We disclaim an opinion on the 2006 Statement of Social Insurance<sup>15</sup> and have not audited and do not express an opinion on the Statement of Social Insurance for 2005, and on other information related to such statements that is included in the accompanying *2009 Financial Report*.

As discussed in Note 26 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 sustainability of the social insurance programs.<sup>16</sup> 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 *2009 Financial Report* includes unaudited information concerning how changes in various assumptions would change the present value of future estimated expenditures in excess of future estimated revenue. As discussed in that section, Medicare projections are very sensitive to changes in the health care cost growth assumption.

In 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 7 years, including for 2009, and also for January and

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<sup>15</sup>Beginning in fiscal year 2006, the Statement of Social Insurance became a principal financial statement and was audited as part of the applicable federal entities' financial statements. We disclaimed an opinion on the fiscal year 2006 consolidated financial statements, including the Statement of Social Insurance. For fiscal years 2009, 2008, and 2007, we designed our audits to provide an opinion on the 2009, 2008, and 2007 consolidated Statements of Social Insurance, respectively.

<sup>16</sup>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.

February of 2010.<sup>17</sup> 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 greater than the amounts presented in the 2009 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 the Supplemental Information section of the *2009 Financial Report*, the Social Security and Medicare Part A trust funds are projected to be exhausted in 2037 and 2017, 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 76 percent of scheduled benefits in 2037, the year of trust fund exhaustion, and decreasing to 74 percent of scheduled benefits in 2083. Similarly, for Medicare Part A, projected future revenues would be sufficient to pay 81 percent of scheduled benefits in 2017, the year of trust fund exhaustion, and decreasing to 29 percent of scheduled benefits in 2083.

Management's Discussion and Analysis, Supplemental Information, and other information included in the accompanying *2009 Financial Report* contain 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.

#### MATERIAL WEAKNESSES RESULTED IN INEFFECTIVE INTERNAL CONTROL OVER FINANCIAL REPORTING

The material weaknesses discussed in this report resulted in ineffective internal control over financial reporting. Consequently, the federal government's internal control did not provide reasonable assurance that misstatements, losses, or noncompliance material in relation to the consolidated financial statements would be prevented or detected and

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<sup>17</sup>The Medicare, Medicaid, and SCHIP Extension Act of 2007, Pub. L. No. 110-173, § 101(a)(1)(B), overrode the scheduled reductions for the first six months of calendar year 2008; the Medicare Improvements for Patients and Providers Act of 2008, Pub. L. No. 110-275, § 131(a)(1), overrode the scheduled reductions for the last six months of calendar year 2008 and all of 2009; and Pub. L. No. 111-118, div. B, § 1011(a), overrode the scheduled reductions for January and February of 2010, but left unchanged the scheduled reductions for the remainder of 2010 and subsequent years.

corrected on a timely basis. The federal government is responsible for establishing and maintaining effective internal control over financial reporting and evaluating its effectiveness. Internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, the objectives of which are to provide reasonable assurance that (1) transactions are properly recorded, processed, and summarized to permit the preparation of the financial statements in conformity with GAAP, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition and (2) transactions are executed in accordance with laws governing the use of budget authority and with other laws and regulations that could have a direct and material effect on the financial statements.

In planning and performing our audit, we considered internal control over financial reporting. We did not consider all internal controls relevant to operating objectives as broadly established under FMFIA, such as those controls relevant to preparing statistical reports and ensuring efficient operations. We do not express an opinion on internal control over financial reporting because the purpose of our work was to determine our procedures for auditing the financial statements, not to express an opinion on internal control. Based on the scope of our work and the effects of the other limitations on the scope of our audit noted throughout this report, our internal control work would not necessarily identify all deficiencies in internal control including those that might be material weaknesses or significant deficiencies.

In addition to the material weaknesses that contributed to our disclaimer of opinion on the accrual-based consolidated financial statements, which were discussed above, we found the following three other material weaknesses in internal control. These material weaknesses are discussed in more detail in appendix III, including the primary effects of the material weaknesses on the accompanying accrual-based consolidated financial statements and on the management of federal government operations. These other material weaknesses were the federal government's inability to

- determine the full extent to which improper payments occur and reasonably assure that appropriate actions are taken to reduce improper payments,
- identify and resolve information security control deficiencies and manage information security risks on an ongoing basis, and
- effectively manage its tax collection activities.

We also found the following three significant deficiencies in internal control, which are discussed in more detail in appendix IV. These significant deficiencies involve the following areas:

- implementing effective internal controls at certain agencies for loans receivable, mortgage-backed securities, and loan guarantee liabilities, which for the most part, involve credit subsidy estimation and related financial reporting processes;

- verification procedures for data input for the TARP equity investment and direct loan valuations; and
- preparing the Statement of Social Insurance for certain programs.

Individual federal entity financial statement audit reports identify additional control deficiencies that were reported by the entity's auditors as either material weaknesses or significant deficiencies at the individual entity level. We do not consider these additional deficiencies to represent material weaknesses or significant deficiencies at the governmentwide level.

### COMPLIANCE WITH LAWS AND REGULATIONS

Our work to test compliance with selected provisions of laws and regulations that have a direct and material effect on the financial statements was limited by the material weaknesses and other scope limitations discussed in this report. U.S. generally accepted government auditing standards and OMB guidance require auditors to report on entities' compliance with selected provisions of laws and regulations. Certain individual entity audit reports contain instances of noncompliance. None of these instances were deemed to be reportable noncompliance with regard to the accompanying consolidated financial statements.

We caution that other noncompliance may have occurred and not been detected. Further, the results of our limited procedures may not be sufficient for other purposes. Our objective was not to, and we do not, express an opinion on compliance with laws and regulations.

### CFO ACT AGENCY FINANCIAL MANAGEMENT SYSTEMS

The federal government's ability to efficiently and effectively manage and oversee its day-to-day operations and programs relies heavily on the ability of entity financial management systems<sup>18</sup> to produce complete, reliable, timely, and consistent financial information for use by executive branch agencies and the Congress. FFMIA was designed to lead to system improvements that would result in CFO Act agency managers routinely having access to reliable, useful, and timely financial-related information to measure performance and increase accountability throughout the year. FFMIA requires auditors, as part of the 24 CFO Act agencies' financial statement audits, to report whether those agencies' financial management systems substantially comply with (1) federal financial management systems requirements, (2) applicable federal accounting standards, and (3) the federal government's Standard General Ledger (SGL) at the transaction level. For fiscal years 2009 and 2008, auditors for 10 and 14 of the 24 CFO Act agencies, respectively, reported that the agencies' financial management systems did not

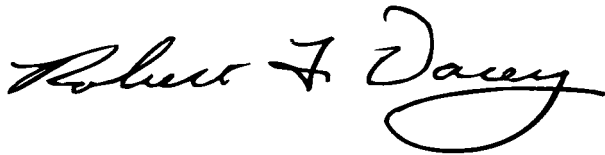
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<sup>18</sup>The term financial management systems includes the financial systems and the financial portions of mixed systems necessary to support financial management, including automated and manual processes, procedures, controls, data, hardware, software, and support personnel dedicated to the operation and maintenance of system functions.

substantially comply with one or more of the three FFMIA requirements. Agency heads for the 24 CFO Act agencies also annually report on FFMIA compliance. A fewer number of agency heads (7 in 2009 and 9 in 2008) reported that their agencies' systems were not in substantial compliance with one or more of the three FFMIA requirements. Long-standing financial management systems weaknesses at several large CFO Act agencies along with the size and complexity of the federal government continue to present a formidable management challenge in providing accountability to the nation's taxpayers and have contributed significantly to our inability to determine the reliability of the accrual-based consolidated financial statements.

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We provided a draft of this report to Treasury and OMB officials, who provided technical comments, which have been incorporated as appropriate. Treasury and OMB officials expressed their continuing commitment to address the problems this report outlines.

A handwritten signature in black ink that reads "Robert F. Dacey". The signature is written in a cursive style with a large, looping "y" at the end.

Robert F. Dacey  
Chief Accountant  
U. S. Government Accountability Office

February 19, 2010

## 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<sup>19</sup> 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<sup>20</sup> requires most other executive branch entities to prepare and have audited annual financial statements. The Office of Management and Budget (OMB) and the Department of the Treasury (Treasury) have identified 35 entities<sup>21</sup> that are significant to the U.S. government's consolidated financial statements including many federal executive branch agencies and some government corporations. Our work was performed in coordination and cooperation with the inspectors general and independent public accountants for these 35 entities to achieve our respective audit objectives. Our audit approach regarding the accrual-based consolidated financial statements focused primarily on determining the current status of the material weaknesses that contributed to our disclaimer of opinion on the accrual-based consolidated financial statements and the other material weaknesses affecting internal control that we had reported in our report on the consolidated financial statements for fiscal year 2008.<sup>22</sup> Our work included separately auditing the financial statements of the following significant federal entities and federal agency components:

- We audited and expressed an unqualified opinion on the Internal Revenue Service's (IRS) fiscal years 2009 and 2008 financial statements.<sup>23</sup> In fiscal years 2009 and 2008, IRS collected about \$2.3 trillion and \$2.7 trillion, respectively, in tax payments and paid about \$438 billion and \$426 billion, respectively, in refunds to taxpayers.<sup>24</sup> For fiscal year 2009, we continued to report material weaknesses that resulted in ineffective internal control over financial reporting. Our tests of IRS's compliance in fiscal year 2009 with selected provisions of laws and regulations disclosed one area of noncompliance. We also found that IRS's financial management systems did not

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<sup>19</sup>31 U.S.C. 901(b), 3521(e). The 1994 act authorized the Office of Management and Budget to designate agency components that also would receive a financial statement audit. See 31 U.S.C. 3515(c) as amended.

<sup>20</sup>Pub. L. No. 107-289, 116 Stat. 2049 (Nov. 7, 2002); see 31 U.S.C. 3515.

<sup>21</sup>See *Treasury Financial Manual*, volume I, part 2, chapter 4700, for a listing of the 35 entities.

<sup>22</sup>For our report on the U.S. government's consolidated financial statements for fiscal year 2008, see U.S. Department of the Treasury, *Fiscal Year 2008 Financial Report of the United States Government* (Washington, D.C.: December 2008), pp. 165-188, which can be found on GAO's Web site at [www.gao.gov](http://www.gao.gov).

<sup>23</sup>GAO, *Financial Audit: IRS's Fiscal Years 2009 and 2008 Financial Statements*, GAO-10-176 (Washington, D.C.: Nov. 10, 2009).

<sup>24</sup>The Economic Stimulus Act of 2008, Pub. L. No. 110-185, §101, 122 Stat. 613, 613-17 (Feb.13, 2008) (*codified at* 26 U.S.C. § 6428), included provisions to help stimulate the economy through recovery rebates. In fiscal year 2008, the IRS disbursed about \$94 billion of recovery rebates to eligible taxpayers. In fiscal year 2009, the American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 115 (Feb. 17, 2009), increased the benefits for several existing refundable credits including the Earned Income Tax Credit (EITC) and the Child Tax Credit as well as authorized several new refundable tax credits.



substantially comply with the requirements of the Federal Financial Management Improvement Act of 1996.

- 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, 2009 and 2008.<sup>25</sup> For these 2 fiscal years, the schedules reported (1) approximately \$7.6 trillion (2009) and \$5.8 trillion (2008) of federal debt held by the public;<sup>26</sup> (2) about \$4.3 trillion (2009) and \$4.2 trillion (2008) of intragovernmental debt holdings;<sup>27</sup> and (3) about \$189 billion (2009) and \$242 billion (2008) of interest on federal debt held by the public. We reported that as of September 30, 2009, BPD had effective internal control over financial reporting relevant to the Schedule of Federal Debt. Further, we reported that there was no reportable BPD noncompliance in fiscal year 2009 with a significant provision of law related to the Schedule of Federal Debt (statutory debt limit) we tested.
- We audited and expressed unqualified opinions on the fiscal years 2009 and 2008 financial statements of the United States Securities and Exchange Commission (SEC).<sup>28</sup> However, we reported that as of September 30, 2009, SEC did not have effective internal control over financial reporting. We identified six significant deficiencies that collectively represented a material weakness in SEC's internal control over financial reporting. In addition, we reported that there was no reportable noncompliance in fiscal year 2009 with the selected provisions of laws and regulations we tested.
- We audited and expressed an unqualified opinion on the fiscal year 2009 financial statements of the Federal Housing Finance Agency (FHFA).<sup>29</sup> We reported that FHFA had effective internal control over financial reporting, and we found no reportable noncompliance in fiscal year 2009 with the selected provisions of laws and regulations we tested.

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<sup>25</sup>GAO, *Financial Audit: Bureau of the Public Debt's Fiscal Years 2009 and 2008 Schedules of Federal Debt*, GAO-10-88 (Washington, D.C.: Nov. 10, 2009).

<sup>26</sup>The public holding federal debt is comprised of individuals, corporations, state and local governments, the Federal Reserve Banks, and foreign governments and central banks.

<sup>27</sup>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.

<sup>28</sup>GAO, *Financial Audit: Securities and Exchange Commission's Financial Statements for Fiscal Years 2009 and 2008*, GAO-10-250 (Washington, D.C.: Nov. 16, 2009).

<sup>29</sup>GAO, *Financial Audit: Federal Housing Finance Agency's Fiscal Year 2009 Financial Statements*, GAO-10-218 (Washington, D.C.: Nov. 16, 2009). FHFA was established by the Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, 122 Stat. 2654 (July 30, 2008), as an independent agency empowered with supervisory and regulatory oversight of the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), and the 12 federal home loan banks. While FHFA was in existence prior to the start of fiscal year 2009, this was its first full year of operations and the first year for which it prepared financial statements. Consequently, FHFA's financial statements do not present comparative information for the prior year.

- We audited and expressed an unqualified opinion on the fiscal year 2009 financial statements of the Office of Financial Stability (OFS) for the Troubled Asset Relief Program (TARP).<sup>30</sup> We reported that although internal controls could be improved, OFS had effective internal control over financial reporting as of September 30, 2009. We also reported that we found no reportable noncompliance for the period ended September 30, 2009, with the selected provisions of laws and regulations we tested.
- We audited and expressed unqualified opinions on the December 31, 2008 and 2007, financial statements of two funds administered by the Federal Deposit Insurance Corporation (FDIC), including the Deposit Insurance Fund (DIF) and the Federal Savings and Loan Insurance Corporation (FSLIC) Resolution Fund.<sup>31</sup> We reported that as of December 31, 2008, FDIC had effective internal control over financial reporting, and we found no reportable noncompliance for calendar year 2008 with the selected provisions of laws and regulations we tested.

In addition, we considered the CFO Act agencies' and certain other federal entities' fiscal years 2009 and 2008 financial statements and the related auditors' reports prepared by the inspectors general or contracted independent public accountants. Financial statements and audit reports for these entities provide information about the operations of each of these entities. The entity audit reports also contain details regarding any audit findings and related recommendations for the respective entity. We did not audit, and we do not express an opinion on, any of these individual federal entity financial statements.

We considered the Department of Defense's (DOD) assertion that DOD management had prepared and submitted pursuant to the provisions of the National Defense Authorization Act for Fiscal Year 2002.<sup>32</sup> In accordance with section 1008 of this act, DOD reported that certain major deficiencies related to noncompliant systems and noncompliant 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 2009 report on internal control over financial reporting, the Inspector General cited material weaknesses in several areas including (1) property, plant, and equipment; (2) inventory and operating material and supplies; (3) environmental liabilities; (4) intragovernmental eliminations; and (5) material amounts of unsupported accounting entries needed to prepare DOD's annual consolidated financial statements.

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<sup>30</sup>GAO, *Financial Audit: Office of Financial Stability (Troubled Asset Relief Program) Fiscal Year 2009 Financial Statements*, GAO-10-301 (Washington, D.C.: Dec. 9, 2009). The Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, div. A, 122 Stat. 3765 (Oct. 3, 2008), *codified in part, as amended*, at 12 U.S.C. §§ 5201-5261, authorized the Secretary of the Treasury to implement TARP and established OFS within Treasury to do so. Fiscal year 2009 was the first year that OFS prepared and issued audited financial statements for TARP.

<sup>31</sup>GAO, *Financial Audit: Federal Deposit Insurance Corporation Funds' 2008 and 2007 Financial Statements*, GAO-09-535 (Washington, D.C.: May 28, 2009).

<sup>32</sup>Pub. L. No. 107-107, §1008, 115 Stat. 1012, 1204 (Dec. 28, 2001).

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 entity preparing a Statement of Social Insurance,<sup>33</sup> we considered the entity's fiscal year 2009, 2008, and 2007 financial statements and the related auditor's reports prepared by the inspectors general or contracted independent public accountants. We believe our audit, including internal control and substantive audit procedures, reperformance procedures, and review of the other auditors' Statement of Social Insurance-related audit work, provides a reasonable basis for our opinions on the 2009, 2008, and 2007 Statements of Social Insurance.

We performed sufficient audit work to provide this report on the consolidated financial statements, internal control, and compliance with selected provisions of laws and regulations. We considered the limitations on the scope of our work regarding the accrual-based consolidated financial statements in forming our conclusions. Our work was performed in accordance with U.S. generally accepted government auditing standards.

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<sup>33</sup>These entities consist of SSA, HHS, the Railroad Retirement Board, and the Department of Labor.

## APPENDIX II

### Material Weaknesses Contributing to Our Disclaimer of Opinion on the Accrual-based Consolidated Financial Statements

The continuing material weaknesses discussed below contributed to our disclaimer of opinion on the federal government's accrual-based consolidated financial statements. The federal government did not maintain adequate systems or have sufficient, reliable evidence to support information reported in the accompanying accrual-based consolidated financial statements, as described below.

#### Property, Plant, and Equipment and Inventories and Related Property

The federal government could not satisfactorily determine that property, plant, and equipment (PP&E) and inventories and related property were properly reported in the accrual-based consolidated financial statements. Most of the PP&E and inventories and related property are the responsibility of the Department of Defense (DOD). As in past years, DOD did not maintain adequate systems or have sufficient records to provide reliable information on these assets. Other entities, most notably the National Aeronautics and Space Administration, reported continued deficiencies in internal control procedures and processes related to PP&E.

Deficiencies in internal control over such assets could affect the federal government's ability to fully know the assets it owns, including their location and condition, and its ability to effectively (1) safeguard assets from physical deterioration, theft, or loss; (2) account for acquisitions and disposals of such assets and reliably report asset balances; (3) ensure that the assets are available for use when needed; (4) prevent unnecessary storage and maintenance costs or purchase of assets already on hand; and (5) determine the full costs of programs that use these assets.

#### Liabilities and Commitments and Contingencies

The federal government could not reasonably estimate or adequately support amounts reported for certain liabilities. For example, DOD was not able to estimate with assurance key components of its environmental and disposal liabilities. In addition, DOD could not support a significant amount of its estimated military postretirement health benefits liabilities included in federal employee and veteran benefits payable. These unsupported amounts related to the cost of direct health care provided by DOD-managed military treatment facilities. Further, the federal government could not determine whether commitments and contingencies, including any related to treaties and other international agreements entered into to further the federal government's interests, were complete and properly reported.

Problems in accounting for liabilities affect the determination of the full cost of the federal government's current operations and the extent of its liabilities. Also, deficiencies in internal control supporting the process for estimating environmental and disposal liabilities could result in improperly stated liabilities as well as adversely affect the federal government's ability to determine priorities for cleanup and disposal activities and to appropriately consider future budgetary resources needed to carry out these activities. In addition, 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 entities 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 those related to DOD.

With respect to disbursements, DOD and certain other federal entities reported continued material weaknesses and significant deficiencies in reconciling disbursement activity. For fiscal years 2009 and 2008, there was unreconciled disbursement activity, including unreconciled differences between federal entities' and the Department of Treasury's (Treasury) records of disbursements and unsupported federal entity adjustments, totaling billions of dollars, which could also affect the balance sheet.

Unreliable cost information affects the federal government's ability to control and reduce costs, assess performance, evaluate programs, and set fees to recover costs where required or authorized. If disbursements are improperly recorded, this could result in misstatements in the financial statements and in certain data provided by federal entities for inclusion in *The Budget of the United States Government* (President's Budget) concerning obligations and outlays.

#### Accounting for and Reconciliation of Intragovernmental Activity and Balances

Federal entities are unable to adequately account for and reconcile intragovernmental activity and balances. The Office of Management and Budget (OMB) and Treasury require the chief financial officers (CFO) of 35 federal entities to reconcile, on a quarterly basis, selected intragovernmental activity and balances with their trading partners. In addition, these entities are required to report to Treasury, the entity's inspector general, and GAO on the extent and results of intragovernmental activity and balance-reconciliation efforts as of the end of the fiscal year.

A substantial number of the entities did not adequately perform the required reconciliations for fiscal years 2009 and 2008. For these fiscal years, based on trading partner information provided to Treasury in entities' closing packages, Treasury produced a "Material Difference Report" for each entity showing amounts for certain

intragovernmental activity and balances that significantly differed from those of the entity's corresponding trading partners as of the end of the fiscal year. Based on our analysis of the "Material Difference Reports" for fiscal year 2009, 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 2009 and 2008, amounts reported by federal entity 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 as to when the differences would be resolved. As a result of these circumstances, the federal government's ability to determine the impact of these differences on the amounts reported in the accrual-based consolidated financial statements is significantly impaired.

Treasury continues to take steps to help resolve material differences in intragovernmental activity and balances. For example, beginning in the third quarter of 2009, Treasury required entities to perform additional reconciliations related to certain intragovernmental appropriations and transfer activity. Resolving the intragovernmental transactions problem remains a difficult challenge and will require a strong commitment by federal entities to fully implement guidance regarding business rules for intragovernmental transactions issued by OMB and Treasury as well as continued strong leadership by OMB and Treasury.<sup>34</sup>

#### Preparation of Consolidated Financial Statements

While further progress was demonstrated in fiscal year 2009, the federal government continued to have inadequate systems, controls, and procedures to ensure that the consolidated financial statements are consistent with the underlying audited entity financial statements, properly balanced, and in conformity with U.S. generally accepted accounting principles (GAAP). During our fiscal year 2009 audit, we found the following:<sup>35</sup>

- Treasury's process for compiling the consolidated financial statements demonstrated that amounts in the Statement of Social Insurance were consistent with the underlying

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<sup>34</sup>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.

<sup>35</sup>Most of the issues we identified in fiscal year 2009 existed in fiscal year 2008, and many have existed for a number of years. In April 2009, we reported the issues we identified to Treasury and OMB and provided recommendations for corrective action in GAO, *Financial Audit: Material Weaknesses in Internal Control Continue to Impact Preparation of the Consolidated Financial Statements on the U.S. Government*, GAO-09-387 (Washington, D.C.: Apr. 21, 2009). We also reported that as of December 9, 2008, the date of our report on our audit of the fiscal year 2008 consolidated financial statements, 16 of the 56 open recommendations from the previous years' audits had been closed.

federal entities' audited financial statements and that the Balance Sheet and the Statement of Net Cost were also consistent with federal entities' financial statements prior to eliminating intragovernmental activity and balances. However, Treasury's process did not ensure that the information in the remaining three principal financial statements was fully consistent with the underlying information in federal entities' audited financial statements and other financial data.

- For fiscal year 2009, auditors for many of the CFO Act agencies continued to report control deficiencies regarding entities' financial reporting processes which, in turn, could affect the preparation of the consolidated financial statements. For example, auditors for several entities reported that a significant number of adjustments were required to prepare the entities' financial statements. These and other auditors are also required to separately audit financial information sent by the federal entities to Treasury through a closing package. In connection with preparing the consolidated financial statements, several auditors reported significant deficiencies regarding the preparation of the closing package. Further, Treasury had to record material adjustments to correct errors found in federal entities' audited closing package information.
- To make the fiscal years 2009 and 2008 consolidated financial statements balance, Treasury recorded net increases of \$17.4 billion and \$29.8 billion, respectively, to net operating cost on the Statement of Operations and Changes in Net Position, which it labeled "Unmatched transactions and balances."<sup>36</sup> An additional net \$8 billion and \$11 billion of unmatched transactions were recorded in the Statement of Net Cost for fiscal years 2009 and 2008, 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 2009 showed a net operating cost of \$1,253.7 billion, to the budget results, which for the same period showed a unified budget deficit of \$1,417.1 billion.
- The federal government continues to be unable to determine the impact of unreconciled intragovernmental activity and balances on the accrual-based consolidated financial statements. Treasury's elimination of certain intragovernmental activity and balances continues to be impaired by the federal entities' problems in handling their intragovernmental transactions. As a result, Treasury recorded the net differences in intragovernmental elimination entries as "Unmatched transactions and balances," in order to force the Statements of Operations and Changes in Net Position into balance. As previously discussed, amounts reported for federal entity trading partners for certain intragovernmental accounts were not in agreement by significant amounts. In addition, there are hundreds of billions of dollars of unreconciled differences between the General Fund of the U.S. Government and federal entity

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<sup>36</sup>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.

trading partners related to appropriation and other intragovernmental transactions. The ability to reconcile such transactions is hampered because only some of the General Fund of the U.S. Government is reported in the Department of the Treasury's financial statements.

- Over the past several years, significant actions have been taken to assist in ensuring that financial information is reported or disclosed in the consolidated financial statements in conformity with GAAP. However, Treasury's reporting of certain financial information required by GAAP continues to be impaired. Due to certain material weaknesses noted in this report—for example, commitments and contingencies related to treaties and other international agreements—Treasury is precluded from determining if additional disclosure is required by GAAP in the consolidated financial statements, and we are precluded from determining whether the omitted information is material. Further, Treasury's ability to report information in accordance with GAAP will also remain impaired until federal entities, such as DOD, can provide Treasury with complete and reliable information required to be reported in the consolidated financial statements.
- The consolidated financial statements include financial information for the executive, legislative, and judicial branches, to the extent that federal entities within those branches have provided Treasury such information. However, as we have reported in past years, there continue to be undetermined amounts of assets, liabilities, costs, and revenues that are not included, and the federal government did not provide evidence that the excluded financial information was immaterial.
- Other internal control deficiencies existed in Treasury's process for preparing the consolidated financial statements, involving inadequate or ineffective (1) policies and procedures related to certain areas; (2) reviews of the financial statements and supporting documentation provided to GAO; and (3) processes for monitoring the preparation of the consolidated financial statements.
- As in previous years, Treasury did not have adequate systems and personnel to address the magnitude of the fiscal year 2009 financial reporting challenges it faced, such as control deficiencies in Treasury's process for preparing the consolidated financial statements noted above. The extension of the date of the issuance of the fiscal year 2009 *Financial Report* from mid December 2009 to mid February 2010 generally alleviated excessive workloads that personnel at Treasury's Financial Management Service have historically experienced in meeting the December 15th reporting deadline.<sup>37</sup> However, the need for additional personnel with specialized financial reporting experience to help ensure reliable financial reporting continues to exist. In addition, the federal government does not perform interim compilations at

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<sup>37</sup>In light of concurrent financial management and audit activities affected by the implementation of emergency economic stabilization and economic recovery programs, OMB issued Memorandum M-10-04, *Fiscal Year 2009 Audited Financial Statement Reporting Deadline* on October 13, 2009. This memorandum allowed federal entities to request an extension on the issuance of their fiscal year 2009 audited financial statements and certain entities requested and were granted extensions. As a result, the preparation of the consolidated financial statements was also extended.



the governmentwide level. Under the typical reporting deadline, this has led to almost all of the compilation effort being performed during a condensed time period at the end of the year.

During fiscal year 2009, Treasury, in coordination with OMB, continued implementing corrective action plans and made progress in addressing certain internal control deficiencies we have previously reported. Until the internal control deficiencies have been fully addressed, the federal government's ability to ensure that the consolidated financial statements are consistent with the underlying audited federal entities' financial statements, properly balanced, and in conformity with U.S. GAAP will be impaired. Resolving some of these internal control deficiencies will be a difficult challenge and will require a strong commitment from Treasury and OMB as they continue to execute and implement their corrective action plans.

### Components of the Budget Deficit

Both the Reconciliation of Net Operating Cost and Unified Budget Deficit and the Statement of Changes in Cash Balance from Unified Budget and Other Activities report a unified budget deficit for fiscal years 2009 and 2008 of \$1,417.1 billion and \$454.8 billion, respectively.<sup>38</sup> 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 entities' Statements of Budgetary Resources (SBR) and Treasury's central accounting records used to compute the budget deficit<sup>39</sup> reported in the consolidated financial statements. Unreconciled net outlays of \$28 billion and \$31 billion existed for fiscal years 2009 and 2008, respectively. OMB and Treasury continue to work towards establishing effective processes and procedures for identifying, resolving, and explaining material differences in this and other components of the deficit between Treasury's central accounting records and information reported in entity financial statements and underlying entity financial information and records. Both entities have recognized the importance of establishing such processes and procedures and that it will take a coordinated effort between them. Until these types of differences are timely reconciled by the federal government, their effect on the U.S. government's consolidated financial statements will continue to be unknown.

In fiscal year 2009, we again noted that several entities' auditors reported internal control deficiencies (1) affecting the entities' SBRs, and (2) related to monitoring, accounting, and reporting of budgetary transactions. These control deficiencies could affect the reporting and calculation of the net outlay amounts in the entities' SBRs. In addition,

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<sup>38</sup>The budget deficit, receipts, and outlays amounts are reported in Treasury's *Monthly Treasury Statement* and the President's Budget.

<sup>39</sup>See GAO, *Financial Audit: Material Weaknesses in Internal Control Continue to Impact Preparation of the Consolidated Financial Statements on the U.S. Government*, GAO-09-387 (Washington, D.C.: Apr. 21, 2009). 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).

such deficiencies may also affect the entities' ability to report reliable budgetary information to Treasury and OMB and may affect the unified budget deficit reported in the accrual-based consolidated financial statements. The unified budget deficit is also reported by Treasury in its *Combined Statement of Receipts, Outlays, and Balances*,<sup>40</sup> and in other federal government publications.

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<sup>40</sup>Treasury's *Combined Statement of Receipts, Outlays, and Balances* presents budget results and cash related assets and liabilities of the federal government with supporting details. Treasury represents this report as the recognized official publication of receipts and outlays of the federal government based on entity reporting.

## APPENDIX III

### Other Material Weaknesses

Material weaknesses in internal control discussed in this report resulted in ineffective controls over financial reporting. In addition to the material weaknesses discussed in appendix II that contributed to our disclaimer of opinion on the accrual-based consolidated financial statements, we found the following three other material weaknesses in internal control.

### Improper Payments

The federal government continues to make progress under the requirements of the Improper Payments Information Act of 2002 (IPIA)<sup>41</sup> in identifying and reporting on the nature and extent of improper payments,<sup>42</sup> including increasing the number of programs that reported estimates of improper payments. Federal entities reported estimates of improper payment amounts that totaled \$98.7 billion for fiscal year 2009, which represented about 5 percent of \$1.9 trillion of reported outlays for the related programs. The \$98.7 billion estimate is a significant increase of \$26.2 billion from the prior year estimate of \$72.5 billion.<sup>43</sup> Entities reported that the improper payment increases were mostly attributable to changes in estimation methodologies or increased program outlays for four major programs: (1) Department of Health and Human Services' (HHS) Medicare Fee-For-Service program, (2) HHS' Medicare Advantage program, (3) Department of Labor's Unemployment Insurance program, and (4) Department of Transportation's Federal Aid Highway program. In addition, the Department of Homeland Security reported improper payment estimates totaling about \$641 million in fiscal year 2009 for 5 programs that did not report in fiscal year 2008.

While progress has been made, the federal government still faces challenges in determining the full extent to which improper payments occur and to reasonably assure that appropriate actions are taken to reduce improper payments. For example, four federal entities did not report estimated improper payment amounts for fiscal year 2009 for 11 risk-susceptible programs that had total outlays of at least \$89 billion. Of these 11 programs, 5 programs had reported improper payment estimated amounts in fiscal year

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<sup>41</sup>Pub. L. No. 107-300, 116 Stat. 2350 (Nov. 26, 2002). The IPIA requires federal executive branch entities 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 reduce improper payments.

<sup>42</sup>IPIA defines an improper payment as any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements. It includes any payment to an ineligible recipient, any payment for an ineligible service, any duplicate payment, payments for services not received, and any payment that does not account for credit for applicable discounts.

<sup>43</sup>In their fiscal year 2009 Performance and Accountability Reports (PAR) and Annual Financial Reports (AFR), select federal entities updated their fiscal year 2008 improper payment estimates to reflect changes since issuance of their fiscal year 2008 PARs and AFRs. These updates increased the governmentwide improper payment estimate for fiscal year 2008 from \$72.1 billion to \$72.5 billion.

2008. Some entities cited insufficient documentation, incorrect computations, and changes in eligibility requirements as causes of improper payments. Entity auditors also reported a variety of control deficiencies and challenges, such as financial systems limitations and contract monitoring issues, that could allow improper payments to occur. Corrective actions needed to reduce improper payments will be unique across specific entities and programs. Furthermore, until the federal government has implemented effective processes to determine the full extent to which improper payments occur and reasonably assure that appropriate actions are taken across entities and programs to effectively reduce improper payments, the federal government will not have reasonable assurance that the use of taxpayer funds is adequately safeguarded.

On November 20, 2009, the President issued Executive Order 13520, *Reducing Improper Payments*, which further heightened awareness of the need to reduce improper payments and eliminate waste, fraud, and abuse in federal programs. The order focuses on transparency, holding entities accountable, and creating incentives to reduce improper payments. We view this as a positive step toward improving transparency over and reducing improper payments, however, it is too soon to determine whether the activities called for in the executive order will achieve its goal of reducing improper payments while continuing to ensure that federal programs serve and provide access to intended beneficiaries.

### Information Security

Although progress has been made, serious and widespread information security control deficiencies 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. We have reported information security as a high-risk area across government since February 1997. During fiscal year 2009, federal entities had reported control deficiencies related to preventing, limiting, or detecting unauthorized access to computing resources. Specifically, control deficiencies were identified related to (1) security management; (2) access to computer resources (data, equipment, and facilities) being reasonable and restricted to authorized individuals; (3) changes to information system resources being authorized and systems being configured and operating as intended; (4) segregation of incompatible duties; and (5) contingency planning for protecting information resources, minimizing the risk of unplanned interruptions, and providing for recovery of critical operations.

Such information security control deficiencies unnecessarily increase the risk that the reliability and availability of data that are recorded in or transmitted by federal financial management systems could be compromised. A primary reason for these deficiencies is that federal entities generally have not yet fully institutionalized comprehensive security management programs, which are critical to identifying information security control deficiencies, resolving information security problems, and managing information security risks on an ongoing basis. The administration has taken important actions to improve information security, such as issuing extensive guidance on information security and

requiring entities to perform specific actions to protect certain personally identifiable information. However, until entities identify and resolve information security control deficiencies and manage information security risks on an on-going basis, federal data and systems, including financial information, will remain at risk.

#### Tax Collection Activities

During fiscal year 2009, material weaknesses and systems deficiencies continued to affect the federal government's ability to effectively manage its tax collection activities. Due to errors and delays in recording taxpayer information, payments, and other activities, taxpayers were not always credited for payments made on their taxes owed, which could result in undue taxpayer burden by causing frustration to taxpayers who either have already paid taxes owed or who owe significantly lower amounts. In addition, these deficiencies indicate that internal controls over the financial reporting process were not effective to (1) ensure that reported amounts of taxes receivable and tax assessments were accurate on an ongoing basis and could be relied upon by management as a tool to aid in making and supporting resource allocation decisions and (2) support timely and reliable financial statements, accompanying notes, and required supplemental and other accompanying information without extensive supplemental procedures and adjustments.

## APPENDIX IV

### Significant Deficiencies

In addition to the material weaknesses discussed in appendices II and III, we found three significant deficiencies in internal control as described below.

#### Loans Receivable, Mortgage-Backed Securities, and Loan Guarantee Liabilities

Internal control deficiencies were identified at federal agencies accounting for the majority of the reported balances for loans receivable, mortgage-backed securities, and loan guarantee liabilities. The deficiencies, for the most part, involved credit subsidy estimation and related financial reporting processes. The issues and the complexities associated with estimating the costs of lending and other loan-related financing activities significantly increase the risk that misstatements in agency and governmentwide financial statements could occur and go undetected. Further, these control deficiencies can adversely affect the federal government's ability to support annual budget requests for these programs, make future budgetary decisions, manage program costs, and measure the performance of lending activities.

#### Verification Procedures for Data Input for the Troubled Asset Relief Program (TARP) Equity Investment and Direct Loan Valuations

There were deficiencies in verification procedures for certain assumptions and related data that were input into the economic and financial credit subsidy models used for the valuation of TARP direct loans, equity investments, and asset guarantees. Effective verification of data inputs used in the subsidy models is key to providing reasonable assurance that the asset valuations and related subsidy cost are reliably reported in the financial statements.

#### Preparation of the Statement of Social Insurance

Deficiencies were identified in certain controls over spreadsheets used by the Department of Health and Human Services (HHS) to prepare its Statement of Social Insurance, including the lack of robust controls over spreadsheet changes and inputs that may result in output that varies from management's intentions. HHS, which administers the Medicare programs, contributes the majority of the amounts reported on the consolidated Statement of Social Insurance. Such control deficiencies could result in misstatements to the consolidated Statement of Social Insurance.

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