2003

Financial Report of the United States Government

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A MESSAGE FROM THE SECRETARY OF THE TREASURY

I am pleased to present the fiscal year 2003 *Financial Report of the United States Government*, which presents and discusses the Government's financial operations for the year. The report includes consolidated financial statements and important disclosures about the government's stewardship responsibilities. Since the first report pursuant to the Government Management Reform Act of 1994 was issued for fiscal year 1997, we have made great strides in improving the usefulness of this important report.

For fiscal 2003, the U.S. Government is reporting a net operating cost of $665 billion, an increase of $300 billion from the $365 billion net operating cost reported last year. The increase is primarily attributable to the increased cost of the global war on terrorism, increases in the government's post-retirement liabilities and a decline in tax revenues caused by the sluggish economy. The report reflects the adoption of a new accounting standard this year which requires the recording as an asset of military equipment and its related depreciation resulting in an increase to assets of $383 billion.

Twenty seven major departments and agencies received unqualified audit opinions on their FY 2003 financial statements and eight Departments issued their audited financial statements by mid-November, a significant increase from last year. When this accelerated reporting time frame is accomplished by all agencies, it will set the stage for the timely preparation of this report. I look forward to when we can issue the Financial Report in December so that it is available to support the budget deliberation process.

While much has been accomplished, much more remains to be done. Our efforts are well underway to eliminate the significant weaknesses cited by the auditors concerning the report's data and processes. It will require a concerted effort across government to resolve these matters and, working with OMB and through the President's Management Council and the Chief Financial Officer's Council, Treasury believes we will succeed.

The government's finances are important and complex, and our reporting will not be truly effective until it provides reliable information in a timely and useful form. Treasury is committed to meeting that challenge and to producing and reporting financial information that meets the highest standards expected by the American public.

John W. Snow

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MANAGEMENT'S DISCUSSION AND ANALYSIS

Introduction

The quality and timeliness of financial reporting in the Federal Government has come a long way since the first Governmentwide report subject to audit issued in March 1998 for fiscal year 1997. At that time, only 8 of the 24 Chief Financial Officers Act (CFO Act) agencies received clean opinions on their 1997 financial statements. This year, 20 of the 24 agencies received clean opinions and 21 of the 32 entities, most significant to these statements, had audited financial statements issued by the end of the calendar year. This improvement in both quality and timeliness was concurrent with the application of new accounting principles and new accounting systems, and involved performing reconciliations that had never been attempted before. This has been a monumental effort requiring years of planning and preparation and the efforts of thousands. However, we still have much to accomplish before we meet our objective of timely, useful financial reporting.

The accompanying *2003 Financial Report of the United States Government* is required by 31 U.S.C. § 331(e)(1) to be submitted to Congress by March 31, and consists of Management's Discussion and Analysis (MD&A), Statements of Net Cost, Statements of Operations and Changes in Net Position, Reconciliations of Net Operating Cost and Unified Budget Deficit, Statements of Changes in Cash Balance from Unified Budget and Other Activities, Balance Sheets, Stewardship Information (Unaudited), Notes to the Financial Statements, and Supplemental Information (Unaudited). Each section is preceded by a description of its contents.

Executive Summary

Purpose

This *Financial Report of the United States Government* is prepared to give the President, Congress, and the American people information about the financial position of the Federal Government. This report provides, on an accrual basis of accounting, a broad, comprehensive view of the Federal Government's finances that is not available elsewhere. It states the Government's financial position and condition, its revenues and costs, assets and liabilities, and other obligations and commitments. It also discusses important financial issues and significant conditions that may affect future operations.

Operating Results

Revenues were down by $81.7 billion primarily due to lower tax collections and costs were up by $225.8 billion due to, among other things, fighting the global war on terrorism. This resulted in a net operating cost of $665.0 billion. This compares with the net operating cost of $364.9 billion for fiscal year 2002. This MD&A discusses results in a historical context and includes a chart (page 17) that shows the relationship of prior U.S. budget deficits as a percentage of the U.S. gross domestic product (GDP), which is the total value of goods and services produced in the United States.

Economic Results

After recovering in fiscal year 2002 from the economic downturn, the economy continued to accelerate in fiscal year 2003 and achieved strong growth. The rate of increase in real GDP picked up in each of the last three quarters of the fiscal year and productivity continued to record substantial gains. The labor market stabilized in fiscal year 2003 following job losses in the previous year and in the final quarter of the fiscal year, employment began to increase. Improvement in the economy was aided by new fiscal policies in 2003, but the lingering effect of the recession and loss in equity wealth, the war with Iraq, homeland security spending, and lower taxes enacted to stimulate growth contributed to a widening in the Federal budget deficit to $374.8 billion for the fiscal year.

Overall Perspective

The 2003 balance sheet shows assets of $1,394 billion and liabilities of $8,499 billion, for a balance or negative net position of $7,105 billion. The Government's responsibilities to make future payments for social insurance and certain other programs are not shown as liabilities according to Federal accounting standards; however, they are measured in other contexts. These programmatic commitments remain Federal responsibilities and as currently structured will have a significant claim on budgetary resources in the future.

As summarized below, and in a more detailed table on page 12 of this section, the net present value for all of the responsibilities (over a 75-year period) is $34,825 billion, including Medicare and Social Security payments, pensions and benefits for Federal employees and veterans, and other financial responsibilities. The reader needs to understand these responsibilities to get a full understanding of the Government's finances.

Overall Perspective (In billions of dollars)	2003 Balance Sheet	2003 Additional Responsibilities	2003 Combined Amounts	2002 Balance Sheet	2002 Additional Responsibilities	2002 Combined Amounts
ASSETS	$ 1,394	$ -	$ 1,394	$ 997	$ [1] 616	$ 1,613
LIABILITIES & NET RESPONSIBILITIES						
Social Insurance	--	(26,858)	(26,858)	--	(24,149)	(24,149)
Fed. empl. & veterans pensions/benefits	(3,880)	--	(3,880)	(3,589)	--	(3,589)
Federal debt held by the public	(3,945)	--	(3,945)	(3,573)	--	(3,573)
Other liabilities & responsibilities	(674)	(862)	(1,536)	(654)	(771)	(1,425)
Total Liabilities & Net Responsibilities	$ (8,499)	$ (27,720)	$ (36,219)	$ (7,817)	$ (24,920)	$ (32,736)
BALANCE (Total Assets minus Total Liabilities & Net Responsibilities)	($7,105)	($27,720)	($34,825)	($6,820)	($24,304)	($31,123)

[1] Source: Fiscal Year 2004 Analytical Perspectives, page 37, Defense Fixed Reproducible Capital, Nonfinancial Assets.

Note: Overall details may not add to total due to rounding.

The table does not reflect the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 that was enacted on December 8, 2003. The Department of Health and Human Services (HHS) actuaries estimated that this legislation would result in direct spending outlays totaling $534 billion over the 2004-2013 period. The 75-year period net present value estimate is not yet available.

Significant Reporting Items for Fiscal Year 2003

Department of Defense Property Addition

In fiscal year 2003, the Department of Defense's (DOD) reported general property, plant, and equipment, net increased by $323.7 billion or 264.2 percent over fiscal year 2002. The majority of this increase was due to the initial recording of the value of DOD's military equipment.

Beginning with the fiscal year 2003 financial statements, DOD was required to record on the balance sheet the value of its military equipment under the new Statement of Federal Financial Accounting Standard No. 23, *Eliminating the Category National Defense Property, Plant, and Equipment* (SFFAS No. 23) issued by the Federal Accounting Standards Advisory Board (FASAB) in May 2003. SFFAS No. 23 establishes generally accepted accounting principles for valuing and reporting military equipment in Federal financial statements. Previously, military equipment was reported as national defense property, plant, and equipment in the Stewardship Information section of this report. For a detailed discussion of this increase, see the Assets section of the Asset and Liability Summary of this report.

Creation of the Department of Homeland Security

On March 1, 2003, more than 20 entities and offices and some 180,000 employees were transferred into the Department of Homeland Security (DHS). The creation of the DHS in 2003 was the most significant transformation of the Federal Government since 1947 when the various branches of the U.S. Armed Forces were merged into a new Department of Defense.

In the aftermath of the September 11, 2001, terrorist attacks, the President and the Congress recognized the need to coordinate the efforts of many Federal agencies, offices, and programs which had responsibility for various aspects of protecting and securing our homeland. President Bush proposed the creation of DHS, and Congress passed legislation establishing this new department. See the U.S. Government Structure & Performance section of this report for further details and a chart showing the entities transferred into DHS.

Iraq Operations

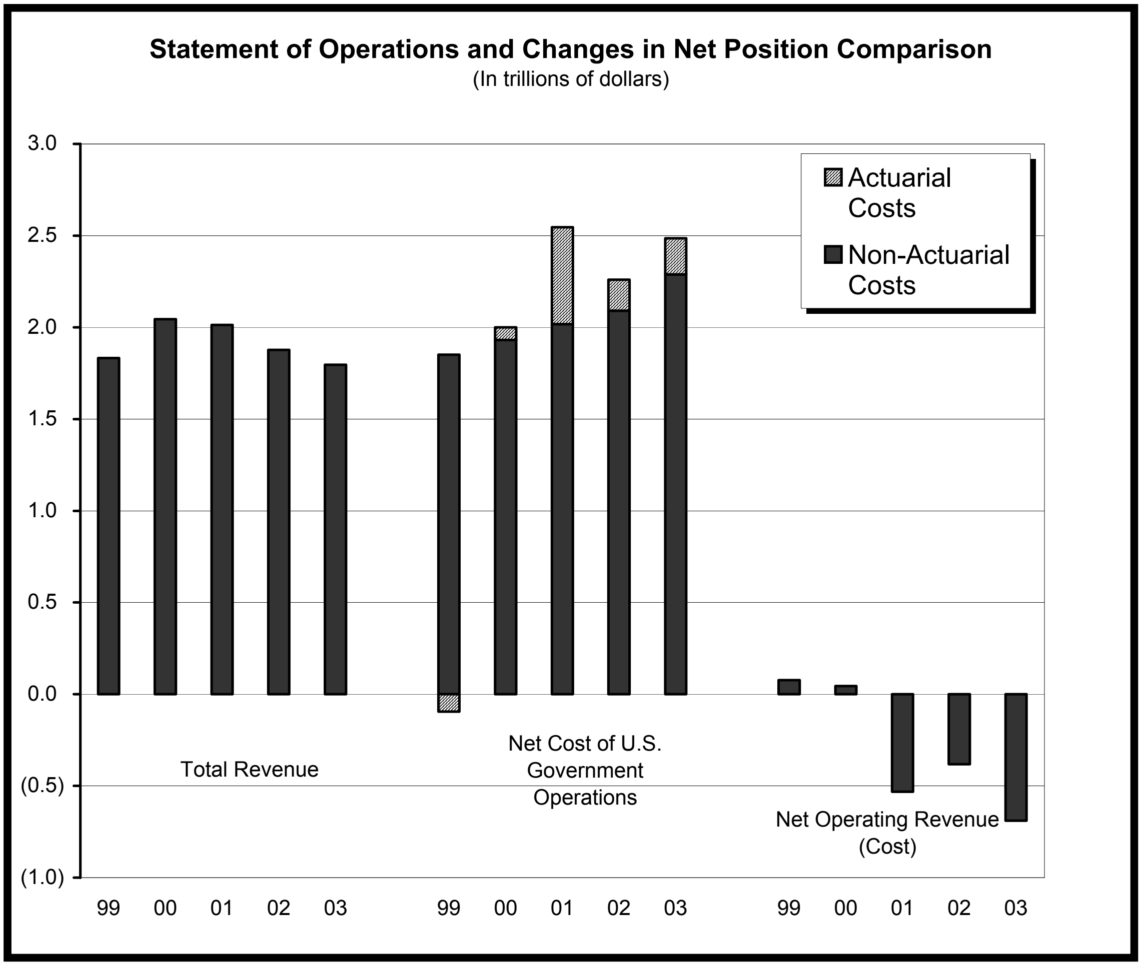
In March 2003, an international coalition led by the United States liberated Iraq and is overseeing a transformation. The vision for a sovereign, stable, prosperous, and democratic Iraq centered on four goals: establishing a secure environment, restoring essential services, promoting economic growth, and developing good governance through a legitimate constitutional government. To conduct military operations and address these goals in 2003, several sources of funding were used: appropriated and nonappropriated funds (seized and vested assets and the Development Fund for Iraq). U.S. agencies obligated $3.9 billion in appropriated funds for Iraq relief, renewal, and construction. Congress also appropriated funds to DOD for Operation Iraqi Freedom in the Emergency Wartime Supplemental Appropriations Act, 2003 (Public Law 108-11) the Consolidated Appropriations Resolution, 2003 (Public Law 108-7). DOD obligated $42.4 billion for incremental costs in support of Iraqi Freedom. For further discussion of the cost of Iraq operations and funding sources and uses, see Iraq Operations in the Financial Results section at the end of the Revenue and Cost Summary.

Debt Ceiling

On February 20, 2003, Treasury's outstanding debt reached the statutory limit of $6,400 billion. This requires Treasury to change its normal borrowing operations to stay within the limit. When this occurs, numerous statutory tools are used which allow the Government to manage without issuing new debt and to continue operations for short time periods. On May 27, 2003, President Bush signed legislation increasing the statutory debt limit to $7,384 billion (P.L. 108-24). For further discussion of the debt ceiling, see the Federal Budget and Federal Debt section of the MD&A.

Financial Results

Revenue and Cost Summary

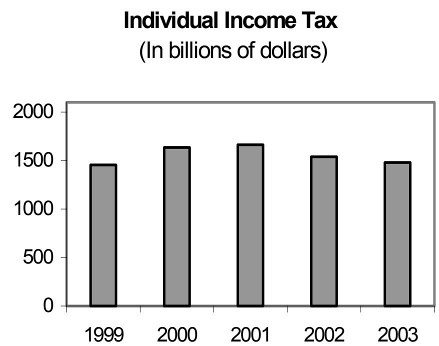


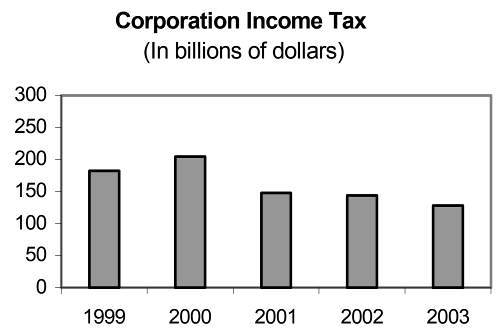
Accrual-Based Results

The financial statements (pages 58-62) present information about the financial position of the Federal Government, the net costs of its operations, and the financing sources used to fund its operations. The information in these statements gives a comprehensive view of the Government's finances. The information is reported generally on the accrual basis of accounting in which costs are recorded when a liability is incurred. This differs from the primarily cash basis used in calculating the budget results, in which outlays are recorded when bills are actually paid. See Note 1B (Basis of Accounting and Revenue Recognition) of this *Financial Report* for a discussion of how revenues are recorded.

The net operating cost as shown in these financial statements for fiscal year 2003 was $665.0 billion, compared to a budget deficit of $374.8 billion. The primary component of the difference between the budget and accrual reported results is the recognition of the year's actuarial expense for pension and health liabilities for civilian and military employees and veteran's compensation of $290.6 billion. This difference is similar to fiscal year 2002 which had a net operating cost of $364.9 billion and a budget deficit of $157.7 billion. For a detailed reconciliation between the two numbers, see the Reconciliations of Net Operating Cost and Unified Budget Deficit in the Financial Statements section.

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

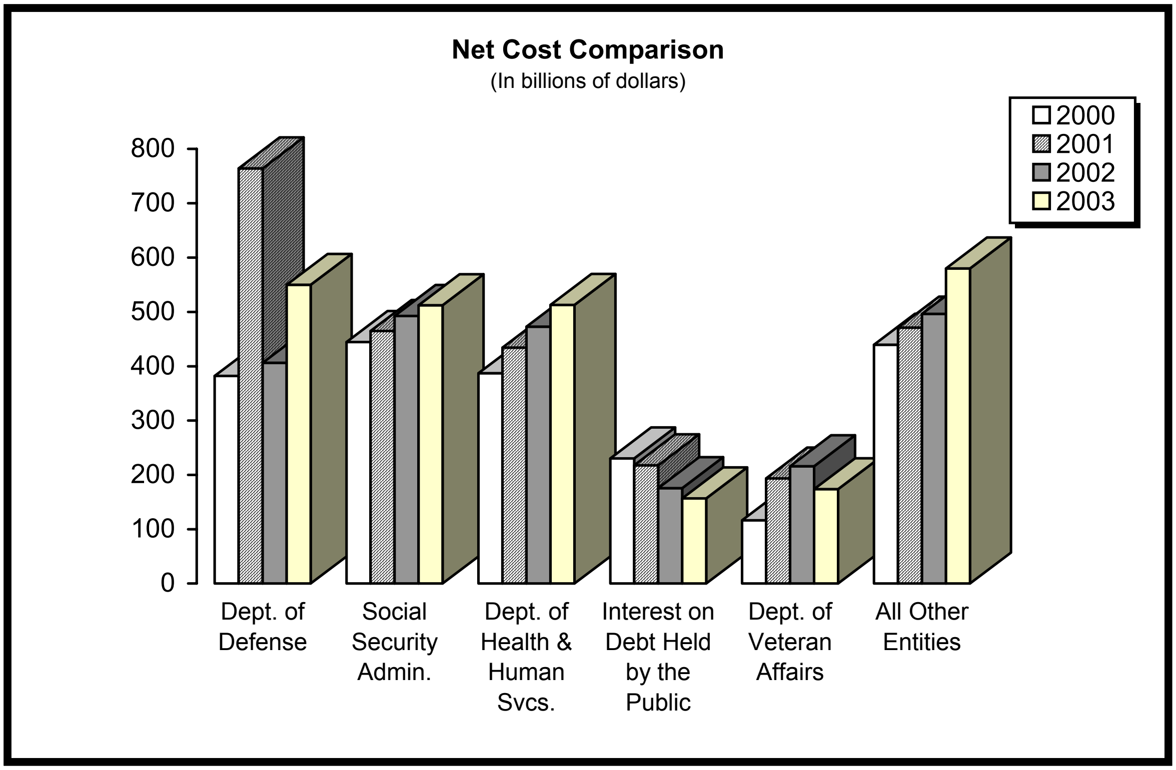




The Government's main source of revenue comes from its ability to demand payments from the public (e.g., taxes, duties, fines, and penalties). As shown in the chart above, the Government's principal source of revenue is individual income tax. In 2003, this revenue category was $1,481.3 billion, representing 82.5 percent of total revenue. This compares to $1,538.6 billion in 2002, a decrease of $57.3 billion or 3.7 percent from 2002. Since fiscal year 2000, when they were 10.0 percent of total revenue, corporate income taxes have fallen until they are 7.1 percent of total revenue in fiscal year 2003.

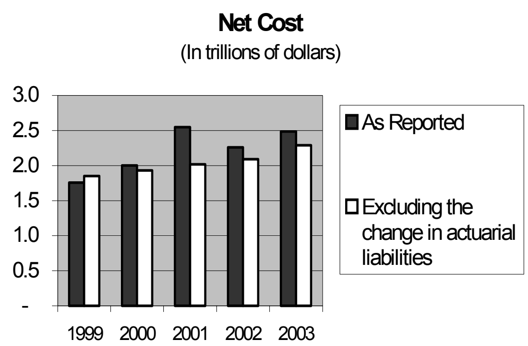
In 2003, total revenue was $1,796.0 billion. This amount compares to $1,877.7 billion in 2002, a decrease of $81.7 billion or a decline of 4.4 percent. Revenue has declined primarily due to a drop in individual income tax and tax withholdings and can be attributed to a variety of factors, including an economy recovering slowly from a recession, recently enacted tax cuts, and a decline in capital gains realizations.

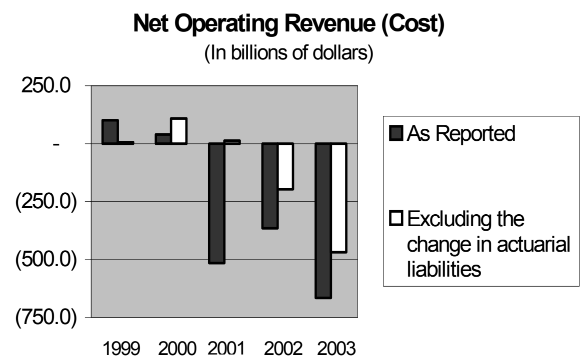
In addition to revenue from its ability to tax, the Government's other source of revenue comes from providing goods and services to the public for a price. This type of revenue is called "earned" revenue because it results from the exchange of transactions. Examples of earned revenue include the postage and mailing fees paid to the U.S. Postal Service and Medicare Part B premiums collected by HHS (these premiums do not comprise the majority of Medicare Part B's funding). This revenue is used to pay for or *offset* the costs of administering these programs or services and is included in the calculation of net cost on the Statements of Net Cost. In fiscal year 2003, the Government earned $164.8 billion from this type of revenue. This amount compares to $156.6 billion in fiscal year 2002, an increase of $8.2 billion or 5.2 percent.



The above chart compares significant elements of net cost by fiscal year. The largest charge was DOD's fiscal year 2003 cost increase of $143.4 billion, or 35.3 percent. This increase was primarily incurred due to fighting the global war on terrorism and an increase in DOD's military post retirement costs. DOD's military post retirement costs increased mainly due to an increase in its actuarial liabilities. DOD's cost in 2003 was also affected by the adoption of SFFAS No. 23 which required, for the first time, capitalizing military equipment and recording depreciation expense. The significant decrease in DOD cost from fiscal year 2001 to 2002 is the result of the initial non-recurring effect of the extension of $293.0 billion in medical benefits to retired personnel and another $91.3 billion in other actuarial assumption changes in 2001.

The social insurance costs at the Social Security Administration (SSA) and HHS continued their consistent upward trend during fiscal year 2003. From fiscal year 2002 to 2003, the net costs of SSA and HHS increased by 4.0 percent and 8.5 percent, respectively. The interest on debt held by the public continued to decrease during fiscal year 2003. Even while the debt principal increased again, the interest on the debt decreased by $18.6 billion, or 10.6 percent, due to the lower interest rates that continued to prevail in fiscal year 2003. The fiscal year 2003 $42.2 billion, or 19.6 percent, decrease in costs for the Department of Veterans Affairs (VA) shows the significant impact of changes in the actuarial calculation of the liability for future years' veterans' compensation and burial benefits on the Department's total cost (see further discussion in the Liabilities section of the MD&A).





The charts above show that over the past 5 fiscal years, significant costs associated with certain employee benefit liabilities have had a major impact on the Government's cost of operations. These incremental costs are the result of changes in interest rates and other actuarial assumptions. Also shown is that, absent these adjustments, all other costs are steadily trending upward and the net operating revenue (cost) has fluctuated from break-even in fiscal year 1999 to a net operating cost of $468.4 billion in fiscal year 2003. Actuarial liabilities include Federal employee and veteran benefits payable and are discussed in Note 11 of the Notes to the Financial Statements section.

Iraq Operations

Iraq Relief & Reconstruction

In March 2003, an international coalition led by the United States liberated Iraq and is overseeing a transformation. The vision for a sovereign, stable, prosperous, and democratic Iraq centered on four goals: establishing a secure environment, restoring essential services, promoting economic growth, and developing good governance through a legitimate constitutional government. Total funds of $9.5 billion were available in 2003 for Iraq relief and reconstruction efforts overseen by the Coalition Provisional Authority. This includes both appropriated and nonappropriated funds (seized and vested assets and the Development Fund for Iraq). Of this amount, approximately $7.6 billion was allocated or committed.

Appropriated Resources—In 2003, $4.5 billion in congressionally appropriated resources were used for Iraq relief, renewal, and reconstruction. Of this amount, about $3.9 billion was obligated in fiscal year 2003; this includes $1.1 billion in funds obligated by DOD for oil infrastructure and Coalition Provisional Authority administrative expenses.

Operation Iraqi Freedom

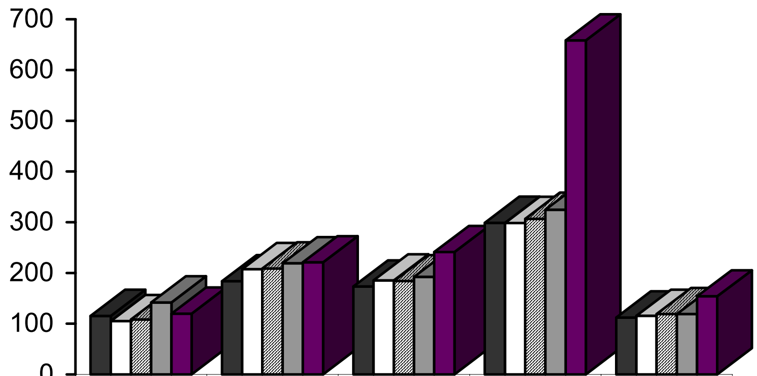
In the Emergency Wartime Supplemental Appropriations Act, 2003 (Public Law 108-11) the Consolidated Appropriations Resolution, 2003 (Public Law 108-7), Congress appropriated funds to DOD for Operation Iraqi Freedom. DOD obligated $42 billion for incremental costs in support of Operation Iraqi Freedom: $10 billion was spent for personnel pay and personnel support costs; and $6 billion was spent to transport personnel, equipment, and materials. The remaining $26 billion was spent for military operations, including the incremental costs for feeding and housing the troops, fuel for combat vehicles, logistics support, other military necessities, and Coalition Provisional Authority operating expenses.

Asset and Liability Summary

Assets

The assets of the U.S. Government are the tangible resources available to pay liabilities or to satisfy future service needs. The accompanying chart depicts a 5-year comparison of the major categories of reported assets as of September 30, for fiscal years 1999 through 2003.

Assets - Key Items Comparison
(In billions of dollars)



	Cash and Other Monetary	Loans Receivable, Net	Inventories and Related Property, Net	Property, Plant and Equipment,	All Other Assets
1999	115.2	183.7	173.3	298.8	112.0
2000	104.9	207.6	185.2	298.5	115.3
2001	108.0	208.9	183.8	306.7	118.7
2002	141.6	219.2	192.2	324.7	118.8
2003	119.6	221.1	241.2	658.2	153.8

Looking at the chart above, fiscal year 2003 property, plant, and equipment exceeded all other asset category increases. This increase mainly was due to a change in the way that DOD reports its military equipment.

In May 2003, the FASAB issued SFFAS No. 23 which became effective for accounting periods beginning after September 30, 2002. SFFAS No. 23 establishes generally accepted accounting principles (GAAP) for valuing and reporting military equipment in Federal financial statements. That is, it requires the capitalization and depreciation of the cost of military equipment, including the cost of modifications and upgrades. Previously, military equipment was expensed when acquired and reported as national defense property, plant, and equipment in the Stewardship Information section of this report.

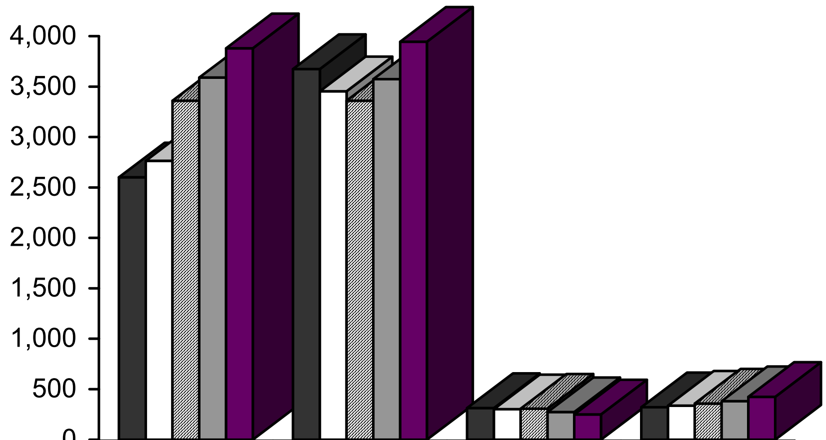
In fiscal year 2003, the DOD equipment component increased by $324.6 billion. Most of this increase was due to the inclusion of $325.1 billion in military equipment on DOD's balance sheet. The $325.1 billion net book value is the result of an estimated total acquisition cost of military equipment of $1,123.5 billion with accumulated depreciation of $798.4 billion. This change also resulted in a change in accounting principle ($383.1 billion) reported on the Statements of Operations and Changes in Net Position and Note 17 of this report.

DOD has determined that it is not yet possible to accumulate the information necessary to value its military equipment for financial statement presentation using its own financial systems. Instead, DOD based the value of its military equipment on data provided by the Bureau of Economic Analysis, Department of Commerce. DOD is working to revise its accounting processes and systems to provide this information in the future. (See DOD's individual financial statements for further details).

Liabilities

This chart presents a 5-year comparison of the major components of liabilities reported on the balance sheets as of September 30, for fiscal years 1999 through 2003. At the end of fiscal year 2003, the U.S. Government reported liabilities of $8,498.6 billion, as compared to $7,816.7 billion for September 30, 2002, an 8.7 percent increase.

Liabilities - Key Items Comparison
(In billions of dollars)



	Federal Employee and Veteran Benefits Payable	Federal Debt Securities Held by the Public and Accrued	Environmental and Disposal Liabilities	All Other Liabilities
1999	2,600.7	3,674.2	313.2	321.1
2000	2,764.7	3,454.2	301.2	336.8
2001	3,360.8	3,359.3	306.8	358.0
2002	3,589.4	3,573.2	273.0	381.1
2003	3,880.0	3,944.9	249.9	423.8

In fiscal year 2003, Federal debt securities held by the public and accrued interest increased 10.4 percent so it is, once again, the largest liability on the balance sheet at $3,944.9 billon. This is a $371.7 billion increase over the balance at the end of fiscal year 2002. Both fiscal years' 2003 and 2002 increase in debt held by the public primarily is due to total Federal spending exceeding total Federal revenues.

The next largest liability, $3,880.0 billion, is Federal employee and veteran benefits payable (which was the largest for fiscal year 2002), which consists of pension, disability, and retiree health care costs for Federal civilian and military employees, as well as for veterans. This liability also increased in fiscal year 2003 by $290.6 billion or 8.1 percent. The largest component of this liability is for civilian and military pensions which, with a combined balance of $1,929.4 billion, increased 3.7 percent in fiscal year 2003. The next largest piece of this liability, $954.8 billion for veterans' compensation and burial benefits, increased $105.6 billion or 12.4 percent, due to a large increase in the average size and number of veteran compensation beneficiaries resulting from Agent Orange cases and an increase in the assumed average benefit payment. The civilian and military retiree health benefits component, $927.4 billion, has more than doubled since fiscal year 2000. The military retiree health component has increased threefold since fiscal year 2000, primarily due to a law passed in 2001 that extended new health benefits to military retirees effective in 2002. See Note 11 in the Notes to the Financial Statements section for a more detailed explanation of this liability.

Another liability is related to environmental cleanup costs associated with environmental damage and contamination. As of September 30, 2003, the recognized cost of cleaning up environmental damage and contamination across Government programs was estimated to be $249.9 billion, a decrease of $23.1 billion or 8.5 percent from September 30, 2002. The most significant component of this reduction relates to the Department of Energy (Energy). Energy has reduced its environmental liability by $26.3 billion or 12.5 percent in fiscal year 2003; this is the second year in a row that Energy's environmental liability decreased. The decrease in 2003 primarily was due to restructuring the cleanup program to focus on its core mission and accelerating cleanup.

Additional Responsibilities

Historically, the Government's financial situation has been evaluated primarily from a cash-based budgeting perspective that measures the flow of funds in and out of Government accounts. As a first step in examining our financial position, we are presenting a condensed perspective based on forward-looking accrual principles. This perspective is meant to complement the cash-based budget estimates of future spending and receipts.

In addition to accrual-based results, the overall perspective depicted below includes many responsibilities disclosed throughout this report but not captured by accrual-based operating results or liability balances. An attempt is made here to go beyond the balance sheet to also examine the impact of these other responsibilities.

Overall Perspective

The schedule below reveals a more complete picture of the Government's financial responsibilities—its liabilities and responsibilities on the balance sheet as well as its responsibilities that are tracked off the balance sheet.

Overall Perspective
(In billions of dollars)

	2003			2002		
	Balance Sheet	Additional Responsibilities	Combined Amounts	Balance Sheet	Additional Responsibilities	Combined Amounts
ASSETS						
Inventory, cash	$ 361	$ -	$ 361	$ 334	$ -	$ 334
Property, plant & equipment	658	-	658	325	[1] 616	941
Loans receivable	221	-	221	219	-	219
Other	154	-	154	119	-	119
Total Assets	$ 1,394	$ -	$ 1,394	$ 997	$ 616	$ 1,613
LIABILITIES & NET RESPONSIBILITIES						
Social Insurance						
Medicare (Parts A & B)	-	(15,006)	(15,006)	-	(12,896)	(12,896)
Social Security (OASDI)	-	(11,742)	(11,742)	-	(11,215)	(11,215)
Other (Railroad Retirement)	-	(110)	(110)	-	(38)	(38)
Subtotal, Social Insurance	-	(26,858)	(26,858)	-	(24,149)	(24,149)
Fed. empl. & veterans pensions/benefits	(3,880)	-	(3,880)	(3,589)	-	(3,589)
Federal debt held by the public	(3,945)	-	(3,945)	(3,573)	-	(3,573)
Other liabilities	(674)	-	(674)	(654)	-	(654)
Other responsibilities	-	(862)	(862)	-	(771)	(771)
Total Liabilities & Net Responsibilities	$ (8,499)	$ (27,720)	$ (36,219)	$ (7,817)	$ (24,920)	$ (32,736)
BALANCE (Total Assets minusTotal Liabilities & Net Responsibilities)	($7,105)	($27,720)	($34,825)	($6,820)	($24,304)	($31,124)

[1] Source: Fiscal Year 2004 Analytical Perspectives, page 37, Defense Fixed Reproducible Capital, Nonfinancial Assets.

Note: Overall details may not add to total due to rounding.

Social Insurance Calculations

The social insurance present value amounts are based on 75-year actuarial projections of scheduled benefits and legislated taxes for current participants.

The present value of these future responsibilities (at January 1, 2003), as presented in the pertinent agencies' financial statements, is $15,006 billion for Medicare and $11,742 billion for Social Security. These numbers are from the Statements of Social Insurance on page 64 of this *Financial Report*. The total of these future responsibilities, including Other and Railroad Retirement social insurance responsibilities of $862 billion and $110 billion, respectively, is $27,720 billion. These items are not recorded on the balance sheet because current accounting standards (GAAP) do not permit it. FASAB is reviewing this area and if it determines that it is proper to record these items, we will do so. A more detailed discussion of these projections and the future outlook for Social Security and Medicare is found in the Stewardship Information section.

As can be seen, the impact of these responsibilities is significant. Clearly, the social insurance component represents a major fiscal responsibility and serious future challenge for the Federal Government. Medicare and Social Security increased by $2,110 billion (or 16.4 percent) and $527 billion (or 4.7 percent), respectively, over fiscal year 2002. Moreover, the 2003 combined total of the future responsibilities (i.e., $27,720 billion) is more than three times the 2003 total accounting liabilities and responsibilities on the balance sheet (i.e., $7,105 billion).

Federal Budget and Federal Debt

At this time, the largest liability for the Federal Government is the Federal debt held by the public and accrued interest, which was $3,945 billion in 2003. This was an increase of $372 billion over the 2002 debt of $3,573 billion. There are two kinds of Federal debt: debt held by the public and the debt the Government owes to itself.

Debt Held by the Public

The first kind of Federal debt is debt held by (or owed to) the public. It includes all Treasury securities (bills, notes, bonds, and other securities) held by individuals, corporations, Federal Reserve banks, foreign governments and other entities outside the U.S. Government. This debt is included as a liability on the balance sheet.

Debt the Government Owes to Itself

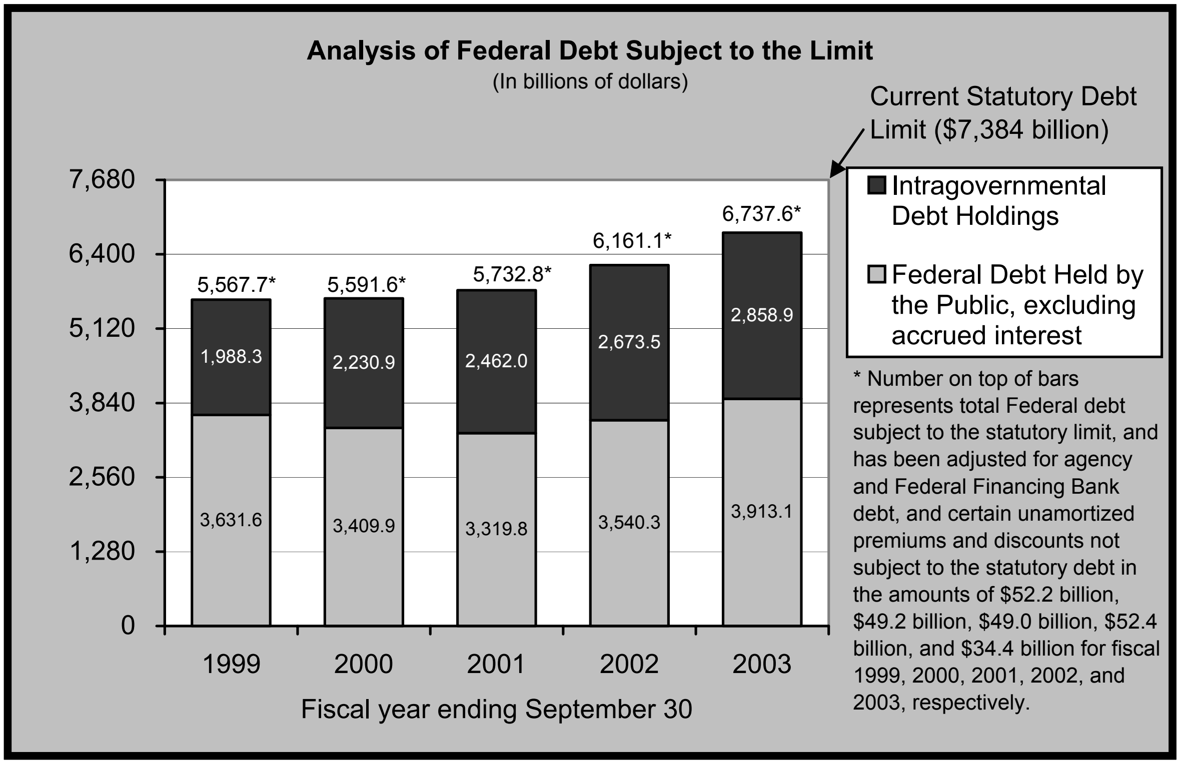
The second kind is debt the Government owes to itself (intra-governmental debt), primarily in the form of special nonmarketable securities held by various parts of the Government. The laws establishing Government trust funds generally require the excess receipts of the trust funds to be invested in these special securities. This debt is not included on the balance sheet since these payments are claims of one part of the Government against another and are eliminated for consolidation purposes.

Statutory Debt Ceiling (Limit)

Both kinds of debt are included in the total debt subject to the limit set by the Congress. The Congress has traditionally exercised control on the size of the Government's debt by establishing limits on the amount of Treasury securities that can be outstanding. This limit is known as the debt ceiling.

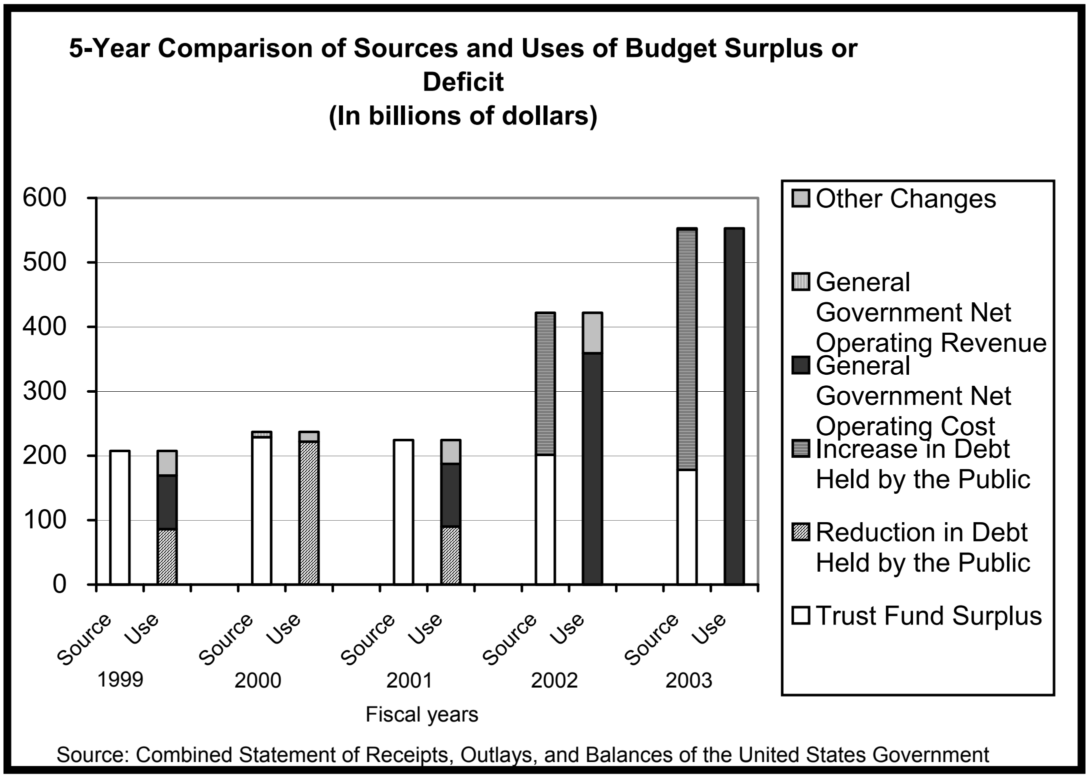
On February 20, 2003, Treasury's outstanding debt reached the statutory limit of $6,400 billion. When this occurs, various statutes authorize the Secretary of the Treasury to "suspend the issuance of additional amounts of obligations of the United States, if such issuances could not be made without causing the public debt of the United States to exceed the public limit, as determined by the Secretary of the Treasury." On May 27, 2003, President Bush signed legislation increasing the statutory debt limit to $7,384 billion (P.L. 108-24).

The following chart shows the amounts of debt held by the public and intra-governmental debt from 1999 through 2003.



Sources & Uses of Surpluses or Deficits

Federal Government operations are composed of two parts: 1) funds that are called trust funds in the Government, which receive their funding from dedicated collections (including collections from the Treasury and other Federal agencies), and 2) general Government, which is funded mainly from general revenues and borrowing. Many of the larger trust funds finance social insurance programs (such as Social Security and Medicare) and Federal military and civilian retirement programs. The following chart illustrates a 5-year comparison of the budget surpluses or deficits of these two parts of Government and how the budget surpluses were used and budget deficits funded.



Trust fund surpluses (the white area in the chart) are invested in Federal debt securities. The cash invested in Federal debt securities is mainly used for two purposes: to reduce the debt held by the public (the diagonally striped area) and to fund the general Government net operating cost (the dark gray area). Other changes (the light gray area) primarily consist of outlays under various loan programs. In fiscal years 2003 and 2002, it was necessary to increase the debt held by the public since the general Government net operating cost exceeded the trust fund surplus.

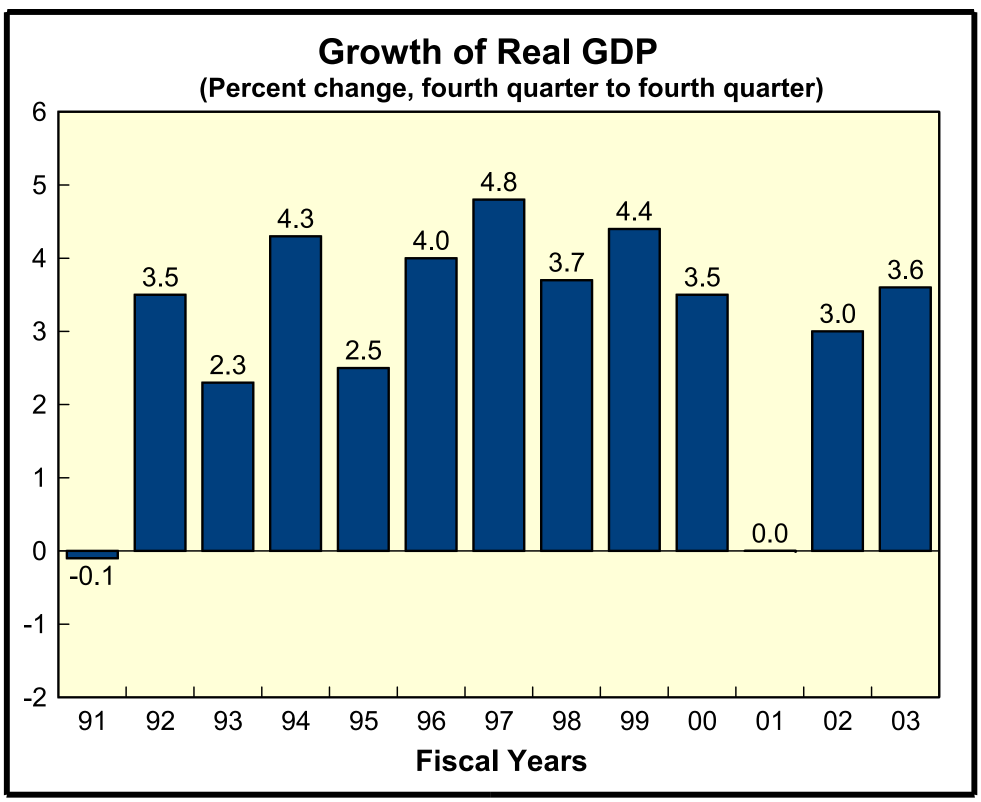
Previous budget surpluses, based primarily on a cash basis, are almost entirely due to the trust fund surpluses. General Government operations experienced budget deficits for fiscal years 1999, 2001, 2002, and 2003, and had a small surplus for fiscal year 2000.

Economic and Budgetary Results

After recovering in fiscal year 2002 from the economic downturn, the economy continued to accelerate in fiscal year 2003 and achieved strong growth. The rate of increase in real GDP picked up in each of the last three quarters of the fiscal year and productivity continued to record substantial gains. The labor market stabilized in fiscal year 2003 following job losses in the previous year; and in the final quarter of the fiscal year, employment began to increase. Improvement in the economy was aided by new fiscal policies in 2003, but the lingering effect of the recession and loss in equity wealth, the war with Iraq, homeland security spending, and lower taxes enacted to stimulate growth contributed to a widening in the Federal budget deficit to $374.8 billion for the fiscal year.

The Economy in Fiscal Year 2003

Real GDP increased 3.6 percent over the four quarters of fiscal year 2003, building on the solid growth recorded in the prior year after the economy underwent a recession in fiscal year 2001. Growth accelerated through fiscal year 2003, starting with a 1.3 percent annual rate of gain in the first fiscal quarter (the fourth quarter of calendar year 2002) and culminating in an 8.2 percent surge at an annual rate in the final quarter (the third quarter of 2003). That was the largest quarterly advance in 20 years and partly reflected the effects of the Jobs and Growth Tax Relief Reconciliation Act (JGTRRA), which was enacted in May. Rapid productivity growth, lower marginal tax rates on individual income, and advance child tax credit checks helped lift disposable personal income in the July-September quarter and fueled a 6.9 percent annual rate increase in real consumer spending. Business investment also surged in that quarter due to improved business profits and cashflow, helped by JGTRRA provisions that increased the bonus depreciation write-off on equipment and raised the expensing limit for small businesses. Real investment in equipment and software jumped at a 17.6 percent rate in the final quarter of fiscal year 2003, the largest increase since the first quarter of calendar year 1998. Rising profits and cashflow stemmed from low unit labor costs, which were held in check by exceptional productivity growth of 5.0 percent over the four quarters of the fiscal year.



Of special importance was a firming in labor market conditions in fiscal year 2003 following a loss of 1.3 million jobs in fiscal year 2002. Declines in payroll jobs diminished through fiscal year 2003 and totaled about 300,000 for the year as a whole, but losses bottomed out towards the end of the year and employment increased in the final 2 months. Those job gains extended into fiscal year 2004 along with a downward trend in the unemployment rate, which averaged 6.0 percent for all of fiscal year 2003.

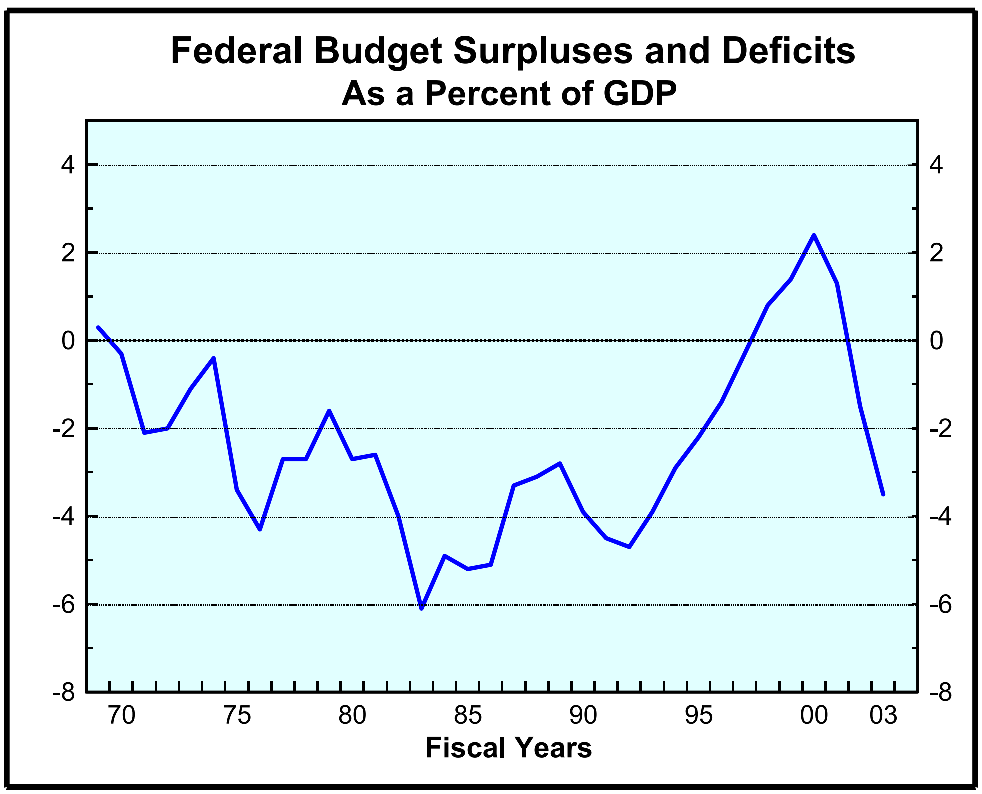
Although the overall consumer price index (CPI) rose 2.3 percent over the year, faster than over the previous fiscal year, the "core" CPI (which excludes food and energy prices) was up just 1.3 percent over the 12 months of fiscal year 2003, the smallest increase since the mid-1960s.

Budget Results

The unified Federal budget deficit was $374.8 billion in fiscal year 2003, up from $157.7 billion in fiscal year 2002 but $81 billion lower than had been projected in the Mid-Session Review. The deficit represented an estimated 3.5 percent of nominal GDP, the highest such share since fiscal year 1993 but well below the shares that were prevalent in the mid-1980s. The lagging economy in the early part of the year and declines in the stock market contributed to the deterioration in the unified budget balance, as did increased defense and homeland security spending and the economic growth plan.

Receipts decreased for the third straight year but the decline was just 3.8 percent, less than the 6.9 percent decrease in fiscal year 2002. In dollar terms, receipts fell by $71.1 billion to $1,782 billion. That represented a 16.5 percent share of GDP, down for the third year in a row after the share reached a record high of 20.8 percent in fiscal year 2000. Outlays rose $145.9 billion in the latest year, or 7.3 percent, and represented a 19.9 percent share of GDP. Departments with the largest rates of growth included Education, Defense, and Homeland Security.

Debt held by the public, excluding accrued interest, increased by $372.8 billion, or 10.5 percent, in fiscal year 2003. That represented a relatively modest 36.2 percent of GDP compared to the average 44.5 percent share that prevailed from the late 1980s through most of the 1990s.



U.S. Government Structure & Performance

Mission & Organization

The Constitution set out the Government's original mission:

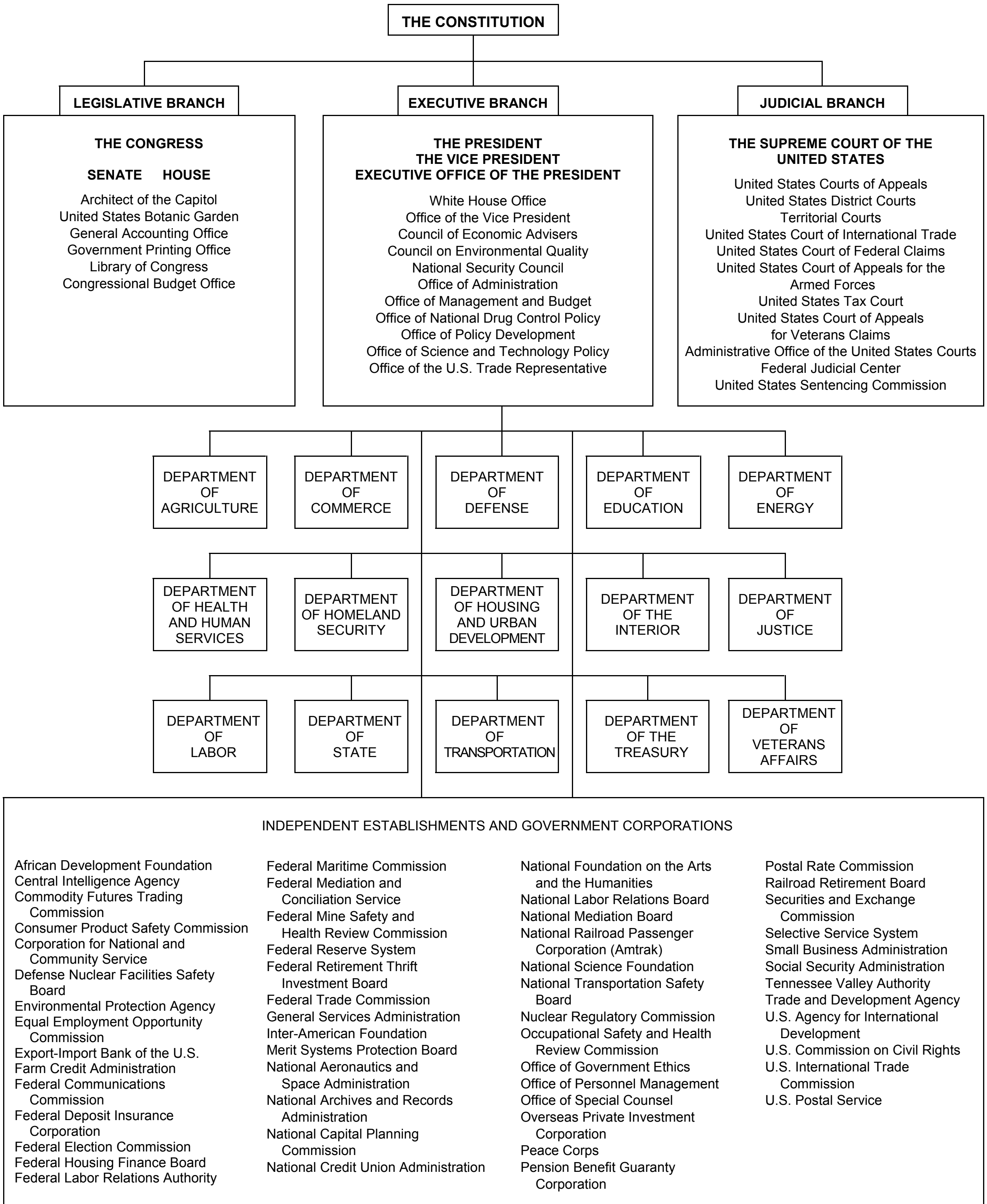
> "…to form a more perfect union, establish justice, insure domestic tranquility, provide for the common defense, promote the general welfare and secure the blessings of liberty to ourselves and our posterity."

Today, the Federal Government's primary mission (managing the security of the nation, homeland, and economy) are still derived from this original mission. Other missions have developed as the Congress authorized the creation of other agencies to carry out various objectives established by law. Some of these objectives were to: promote health care, foster income security, boost agricultural productivity, provide benefits and services to veterans, facilitate commerce, support housing, support the transportation system, protect the environment, contribute to the security over energy resources, and assist the States in providing education.

U.S. Government's Organization

The fundamental organization of the U.S. Government was set out in the Constitution. Article I vested legislative powers in a Congress consisting of a Senate and a House of Representatives; Article II vested executive powers in a President and Vice President; and Article III vested judicial power in a Supreme Court and lower courts to be established by the Congress. An organization chart follows.

THE GOVERNMENT OF THE UNITED STATES



Original source: *U.S. Government Manual 2003/2004*

The United States is impressive in its position as one of the world powers. The following table illustrates several interesting facts about the United States, as compared with other countries.

Item of Interest	United States	Estimate as of	Country Rank	Comments
Land area only	9.2 million sq. km	2003	4	Russia, China, and Canada are larger
Population	290.3 million	2003 (July)	3	China (1.3B) and India (1.0B) are greater
Gross domestic product (GDP) (basis: purchasing power parity)[1]	$10.4 trillion	2002	1	China was second with $5.7 trillion
GDP per capita	$37,600	2002	2	Luxembourg was first with $44,000
Low infant mortality rate	6.75 deaths per 1,000 live births	2003	42	Countries with populations > 50 million with lower rate: Italy, 6.19; UK, 5.28; France, 4.37; Germany, 4.23; Japan, 3.30.
Electricity production	3.72 trillion kWh	2001	1	China was second with 1.42 trillion kWh
Military expenditures– percent of GDP	3.2 percent	2003 (Jan 1)	47	North Korea was first with 33.9 percent (FY02)

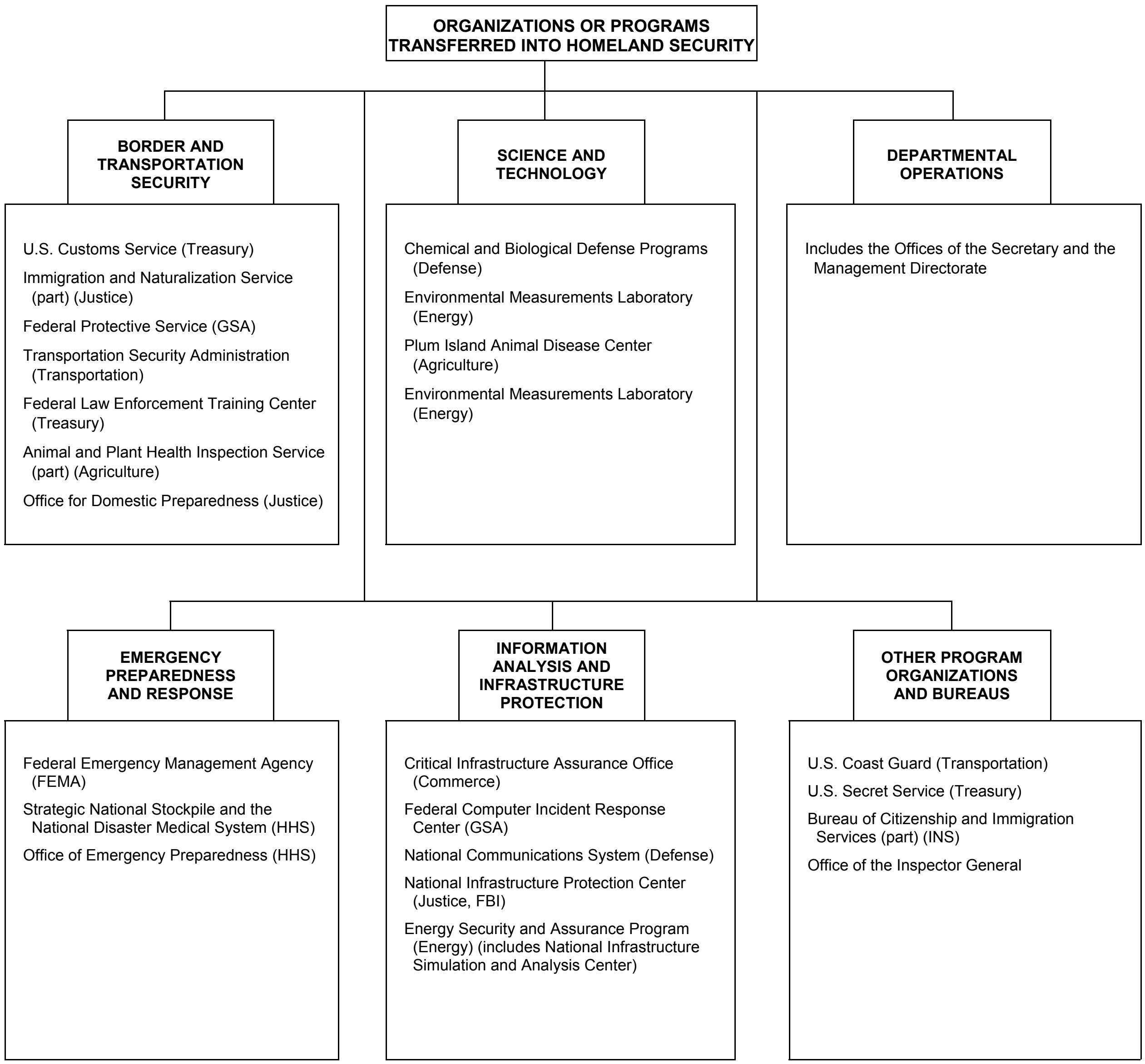
[1] Purchasing power parity indicates how many units of currency are needed in one country to buy the same amount of goods and services purchased with one unit of currency in another country.
Source: Central Intelligence Agency's *The World Factbook 2003*

Creation of the Department of Homeland Security

The creation of DHS in 2003 was the most significant transformation of the Federal Government since 1947 when the various branches of the U.S. Armed Forces were merged into a new Department of Defense. In the aftermath of the September 11, 2001, terrorist attacks, the President and the Congress recognized the need to coordinate the efforts of many Federal agencies, offices, and programs which had responsibility for various aspects of protecting and securing our homeland. President George W. Bush proposed the creation of DHS, and Congress passed the Act that established this new department.

More than 20 agencies and offices and some 180,000 employees were transferred into DHS on March 1, 2003. They are located, for the most part, within one of four major program directorates: Border and Transportation Security, Emergency Preparedness and Response, Science and Technology, and Information Analysis and Infrastructure Protection. A fifth directorate coordinates management of the DHS. The Secret Service and the Coast Guard, although located within DHS, remained intact and report directly to the Secretary of DHS. In addition, the Immigration and Naturalization Service's adjudications and benefits programs are now the Bureau of Citizenship and Immigration Services. The following chart shows how the incoming or *legacy* organizations or programs fit within the new department.

THE DEPARTMENT OF HOMELAND SECURITY



Source: *Based on information provided by the Department of Homeland Security*

Significant Performance Accomplishments

Progress on Audited Financial Statements

As recently as 1996, not only were just six agencies able to issue financial statements with clean opinions, but most agencies took as least 5 months to issue them. Before implementing the Improved Financial Performance Initiative of the President's Management Agenda, 18 of 24 of the Government's major agencies received clean opinions on their audited financial reports, however, it still took 5 months to prepare most of them. Today, most major agencies are getting clean audit opinions and issuing them in a condensed period of time.

A clean audit opinion provides assurance that agencies are responsibly accounting for the people's money. If it takes them 5 months to issue audited financial statements, however, it is a good indication they do not have timely and accurate financial information available on a regular basis. That is why the Administration is working with all agencies to close their books more quickly. Eight agencies have accelerated the issuance of audited financial reports to 45 days after year end, which is the 2004 Governmentwide requirement. One particular agency of note is the U.S. Agency for International Development (USAID), which not only accelerated the reporting of its financial statements, but also received a clean opinion for the first time in its history. Additionally, agencies are now reporting quarterly financial information in addition to the end of the year data.

Through the first quarter of fiscal year 2004, four agencies–Education, Environmental Protection Agency (EPA), National Science Foundation (NSF), and SSA – have demonstrated their ability to use timely and accurate financial information to make decisions about program management. For example, Education uses up-to-the-minute financial data to track whether schools are receiving the appropriate amount of Federal funds. In addition, EPA's Leaking Underground Storage Tank program negotiates performance commitments with grantees and provides resources based on those commitments. If a grantee is not meeting its commitments, EPA may withhold some resources from the nonperformers and redirect those resources to grantees that are meeting their commitments.

The President's Management Agenda: Ensuring Government's Effectiveness

In August 2001, The President's Management Agenda (PMA) was launched with the broad goal of making the Government results-oriented and focused on achievement and accountability. Over the past 2 ½ years, Federal agencies have established aggressive implementation plans for the PMA and are meeting their goals. As a result, the Federal Government is better managed and achieving greater results. It is managing its finances and investments more professionally and efficiently. It is providing better service to the American people. The Government is getting the people it needs to accomplish its mission at the best value to the taxpayer. Most important, it is evaluating its performance; asking what works, what doesn't, and what to do about it.

Five areas of emphasis, or subcomponents, were identified for the agenda:

Strategic Management of Human Capital:

- Helps the Government maximize the value of its most important resource, its workforce. Agencies are now establishing and implementing practices to manage their personnel to achieve their missions.

Competitive Sourcing Initiative:

- Before this initiative was launched, too few agencies regularly assessed the efficiency and effectiveness of the commercial activities they performed. Today, by contrast, a steadily increasing number of agencies are looking to competition to strengthen both the return on taxpayer investment and overall customer satisfaction.

Improved Financial Performance Initiative:

- Helps the Government ensure the availability, accuracy, and timeliness of its financial information, helping it make better decisions about program management.

The Expanded Electronic Government Initiative:

- Focuses on two key areas – strengthening agencies' management of their information technology (IT) resources and using the Internet to simplify and enhance service delivery.

The Budget Performance/Integration Initiative:

- Helps agencies use meaningful information about how programs are performing to inform their budget and management decisions.

The PMA measures the Government's progress toward its goals through the use of the Executive Branch Management Scorecard. This Scorecard is used to assess agencies' overall status in achieving the expected levels of achievement, or standards for success, identified in the agenda. Their quarterly efforts in working toward those goals are also assessed.

Implementation of the PMA has brought focus and attention to how the Government is operated, and identified ways that it can be more effective. Agencies are improving—managing for and achieving better results.

	Explanation of Status Scores
Green	Agency meets all of the standards for success.
Yellow	Agency achieves some, but not all, of the criteria.
Red	Agency has any of a number of serious flaws.
	Explanation of Progress Scores
Green	Implementation is proceeding according to plans.
Yellow	Slippage in implementation schedule, quality of deliverables, or other issues requiring adjustments by agency in order to achieve initiative on a timely basis.
Red	Initiative in serious jeopardy. Unlikely to realize objectives without significant management intervention.

The Scorecard

Executive Branch Management Scorecard										
	Current Status as of September 30, 2003					Progress in Implementing the President's Management Agenda				
	Human Capital	Competi-tive Sourcing	Financial Perf.	E-Gov	Budget/ Perf. Integra-tion	Human Capital	Competi-tive Sourcing	Financial Perf.	E-Gov	Budget/ Perf. Integra-tion
AGRICULTURE	R	Y	R	Y	R	G	G	G	Y	G
COMMERCE	Y	Y	R	Y	Y	G	Y	G	G	G
DEFENSE	Y	Y	R	R	Y	G	Y	G	G	G
EDUCATION	Y	Y	R	Y	R	G	G	G	G	G
ENERGY	Y	Y	Y	Y	Y	G	G	G	G	G
EPA	R	R	G	Y	Y	G	G	G	G	G
HHS	R	Y	R	R	R	G	G	G	Y	Y
HOMELAND	R	R	R	R	R	G	G	G	Y	G
HUD	R	R	R	R	R	Y	Y	G	Y	G
INTERIOR	R	Y	R	R	R	G	G	Y	Y	Y
JUSTICE	R	Y	R	R	R	G	G	G	G	G
LABOR	Y	R	Y	Y	Y	G	Y	G	G	G
STATE	Y	R	R	R	R	G	Y	G	G	G
DOT	Y	Y	R	R	Y	G	G	G	G	G
TREASURY	R	R	R	R	R	Y	Y	Y	Y	Y
VA	R	R	R	Y	Y	G	R	G	G	G
USAID	R	R	R	R	R	G	R	G	G	G
CORPS OF ENGINEERS	Y	R	R	R	R	G	Y	Y	G	Y
GSA	R	Y	Y	R	R	G	G	G	G	Y
NASA	Y	R	R	R	Y	G	G	G	G	G
NSF	R	R	G	G	Y	Y	R	G	G	Y
OMB	R	R	R	R	R	G	Y	Y	G	R
OPM	Y	Y	Y	Y	R	G	G	G	G	G
SBA	Y	R	R	Y	Y	G	G	Y	Y	G
SMITHSONIAN	R	R	R	R	R	R	R	Y	Y	Y
SSA	Y	R	G	Y	Y	G	G	G	G	G
Legend: R = Red Y = Yellow G = Green										

Systems, Controls, and Legal Compliance

Systems

The Federal Government continues to face agency-specific and Governmentwide challenges in modernizing and standardizing its financial management systems. Much emphasis has been placed on streamlining systems and standard processes across the agencies and minimizing redundant investments in duplicative systems. The Administration's Expanded Electronic Government initiative (E-Gov) has focused on leveraging information technology to make the Federal Government more citizen-centered and results oriented.

For example, the *E-Payroll* initiative is working to consolidate 22 Federal payroll systems down to two payroll provider partnerships in order to simplify and standardize Federal payroll processes. The E-Payroll initiative completed a major milestone in August with the successful migration of Energy, the first agency to migrate to an E-Payroll provider. Several other agencies have also completed their migrations in this area.

The *Grants.gov* initiative will minimize the burden of finding and applying for grants and enable agencies to make awards more efficiently. This initiative recently completed the "Find Grant Opportunities" and the "Apply for Grants" features of the Grants.gov web site, which was officially launched in November.

The *Geospatial One-Stop* initiative introduced GeoData.gov, a portal featuring "one-stop" access to geospatial information and resources from diverse sources, quickly compiled and posted links to web sites, maps and information from numerous Government sources on the impact of Hurricane Isabel that shut down much of the East Coast of the United States as well as the September 25th earthquake in Japan and its potential impact on the United States. GeoData.gov responded twice in the month of September to major natural disasters.

The *Recruitment One-Stop* initiative unveiled the new look and feel of www.usajobs.opm.gov, showcasing new user-friendly features such as: enhanced job search engine and sorting capability, resume storage, a personal career management homepage, and improved accessibility for disabled users. The web site is the foremost destination for those seeking employment with the Federal Government, allowing job seekers to quickly and easily find and apply for Federal jobs in a centralized location.

Additionally, the *Expanding Electronic Government* initiative is making progress in several other areas, such as the *Financial Management Line of Business*. The *Financial Management Line of Business* initiative will standardize data structures and business processes for core accounting systems within a well-defined common architecture. This initiative will address opportunities for more effective IT spending in the areas of: Financial Management, Human Resources, Federal Health Architecture, and Case Management.

Further information on Expanded Electronic Government, the E-Gov Strategy, or other E-Gov topics of interest can be found at www.egov.gov, the official web site of the President's E-Government initiatives. The web site is an up-to-date, public source of information about the E-Gov Initiatives and their accomplishments.

Controls

The Federal Government has historically emphasized the need for good internal controls in its internal management review and external financial reporting requirements. Together, these requirements assist management in ensuring the integrity of Government financial management information.

Since its passage in 1982, the Federal Managers' Financial Integrity Act has required agencies to annually report on the adequacy of their management controls. To meet this reporting requirement, agencies undertake annual internal reviews of key controls over major programs to determine if they are functioning properly. Any control deficiencies identified are reported by the head of the agency to the President.

The Federal Financial Management Improvement Act of 1996 requires agency management and independent financial auditors to determine whether financial management systems meet systems requirements, comply with the U.S. Government Standard General Ledger, and adhere to accounting standards. Independent auditors report their determination as part of their annual financial audit report on agency financial statements, which is included in agencies' annual Performance and Accountability Reports.

Beginning in 2003, the Federal Information Security Management Act of 2002 requires reviews of agency information security programs to ensure they meet Federal requirements and that significant deficiencies are reported.

Both financial and information technology internal controls are also reviewed and reported on by independent auditors as part of the annual agency financial audit. Internal control deficiencies reported by agencies that materially affect the Governmentwide financial statements are described in the accompanying report prepared by the General Accounting Office (GAO).

Where controls are not functioning as planned, agencies are responsible for developing and implementing corrective action plans to address how financial management systems and internal controls will be improved.

Eliminating Erroneous Payments

The Administration has launched a major effort to eliminate erroneous payments—in other words, payments the Government makes in error. In most instances, such payments are overpayments. However, in all cases, taxpayers are shortchanged.

Selected Federal agencies have been required to report the extent of erroneous payments made in their major benefit programs. Information we have today tells us that for programs with nearly $1 trillion in annual payments, erroneous payments exceed $35 billion annually.

Congress endorsed the President's effort to eliminate erroneous payments by passing the Improper Payments Information Act of 2002 (P.L. 107-300). The Act requires an estimate of the extent of erroneous payments from all Federal programs and in effect expands the scope of review to all Government expenditures. In May 2003, the Administration provided guidance as to how Federal agencies must comply with the Act. Now, all major agencies are beginning to develop and implement plans to identify and eliminate erroneous payments in all programs and activities susceptible to significant erroneous payments. Ultimately, full implementation of the Act will lead to a review of every dollar that the Government spends.

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 tested for compliance with selected laws and regulations related to financial reporting. As a result of their testing, auditors found no instances of material noncompliance that affected the Governmentwide financial statements. There were, however, instances that were material to an individual agency, and these were reported in the individual agencies' financial statement audit reports.

Basis of Accounting and Reporting Entity

Accounting Standards

The accompanying financial statements were prepared based on U.S. GAAP standards developed by FASAB, except as noted in GAO's auditor's report.

GAAP for the Federal Government is tailored to the U.S. Government's unique characteristics and special needs. For example, the Stewardship Information section of this report contains important information about diverse subjects such as land set aside for the use and enjoyment of present and future generations, heritage assets, and social insurance programs such as Social Security.

Accrual Basis

GAAP requires that these financial statements be prepared using the accrual basis of accounting, but permits the use of modified cash accounting for taxes and duties. Under the accrual basis, transactions are reported when the events creating the transactions occur, rather than when cash is received or paid (cash basis). Therefore, expenses are recorded when incurred, exchange revenue is recorded when earned, and taxes and duties (the majority of nonexchange revenue) are recorded on a modified cash basis of accounting (generally when received). In contrast, Federal budgetary reporting is generally on the cash and obligation basis in accordance with accepted budget concepts.

The most significant difference between cash and accrual bases involves the timing of recognition and measurement of revenues and costs. For example, GAAP requires recognition of liabilities for costs related to environmental cleanup when the events requiring such costs occur and, among other things, the Government has acknowledged responsibility for the event. By contrast, current budget concepts recognize such costs later, at the time payment is made for the cleanup. Additionally, GAAP requires the recognition of depreciation expenses on fixed assets, a liability for accrued leave, and the total actuarial liabilities for pensions, retired pay, and post-retirement health benefits. These differences are reflected in the Reconciliations of Net Operating Cost and Unified Budget Deficit that is found in the Financial Statements section of this *Financial Report*.

Coverage

These financial statements cover the executive and legislative branches, as well as parts of the judicial branch of the U.S. Government. A list of the significant entities included in these financial statements is in the Appendix. Information from the judicial branch is limited because these entities are not required by law to submit comprehensive financial statement information to the Treasury. The Federal Reserve System is excluded because of its private ownership and independence. The Federal Retirement Thrift Investment Board is excluded because it charges all of its administrative expenses to the Thrift Savings Fund. Therefore, it has no financial activity that would affect the Government's results. Moreover, Government-sponsored but privately-owned enterprises (e.g., the Federal Home Loan Banks, the Federal National Mortgage Association, and the Federal Home Loan Mortgage Corporation) are also excluded since the Federal Government does not control them and is not responsible for their finances.

Additional Information

Details about the information contained in these financial statements can be found in the financial statements of the individual agencies listed in the Appendix. In addition, related U.S. Government publications such as the *Budget of the United States Government*, the *Treasury Bulletin*, the *Monthly Treasury Statement of Receipts and Outlays of the United States Government*, the *Monthly Statement of the Public Debt of the United States*, the *Economic Report of the President*, and the Trustees' Reports for the Social Security and Medicare programs may be of interest.

History of the Report

Financial Reports of the United States Government

Benefiting from a private-sector produced report that featured financial statements for the U.S. Government's 1973 and 1974 fiscal years, Treasury has published financial statements for the Government in every fiscal year since 1975. The earliest reports were budget-based and unaudited, though Treasury hired private sector firms to conduct independent reviews of source data and collection procedures. The CFO Act of 1990 established the position of Chief Financial Officer in 24 agencies and FASAB to develop Federal accounting standards and concepts. The Government Management Reform Act of 1994 (GMRA) required audited financial statements from most Government departments and agencies beginning in fiscal year 1996. GMRA also required the U.S. Government to submit consolidated financial statements audited by GAO beginning with fiscal year 1997's *Financial Report of the United States Government*. In 1999, the American Institute of Certified Public Accountants recognized FASAB as the promulgator of GAAP for the Federal Government. FASAB continually reviews its reporting standards to enhance the usefulness of the Government's financial statements to all users.

Visit http://www.treas.gov/offices/economic-policy/speeches_testimony_refund.html for a more detailed history of the *Financial Report of the United States Government.*

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GAO
Accountability * Integrity * Reliability

Comptroller General
of the United States

United States General Accounting Office
Washington, DC 20548

February 27, 2004

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

Our report on the U.S. government's consolidated financial statements for the fiscal years 2003 and 2002 is enclosed. As in the 6 previous fiscal years, certain material weaknesses in internal control and in selected accounting and reporting practices resulted in conditions that continued to prevent us from being able to provide the Congress and American citizens an opinion as to whether the consolidated financial statements of the U.S. government are fairly stated in conformity with U.S. generally accepted accounting principles.

Proper accounting and reporting practices are essential in the public sector. After all, the U.S. government is the largest, most diverse, most complex, and arguably the most important entity on earth today. Its services—homeland security, national defense, Social Security, mail delivery, and food inspection, to name a few—directly affect the well-being of almost every American. But sound decisions on the future direction of vital government programs and policies are made more difficult without timely, accurate, and useful financial and performance information.

Until the problems discussed in our report are adequately addressed, they will continue to (1) hamper the federal government's ability to accurately report a significant portion of its assets, liabilities, and costs; (2) affect the federal government's ability to accurately measure the full cost as well as the financial and nonfinancial performance of certain programs while effectively managing related operations; and (3) significantly impair the federal government's ability to adequately safeguard certain significant assets and properly record various transactions.

Across government, financial management improvement initiatives are under way that, if effectively implemented, have the potential to appreciably improve the quality of the federal government's financial management and reporting. In this regard, federal agencies have made progress in their efforts to modernize their financial management systems and improve financial management performance as called for in the President's Management Agenda.[1]

In identifying improved financial performance as one of its five governmentwide initiatives, the President's Management Agenda recognized that a clean (unqualified) financial audit opinion is a basic prescription for any well-managed organization. At the same time, it recognized that "most federal agencies that obtain clean audits only do so after making extraordinary, labor-intensive assaults on financial records" at or after year-end and that without sound internal control and accurate and timely financial information, it is not possible to accomplish the President's Management Agenda and secure the best performance and highest measure of accountability for the American people. The Principals of the Joint Financial Management Improvement Program (JFMIP)[2] have defined certain measures, in addition to receiving an unqualified financial statement opinion, for achieving financial management success. These additional measures include being able to routinely provide timely, accurate, and useful financial and performance information and having no material internal control weaknesses or material noncompliance with laws and regulations and the requirements of the Federal Financial Management Improvement Act of 1996 (FFMIA).

For fiscal year 2003, as in fiscal year 2002, 20 of 23 Chief Financial Officers (CFO) Act agencies[3] were able to attain unqualified audit opinions on their financial statements,[4] up from 6 agencies for fiscal year 1996. This is the same number of unqualified opinions received by these CFO Act agencies in fiscal year 2002. However, 2 agencies' fiscal year 2003 opinions were different from those they received in fiscal year 2002. The Agency for International Development (AID) received an unqualified opinion on all of its fiscal year 2003 financial statements for the first time, while the National Aeronautics and Space Administration, which in fiscal year 2002 received an unqualified opinion on its financial statements, received a disclaimer of opinion for fiscal year 2003. A 24th major

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[1]The President's Management Agenda is the Bush administration's strategy for improving the management and performance of the federal government. Its purpose is to identify and address the most significant problems facing the federal government. It contains five governmentwide and nine agency-specific goals to improve federal management and deliver results to the American people.

[2]JFMIP is a joint and cooperative undertaking of the Department of the Treasury, GAO, OMB, and the Office of Personnel Management working in cooperation with each other and other federal agencies to improve financial management practices in the federal government. Leadership and program guidance are provided by the four Principals of the JFMIP—the Comptroller General of the United States, the Secretary of the Treasury, and the Directors of OMB and the Office of Personnel Management.

[3]One of the 24 CFO Act agencies, the Federal Emergency Management Agency (FEMA), was transferred to the new Department of Homeland Security (DHS) effective March 1, 2003, which was 5 months into the fiscal year. With this transfer, FEMA will no longer be required to prepare and have audited stand-alone financial statements under the CFO Act, leaving 23 CFO Act agencies.

[4]At least 4 CFO Act agencies restated certain of their audited fiscal year 2002 financial statements to correct misstatements in such financial statements. All 4 of the agencies had received unqualified opinions on their fiscal year 2002 financial statements. These restatements were not material to the consolidated financial statements.

agency, the Department of Homeland Security (DHS),[5] though not subject to the CFO Act, prepared consolidated financial statements for fiscal year 2003 covering its first 7 months of operations and received a qualified opinion on two of the six required financial statements.[6]

The JFMIP Principals agreed with OMB's initiative to accelerate the agency financial statements reporting date to November 15 for fiscal year 2004. For fiscal year 2003, OMB required the CFO Act agencies to deliver their Performance and Accountability Reports, including their audited financial statements, to OMB by January 30, 2004. However, to prepare for meeting the required November 15 accelerated reporting date for fiscal year 2004, OMB encouraged the CFO Act agencies to accelerate the issuance of their fiscal year 2003 audited financial statements to November 15, 2003, or as close to that date as possible. OMB reported that 8 CFO Act agencies—the Department of Education, the Environmental Protection Agency, the Department of Health and Human Services, the National Science Foundation, the Social Security Administration, the Department of the Treasury (Treasury), AID, and the Department of Veterans Affairs—were able to issue their fiscal year 2003 financial statements with unqualified opinions by mid-November 2003. Another 10 CFO Act agencies issued their financial statements by December 31, 2003, and the remaining 5 CFO Act agencies issued by the end of January 2004. DHS, which faced a herculean challenge, issued its financial statements on February 13, 2004. While these results represent a significant improvement over previous years in the timeliness of CFO Act agencies' issuance of financial statements, they also demonstrate the significant challenges that the federal government will face in meeting the accelerated reporting date for fiscal year 2004.

Auditors at several of the CFO Act agencies reported that the agencies may not be able to produce auditable financial statements within the accelerated time frame for fiscal year 2004 without making fundamental changes to improve a number of their financial management practices. For example, certain federal agency auditors reported that major improvements are needed in (1) management controls to monitor established policies and

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[5]DHS is not a CFO Act agency and is therefore not subject to CFO Act requirements. However, along with most other executive branch agencies not covered by the CFO Act, DHS is required to prepare and have audited financial statements under the Accountability of Tax Dollars Act of 2002, Pub. L. No. 107-289, 116 Stat. 2049. For fiscal year 2003, the act provided that OMB could grant executive branch agencies' requests for waivers from having audited financial statements for fiscal year 2003. However, DHS and certain other agencies chose to prepare and have their fiscal year 2003 financial statements audited.

[6]DHS began operations as an agency 5 months after the start of the fiscal year, on March 1, 2003. Transfers of funds, assets, liabilities, and obligations from 22 existing federal agencies to DHS began on March 1, 2003. DHS's auditors issued a qualified opinion on the consolidated balance sheet and statement of custodial activity as of September 30, 2003, and disclaimed on the consolidated statement of net cost, consolidated statement of changes in net position, combined statement of budgetary resources, and consolidated statement of financing for the 7 months ended September 30, 2003. In accordance with Federal Accounting Standards Advisory Board Technical Bulletin 2003-1, *Certain Questions and Answers Related to the Homeland Security Act of 2002,* the fiscal year 2003 activities that occurred prior to the transfer of operations to DHS were to be reflected in the transferring agencies' financial statements.

procedures for conducting financial analyses and reconciliations throughout the year, (2) fully integrating financial management systems, and (3) providing adequate and skilled staff to support efficient, effective preparation of federal agency consolidated financial statements.

More importantly, federal agency management must continue to work toward fully resolving the pervasive and generally long-standing material weaknesses that have been reported at the agency level for the past 7 fiscal years. The underlying causes of these issues are significant financial management systems problems, with the auditors of 17 of the 23 CFO Act agencies reporting that the agencies' financial management systems did not comply substantially with one or more of FFMIA's three requirements,[7] problems with fundamental recordkeeping and financial reporting, incomplete documentation, and weak internal control. While the severity and magnitude of the problems identified vary greatly, reports of inspectors general and their contract auditors indicated that only the Social Security Administration, Department of Energy, and National Science Foundation had neither a material weakness in internal control, an issue involving compliance with applicable laws and regulations, nor an instance of lack of substantial compliance with FFMIA requirements. Many federal agencies have continued to expend significant resources to use extensive ad hoc procedures and some have had to make billions of dollars in adjustments to derive financial statements months after the end of the fiscal year.

There are three primary reasons why the consolidated financial statements remained unauditable for fiscal year 2003: (1) serious financial management problems at the Department of Defense (DOD), (2) the federal government's inability to account for billions of dollars of transactions between federal government entities, and (3) the federal government's ineffective process for preparing the consolidated financial statements.

First, we have designated the serious financial management problems at DOD as high risk[8] since 1995. Overhauling DOD's financial management operations represents a challenge that goes far beyond financial accounting to the very fiber of DOD's range of business operations, management information systems, and culture. DOD's financial management problems are pervasive, complex, long-standing, and deeply rooted in virtually all business operations throughout the department. To date, none of the military services or major DOD components has passed the test of an independent financial audit[9] because of pervasive weaknesses in financial management systems, operations, and

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[7]FFMIA requires auditors, as part of CFO Act agencies' financial statement audits, to report whether agencies' financial management systems substantially comply with (1) federal financial management systems requirements, (2) applicable federal accounting standards (U.S. generally accepted accounting principles), and (3) the federal government's Standard General Ledger at the transaction level.
[8]GAO identifies areas at high risk due to either their greater vulnerabilities to waste, fraud, abuse, and mismanagement or major challenges associated with their economy, efficiency, or effectiveness.
[9]Although not major DOD components, the Military Retirement Fund received an unqualified opinion on its fiscal year 2003 financial statements, and the DOD Medicare-Eligible Retiree Health Care Fund received a qualified opinion on its fiscal year 2003 financial statements.

controls. To address these problems, DOD has taken several positive steps in many key areas. For example, the Secretary of Defense has included improving DOD's financial management as one of his top 10 priorities, and the department has taken a number of actions under its Business Management Modernization Program, including development in April 2003 of an initial business enterprise architecture to guide operational and technological changes. DOD is currently working to refine and implement that architecture and expects to issue new versions of it during 2004. DOD reports that it is also developing detailed financial improvement plans intended to provide disciplined leadership, identify corrective actions, implement solutions, and result in a favorable audit opinion on the fiscal year 2007 DOD-wide financial statements. But DOD still has a long way to go, and top leadership must continue to stress the importance of achieving lasting improvement that truly transforms the department's business systems and operations. Only through major transformation will DOD be able to meet the mandate of the CFO Act and achieve the President's Management Agenda goal of improved financial performance.

Second, we reported in previous years that the heart of the intragovernmental transactions issue was that the federal government lacked clearly articulated business rules for these transactions so that they would be handled consistently by agencies. In this regard, at the start of fiscal year 2003, OMB issued business rules to transform and standardize intragovernmental ordering and billing. However, CFO Act agencies continue to be unable to perform reconciliations of intragovernmental activity and balances with their trading partners,[10] citing reasons such as (1) trading partners not providing needed data; (2) limitations and incompatibility of agency and trading partner information systems; and (3) lack of human resources. Amounts reported for federal agency trading partners for certain intragovernmental accounts were significantly out of balance in the aggregate for both fiscal years 2003 and 2002. To address long-standing problems with intragovernmental exchange transactions between federal agencies, Treasury provided federal agencies with quarterly detailed trading partner information during fiscal year 2003 to help them better perform their trading partner reconciliations. In addition, the federal government began a three-phase Intragovernmental Transactions e-gov project to define a governmentwide data architecture and provide a single source of detailed trading partner data.

Third, with respect to preparing the consolidated financial statements, Treasury is developing a new system and procedures to prepare the consolidated financial statements beginning with the statements for fiscal year 2004. Treasury officials have stated that these actions are intended to, among other things, directly link information from federal agencies' audited financial statements to amounts reported in the consolidated financial statements and resolve many of the issues we identified in the process for preparing the consolidated financial statements.

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[10]Trading partners are U.S. government agencies, departments, or other components included in the consolidated financial statements that do business with each other.

The continued strong leadership of both OMB and Treasury will be important to resolve the intragovernmental transactions issue and issues surrounding preparing the consolidated financial statements.

The need for timely, accurate, and useful financial and performance information is greater than ever. Our nation's large and growing long-term fiscal imbalance, which is driven largely by known demographic trends and rising health care costs, coupled with new homeland security and defense commitments, serves to sharpen the need to fundamentally review and re-examine the base of federal entitlement, discretionary, and other spending and tax policies. For example, as we look ahead, our nation faces an unprecedented demographic challenge, with significant budgetary, economic, and other implications. Between now and 2035, the number of people who are 65 years old or over will double, driving federal spending on the elderly to a larger and ultimately unsustainable share of the federal budget. As a result, tough choices will be required to address the resulting structural imbalance.

The federal government's gross debt as of September 2003 was about $7 trillion, or about $24,000 for every man, woman, and child in the country. But that number excludes such items as the gap between promised and funded Social Security and Medicare commitments and veterans health care benefit commitments provided through the Department of Veterans Affairs. If these items are factored in, the current dollar burden for every American rises to well over $100,000. In addition, the new Medicare prescription drug benefit will add thousands more to that tab.

The Trustees of the Social Security and Medicare trust funds report annually on the current and projected status of these programs over the next 75 years. As highlighted in our report last year, the 2003 trustees' reports stated that the fundamentals of the financial status of both Social Security and Medicare remain highly problematic.[11] However, the trustees reported that Medicare faces financial difficulties that are more severe than those confronting Social Security because Medicare program costs are projected to rise faster than Social Security program costs. In their 2003 report, the trustees once again stated that action to address the financial difficulties facing Social Security and Medicare must be taken in a timely manner and that the sooner these financial challenges are addressed, the more varied and less disruptive the solutions can be. In addition, the new prescription drug benefit, which is one of the largest unfunded commitments ever undertaken by the federal government, will serve to increase this financial and fiscal challenge. The trustees will include an official estimate of the discounted present value cost of this new benefit

[11]Last year, our auditor's report was issued subsequent to the release of the 2003 Annual Reports of the Boards of Trustees of the Social Security and Medicare Trust Funds and, as a result, included certain information from those reports. Due to the accelerated issuance of the fiscal year 2003 *Financial Report of the United States Government* this year, similar information from the 2004 Annual Reports of the Trustees is not available. Data from these reports will be used to prepare the social insurance disclosures in the fiscal year 2004 *Financial Report of the United States Government*.

over the next 75 years in their annual report, which is scheduled for issuance in March 2004. Preliminary estimates of the long-term cost are in the trillions of dollars in discounted present value terms over a 75-year period.

The Congress and the President face the challenge of sorting out the many claims on the federal budget without the budget enforcement mechanisms or fiscal benchmarks that guided the federal government through the years of deficit reduction into a brief period of federal surpluses. While a number of steps will be necessary to address this challenge, truth and transparency in federal government reporting are essential elements of any attempt to address the nation's long-term fiscal challenges. The fiscal risks just mentioned can be managed only if they are properly accounted for and publicly disclosed, including the many existing commitments facing the government. In addition, new budget control mechanisms will be required, along with effective approaches to successfully engage in a fundamental review, reassessment, and reprioritization of the base of federal government programs and policies that I have mentioned previously.

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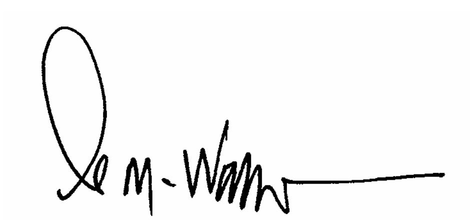
Once again, we appreciate the cooperation and assistance of Treasury and OMB officials, as well as the chief financial officers and inspectors general, in carrying out our responsibility to report on the U.S. government's consolidated financial statements. We look forward to continuing to work with these officials and the Congress to achieve the goals and objectives of financial management reform.

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



David M. Walker
Comptroller General
of the United States

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Comptroller General
of the United States

United States General Accounting 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 (OMB), is required annually to submit financial statements for the U.S. government to the President and the Congress. GAO is required to audit these statements.[1] This is our report on the accompanying U.S. government's consolidated financial statements for the fiscal years ended September 30, 2003 and 2002,[2] and our associated reports on internal control and compliance with laws and regulations.

The federal government is responsible for (1) preparing annual consolidated financial statements in conformity with U.S. generally accepted accounting principles (GAAP); (2) establishing, maintaining, and assessing internal control to provide reasonable assurance that the control objectives of the Federal Managers' Financial Integrity Act are met;[3] and (3) complying with applicable laws and regulations. Also, the 23 Chief Financial Officers (CFO) Act agencies[4] are responsible for implementing and maintaining financial management systems that substantially comply with Federal Financial Management

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[1]The Government Management Reform Act of 1994 has required such reporting, covering the executive branch of government, beginning with financial statements prepared for fiscal year 1997. 31 U.S.C. 331 (e) (2000). The federal government has elected to include certain financial information on the legislative and judicial branches in the consolidated financial statements as well.

[2]The consolidated financial statements for the fiscal years ended September 30, 2003 and 2002, consist of the Statements of Operations and Changes in Net Position, Statements of Net Cost, Reconciliations of Net Operating Cost and Unified Budget Deficit, Statements of Changes in Cash Balance from Unified Budget and Other Activities, and Balance Sheets, including the related notes to these financial statements.

[3]31 U.S.C. 3512 (c), (d) (2000). This act requires agency heads to evaluate and report annually to the President on the adequacy of their internal control and accounting systems and on actions to correct significant problems.

[4]31 U.S.C. 901(b) (2000). The Federal Emergency Management Agency (FEMA) was transferred to the new Department of Homeland Security (DHS) effective March 1, 2003. With this transfer, FEMA is no longer required to prepare and have audited stand-alone financial statements under the CFO Act, leaving 23 CFO Act agencies. DHS, along with most other executive branch agencies, is required to prepare and have audited financial statements under the Accountability of Tax Dollars Act of 2002, Pub. L. No. 107-289, 116 Stat. 2049.

Improvement Act of 1996 (FFMIA)[5] requirements. Our objective was to audit the consolidated financial statements for the fiscal years ended September 30, 2003 and 2002. Appendix I discusses the scope and methodology of our work.

A significant number of material weaknesses[6] related to financial systems, fundamental recordkeeping and financial reporting, and incomplete documentation continued to (1) hamper the federal government's ability to accurately report a significant portion of its assets, liabilities, and costs; (2) affect the federal government's ability to accurately measure the full cost and financial performance of certain programs and effectively manage related operations; and (3) significantly impair the federal government's ability to adequately safeguard significant assets and properly record various transactions. Several of these material weaknesses (referred to hereafter as material deficiencies) resulted in conditions that continued to prevent us from forming and expressing an opinion on the accompanying consolidated financial statements for the fiscal years ended September 30, 2003 and 2002.[7] There may also be additional issues that could affect the consolidated financial statements that have not been identified.

In accordance with section 1008 of the National Defense Authorization Act for Fiscal Year 2002,[8] the Department of Defense (DOD) reported that for fiscal year 2003, it was not able to provide adequate evidence supporting material amounts in its financial statements. DOD stated that it is unable to comply with applicable financial reporting requirements for (1) property, plant, and equipment (PP&E); (2) inventory and operating materials and supplies; (3) environmental liabilities; (4) intragovernmental eliminations and related accounting adjustments; (5) disbursement activity; and (6) cost accounting by responsibility segment. Although DOD represented that the military retirement health care liability data had improved for fiscal year 2003, the cost of direct health care provided by DOD-managed military treatment facilities was a significant amount of DOD's total recorded health care liability and was based on estimates for which adequate support was not available.

As had been the case for the previous 7 fiscal years, the DOD Inspector General disclaimed an opinion on DOD's financial statements for fiscal year 2003. DOD's financial management systems and reporting weaknesses substantially impair our ability to determine the reliability of the financial information reported in the federal government's overall financial reports. Given the significance of DOD's activities and balances to the consolidated financial statements, until DOD corrects its material weaknesses, it will continue to impede our ability to express an opinion on the

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[5]31 U.S.C. 3512 note (2000) (Federal Financial Management Improvement).
[6]A material weakness is a condition that precludes the entity's internal control from providing reasonable assurance that misstatements, losses, or noncompliance material in relation to the financial statements or to stewardship information would be prevented or detected on a timely basis.
[7]We previously reported that material deficiencies prevented us from expressing an opinion on the fiscal years 1997, 1998, 1999, 2000, 2001, and 2002 consolidated financial statements of the U.S. government.
[8]Pub. L. No. 107-107, 115 Stat. 1012, 1204 (2001).

consolidated financial statements. In addition, as noted later in this report, there are other material weaknesses that will need to be corrected.

DISCLAIMER OF OPINION ON THE CONSOLIDATED FINANCIAL STATEMENTS

Because of the federal government's inability to demonstrate the reliability of significant portions of the accompanying fiscal years 2003 and 2002 U.S. government's consolidated financial statements and limitations on the scope of our work related to the preparation of the consolidated financial statements and management and legal representations, all of which are discussed below, we are unable to, and we do not, express an opinion on such financial statements.

As a result of the material deficiencies in the federal government's systems, recordkeeping, documentation, and financial reporting, as discussed below, readers are cautioned that amounts reported in the consolidated financial statements and related notes may not be reliable. These material deficiencies also affect the reliability of certain information contained in the accompanying Management's Discussion and Analysis and other financial management information—including information used to manage the government day to day and budget information reported by federal agencies—which is taken from the same data sources as the consolidated financial statements.

We have not audited and do not express an opinion on the Management's Discussion and Analysis, Stewardship Information, Supplemental Information, or other information included in the accompanying fiscal year 2003 *Financial Report of the United States Government*.

Implementation of Statement of Federal Financial Accounting Standards (SFFAS) No. 23, *Eliminating the Category National Defense Property, Plant, and Equipment*, effective October 1, 2002, required the capitalization and, except for land and land improvements, subsequent depreciation of military equipment in the financial statements. This equipment had previously been charged to expense and reported in memorandum fashion among the required supplemental stewardship information. This change in accounting principle, as discussed in notes 6, 7, and 17 of the consolidated financial statements, resulted in an increase in PP&E of $317 billion and in inventories and related property of $66 billion. This adjustment was based on estimated values for which reasonableness could not be assured by DOD management. In addition, because of the material deficiencies over PP&E and inventories and related property as discussed below, these amounts may not be reliable.

The Department of Energy's (DOE) accelerated cleanup approach enabled the department to reduce its environmental liabilities during the fiscal years ended September 30, 2003 and 2002. However, as discussed in note 18 to the U.S. government's consolidated financial statements, a federal district court ruled that certain aspects of DOE's proposed high-level waste cleanup approach are not in compliance with provisions of the Nuclear Waste Policy Act of 1982. If DOE is not successful in either its appeal of this court ruling or in its proposal to modify provisions of the act, DOE estimates that its environmental liabilities could increase by more than $100 billion.

Additional Limitations on the Scope of Our Work

There were additional limitations on the scope of our work. As agreed with the Department of the Treasury (Treasury) and OMB, we accelerated the time frame to issue our reports on the audit of the fiscal year 2003 consolidated financial statements to meet the federal government's February 27, 2004, accelerated reporting date. It was understood that OMB anticipated that all of the CFO Act agencies' and the Department of Homeland Security's (DHS) financial statements would be issued by December 30, 2003. However, several CFO Act agencies' fiscal year 2003 financial statements were not issued until late January 2004, and DHS's financial statements were not issued until February 13, 2004. These delays, along with the lack of timely submission by several federal agencies of certain key agency information used by Treasury to prepare the consolidated financial statements, significantly impaired Treasury's ability to provide us with complete and accurate drafts of the consolidated financial statements, including the February 5, 2004, draft which was to have been the final draft of the consolidated financial statements. As a result, we did not receive the U.S. government's consolidated financial statements in time to complete our planned auditing procedures related to the compilation of these financial statements within the reporting deadline.

For each federal agency financial statement audit, U.S. generally accepted auditing standards require that agency auditors obtain written representations as part of the audit. However, we continued to identify problems with the adequacy of certain federal agencies' management and legal representations on which Treasury and OMB depend to provide their representations to us regarding the consolidated financial statements. Further, due primarily to the lack of timely submission of certain federal agencies' legal representations to the Department of Justice, the department was not able to provide us with the legal representation letter relating to the consolidated financial statements until February 19, 2004, which did not allow us time to complete our planned auditing procedures in this area within the accelerated reporting deadline.

Due to the material deficiencies discussed below and the above-noted additional limitations on the scope of our work, there may also be additional issues that could affect the consolidated financial statements that have not been identified.

Material Deficiencies

The federal government did not maintain adequate systems or have sufficient, reliable evidence to support information reported in the accompanying consolidated financial statements, as described below. These material deficiencies contributed to our disclaimer of opinion and also constitute material weaknesses in internal control. Appendix II highlights the primary effects of these material weaknesses on the accompanying consolidated financial statements and on the management of federal government operations.

Property, Plant, and Equipment and Inventories and Related Property

The federal government could not satisfactorily determine that all PP&E and inventories and related property were included in the consolidated financial statements, verify that certain reported assets actually exist, or substantiate the amounts at which they were valued. Most of the PP&E and inventories and related property are the responsibility of DOD. As in past years, DOD did not maintain adequate systems or have sufficient records to provide reliable information on these assets. Other agencies, most notably the National Aeronautics and Space Administration, reported continued weaknesses in internal control procedures and processes related to PP&E.

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 those related to treaties and other international agreements entered into to further the U.S. government's interests, were complete and properly reported.

Cost of Government Operations and Disbursement Activity

The previously discussed material deficiencies in reporting assets and liabilities, material deficiencies in financial statement preparation, as discussed below, and the lack of adequate disbursement reconciliations at certain federal agencies affect reported net costs. As a result, the federal government was unable to support significant portions of the total net cost of operations, most notably related to DOD.

With respect to disbursements, DOD and certain other federal agencies did not adequately reconcile disbursement activity. For fiscal years 2003 and 2002 there were unsupported adjustments to federal agencies' records and unreconciled disbursement activity, including unreconciled differences between federal agencies' and Treasury's records of disbursements, totaling billions of dollars, which could also affect the balance sheet.

Accounting for and Reconciliation of Intragovernmental Activity and Balances

OMB and Treasury require the CFOs of 35 executive departments and agencies, including the 23 CFO Act agencies, to reconcile selected intragovernmental activity and balances with their "trading partners"[9] and to report to Treasury, the agency's inspector general, and GAO on the extent and results of intragovernmental activity and balances reconciliation efforts. A substantial number of the agencies did not fully perform the required reconciliations for fiscal years 2003 and 2002, citing reasons such as (1) trading partners not providing needed data, (2) limitations and incompatibility of agency and trading partner information systems, and (3) lack of human resources. For both of these years, amounts reported for federal agency trading partners for certain intragovernmental accounts were significantly out of balance. Treasury's ability to eliminate certain intragovernmental activity and balances is impaired by these federal agencies' problems in handling their intragovernmental transactions.

To address long-standing problems with intragovernmental exchange transactions between federal agencies, Treasury and OMB have undertaken various efforts. However, resolving the intragovernmental transactions problem remains a difficult challenge and will require a commitment by federal agencies and continued strong leadership by OMB.

Net Outlays

OMB Bulletin 01-09, *Form and Content of Agency Financial Statements,*[10] states that outlays in federal agencies' Statements of Budgetary Resources (SBR) should agree with the respective agency's net outlays reported in the budget of the U.S. government. In addition, SFFAS No. 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting,* requires explanation of any material differences between the information required to be disclosed (including net outlays) and the amounts described as "actual" in the budget of the U.S. government.

We found material differences between the total net outlays reported in selected federal agencies' audited SBRs and the records used to prepare the Statement of Changes in Cash Balance from Unified Budget and Other Activities (Statement of Changes in Cash Balance),[11] totaling about $140 billion and $186 billion for fiscal years 2003 and 2002,

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[9]Trading partners are U.S. government agencies, departments, or other components included in the consolidated financial statements that do business with each other.

[10]Office of Management and Budget Bulletin No. 01-09, *Form and Content of Agency Financial Statements* (Washington, D.C.: Sept. 25, 2001). This bulletin is OMB's official guidance for the form and content of federal agencies' financial statements.

[11]OMB and U.S. generally accepted accounting principles (GAAP) require agencies to report net outlays in the SBR. The Statement of Changes in Cash Balance also reports unified budget outlays-actual. Both are intended to represent the same amount and be consistent with the information presented in the budget of the U.S. government.

respectively.[12] Two agencies (Treasury and the Department of Health and Human Services (HHS)) accounted for about 83 percent and 75 percent of the differences identified in fiscal years 2003 and 2002, respectively. We found that the major cause of the differences for the two agencies was the treatment of offsetting receipts.[13] Some offsetting receipts for these two agencies had not been included in the agencies' SBRs, which would have reduced the agencies' net outlays and made the amounts more consistent with the records used to prepare the Statement of Changes in Cash Balance.[14] For example, we found that HHS reported net outlays for fiscal year 2003 as $596 billion on its audited SBR, while the records that Treasury uses to prepare the Statement of Changes in Cash Balance showed $505 billion for fiscal year 2003 for this agency. Until these differences between the total net outlays reported in the federal agencies' SBRs and the records used to prepare the Statement of Changes in Cash Balance are reconciled, the effect that these differences may have on the U.S. government's consolidated financial statements will be unknown. OMB has stated that it plans to work with the agencies to address this issue.

Preparation of Consolidated Financial Statements

The federal government did not have adequate systems, controls, and procedures to ensure that the consolidated financial statements are consistent with the underlying audited agency financial statements, balanced, and in conformity with GAAP. During our fiscal year 2003 audit, we found the following:[15]

- The process for compiling the consolidated financial statements does not directly link information from federal agencies' audited financial statements to amounts reported in the consolidated financial statements, and therefore does not ensure that the information in the consolidated financial statements is consistent with the underlying information in federal agencies' audited financial statements and other financial data.

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[12]In some agencies' fiscal year 2003 financial statements, the comparable fiscal year 2002 amounts were restated.
[13]Offsetting receipts are collections that are credited to general fund, special fund, or trust fund receipt accounts and that offset gross outlays at the agency or governmentwide level.
[14]These two agencies did not adequately explain their fiscal year 2002 differences between the net outlays reported on the SBR and the budget of the U.S. government in their notes to the fiscal year 2003 financial statements.
[15]The same issues we identified in fiscal year 2003 existed in fiscal year 2002, and some have existed for a number of years. In October 2003, we reported in greater detail on the issues we identified, in U.S. General Accounting Office, *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). This report included 44 recommendations to address weaknesses we identified. It also included recommendations related to 16 disclosure areas that are required by GAAP. We recommended that the 16 disclosures that are not included in the consolidated financial statements either be included or that the rationale for their exclusion be documented.

- Internal control weaknesses exist in Treasury's process for preparing the consolidated financial statements, such as a lack of (1) segregation of duties and (2) appropriate documentation of certain policies and procedures for preparing the consolidated financial statements.

- The net position reported in the consolidated financial statements is derived by subtracting liabilities from assets, rather than through balanced accounting entries. To make the fiscal years 2003 and 2002 consolidated financial statements balance, Treasury recorded a net $24.5 billion and a net $17.1 billion decrease, respectively, to net operating cost on the Statements of Operations and Changes in Net Position, which it labeled "Unreconciled Transactions Affecting the Change in Net Position."[16] An additional net $11.3 billion and $12.5 billion of unreconciled transactions were recorded in the Statements of Net Cost for fiscal years 2003 and 2002, respectively. Treasury does not identify and quantify all components of these unreconciled activities, nor does Treasury perform reconciliation procedures, which would aid in understanding and controlling the net position balance as well as eliminating the unreconciled transactions associated with compiling the consolidated financial statements.

- Significant differences in other intragovernmental accounts, primarily related to appropriations, still remain unresolved. Intragovernmental activity and balances are "dropped" or "offset" in the preparation of the consolidated financial statements rather than eliminated through balanced accounting entries. This contributes to the federal government's inability to determine the impact of these differences on amounts reported in the consolidated financial statements.

- The federal government did not have an adequate process to identify and report items needed to reconcile the operating results, which for fiscal year 2003 showed a net operating cost of $665 billion, to the budget results, which for the same period showed a unified budget deficit of $374.8 billion.

- The consolidated financial statements include certain financial information for the executive, legislative, and judicial branches, to the extent that federal agencies within those branches have provided Treasury such information. However, there are undetermined amounts of assets, liabilities, costs, and revenues that are not included, and the federal government did not provide evidence or disclose in the consolidated financial statements that such excluded financial information was immaterial.

- Treasury lacks an adequate process to ensure that the financial statements, related notes, Stewardship Information, and Supplemental Information are presented in

[16]Although Treasury was unable to determine how much of the unreconciled transactions, if any, relate to operations, it reported unreconciled transactions as a component of net operating cost in the accompanying consolidated financial statements.

conformity with GAAP. We found that certain financial information required by GAAP was not disclosed in the consolidated financial statements. Treasury did not provide us with documentation of its rationale for excluding this information. As a result of this and certain material deficiencies noted above, we were unable to determine if the missing information was material to the consolidated financial statements.

Beginning with fiscal year 2004, Treasury is planning on using a new system and procedures that will collect agency financial statement information directly from federal agencies' audited financial statements rather than using federal agencies' Standard General Ledger data. Treasury has stated that these actions are intended to, among other things, directly link information from federal agencies' audited financial statements to amounts reported in the consolidated financial statements and resolve many of the weaknesses we identified in the process for preparing the consolidated financial statements.

OPINION ON INTERNAL CONTROL

In addition to the material weaknesses noted above, we found four other material weaknesses in internal control as of September 30, 2003, which are described below. Because of the effects of the material weaknesses discussed in this report, in our opinion, the federal government did not maintain effective internal control to meet the following objectives: (1) transactions are properly recorded, processed, and summarized to permit the preparation of the financial statements and stewardship information in conformity with GAAP, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition; and (2) transactions are executed in accordance with laws governing the use of budget authority and with other laws and regulations that could have a direct and material effect on the financial statements and stewardship information. Individual federal agency financial statement audit reports identify additional reportable conditions[17] in internal control, some of which were reported by agency auditors as being material weaknesses at the individual agency level. These matters do not represent material weaknesses at the governmentwide level. Also, due to the issues noted throughout this report, additional material weaknesses may exist that have not been reported.

Loans Receivable and Loan Guarantee Liabilities

In general, federal agencies continue to make progress in reducing the number of material weaknesses and reportable conditions related to their lending activities. However, significant deficiencies in the processes and procedures used to estimate the costs of certain lending programs and value the related loans receivable still remain. The most

[17]Reportable conditions are matters coming to our attention that, in our judgment, should be communicated because they represent significant deficiencies in the design or operation of internal control that could adversely affect the federal government's ability to meet the internal control objectives described in this report.

notable deficiencies existed at the Small Business Administration (SBA), which, while improved from last year, continues to have a material weakness related to this area. For example, SBA did not adequately document its estimation methodologies, lacked the management controls necessary to ensure that appropriate estimates were prepared and reported based on complete and accurate data, and could not fully support the reasonableness of the costs of its lending programs and valuations of its loan portfolio. SBA's material weakness plus deficiencies at other federal credit agencies relating to the processes and procedures for estimating credit program costs continue to adversely affect the 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.

Improper Payments

Across the federal government, improper payments occur in a variety of programs and activities, including those related to health care, contract management, federal financial assistance, and tax refunds.[18] While complete information on the magnitude of improper payments is not yet available, based on available data, OMB has estimated that improper payments exceed $35 billion annually. Many improper payments occur in federal programs that are administered by entities other than the federal government, such as states. Improper payments often result from a lack of or an inadequate system of internal controls. Although the President's Management Agenda includes an initiative to reduce improper payments, most federal agencies have not reported the magnitude of improper payments in their programs and activities.

The Improper Payments Information Act of 2002 provides for federal agencies to estimate and report on their improper payments.[19] It requires federal agencies to (1) annually review programs and activities that they administer to identify those that may be susceptible to significant improper payments, (2) estimate improper payments in susceptible programs and activities, and (3) provide reports to the Congress that discuss the causes of improper payments identified and the status of actions to reduce them. In accordance with the legislation, OMB issued guidance for federal agencies' use in implementing the act. Among other things, the guidance requires federal agencies to report on their improper payment-related activities in the Management Discussion and Analysis section of their annual Performance and Accountability Reports (PAR). While the act does not require such reporting by all federal agencies until fiscal year 2004, OMB required 44 programs and 14 CFO Act agencies to report improper payment information in their fiscal year 2003 PARs. Our preliminary review of the PARs found

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[18]Improper payments include inadvertent errors, such as duplicate payments and miscalculations, payments for unsupported or inadequately supported claims, payments for services not rendered, payments to ineligible beneficiaries, and payments resulting from fraud and abuse by program participants and/or federal employees.

[19]Pub. L. No. 107-300, 116 Stat. 2350. The act's reporting requirement applies only to an agency program or activity with estimated improper payments exceeding $10 million.

that 12 of the 14 agencies reported improper payment amounts for 27 of the 44 programs identified in the guidance. We also found that, for the programs where improper payments were identified, the reports often contained information on the causes of the payments but little information that addressed the other reporting requirements cited in the legislation.

Information Security

Although progress has been made, serious and widespread information security weaknesses continue to place federal assets at risk of inadvertent or deliberate misuse, financial information at risk of unauthorized modification or destruction, sensitive information at risk of inappropriate disclosure, and critical operations at risk of disruption. GAO has reported information security as a high-risk area across government since February 1997. Such information security weaknesses could result in compromising the reliability and availability of data that are recorded in or transmitted by federal financial management systems. A primary reason for these weaknesses is that federal agencies have not yet fully institutionalized comprehensive security management programs, which are critical to identifying information security weaknesses, resolving information security problems, and managing information security risks on an ongoing basis. The Congress has shown continuing interest in addressing these risks, as evidenced by recent hearings on information security and enactment of the Federal Information Security Management Act of 2002[20] and the Cyber Security Research and Development Act.[21] In addition, the administration has taken important actions to improve information security, such as integrating information security into the Executive Branch Management Scorecard.[22]

Tax Collection Activities

Material internal control weaknesses and systems deficiencies continue to affect the federal government's ability to effectively manage its tax collection activities.[23] Due to errors and delays in recording activity in taxpayer accounts, taxpayers were not always credited for payments made on their taxes owed, which could result in undue taxpayer burden. In addition, the federal government did not always follow up on potential unreported or underreported taxes and did not always pursue collection efforts against taxpayers owing taxes to the federal government.

[20]Title III of the E-Government Act of 2002, Pub. L. No. 107-347, 116 Stat. 2899.
[21]Pub. L. No. 107-305, 116 Stat. 2367 (2002).
[22]The Executive Branch Management Scorecard highlights agencies' progress in achieving management and performance improvements embodied in the President's Management Agenda.
[23]U.S. General Accounting Office, *Financial Audit: IRS's Fiscal Years 2003 and 2002 Financial Statements,* GAO-04-126 (Washington, D.C.: Nov. 13, 2003).

COMPLIANCE WITH APPLICABLE LAWS AND REGULATIONS

Our work to determine compliance with selected provisions of applicable laws and regulations related to financial reporting was limited by the material weaknesses discussed above. U.S. generally accepted government auditing standards and OMB Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements,* require auditors to report on the agency's compliance with laws and regulations. Individual agency audit reports contain instances of noncompliance. None of these instances were material 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 applicable laws and regulations.

AGENCY FINANCIAL MANAGEMENT SYSTEMS

To achieve the financial management improvements envisioned by the CFO Act, FFMIA, and, more recently, the President's Management Agenda, federal agencies need to modernize their financial management systems to generate reliable, useful, and timely financial and performance information throughout the year and at year-end. As discussed throughout this report, serious financial management systems weaknesses have contributed significantly to our inability to determine the reliability of the consolidated financial statements. FFMIA requires auditors, as part of CFO Act agencies' financial statement audits, to report whether agencies' financial management systems substantially comply with (1) federal financial management systems requirements, (2) applicable federal accounting standards (GAAP), and (3) the federal government's Standard General Ledger at the transaction level. For fiscal year 2003, auditors for 17 of the 23 CFO Act agencies[24] reported that the agencies' financial management systems did not comply substantially with one or more of these three FFMIA requirements. A 24th agency, DHS, is not subject to the requirements of the CFO Act and, consequently, is not required to comply with FFMIA. Accordingly, DHS's auditor did not report on DHS's compliance with FFMIA. However, the auditors identified and reported deficiencies that related to the three requirements of FFMIA noted above. Meeting the requirements of FFMIA has presented long-standing, significant challenges. These challenges will be resolved only through time, investment, and sustained emphasis on correcting deficiencies in federal financial management systems.

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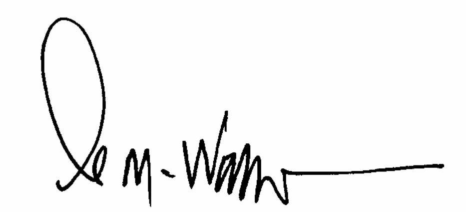
[24]For the remaining 6 CFO Act agencies, auditors provided negative assurance, meaning that nothing came to their attention indicating that the agencies' financial management systems did not substantially meet FFMIA requirements. The auditors for these 6 agencies did not definitively state whether the agencies' systems substantially complied with FFMIA requirements, as is required under the statute.

We provided a draft of this report to Treasury and OMB officials, who provided technical comments, which have been incorporated as appropriate. Treasury and OMB officials expressed their continuing commitment to address the problems this report outlines.



David M. Walker
Comptroller General
of the United States

February 20, 2004

APPENDIX I

SCOPE AND METHODOLOGY

The Government Management Reform Act of 1994 expanded the requirements of the Chief Financial Officers (CFO) Act by making the inspectors general of 24 major federal agencies[25] 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.[26] Our work was performed in coordination and cooperation with the inspectors general to achieve our joint audit objectives. This work included separate GAO audits of certain significant federal agency components, as discussed below. Our audit approach focused primarily on determining the current status of the material deficiencies and the other material weaknesses affecting internal control that we had previously reported in our report on the consolidated financial statements for fiscal year 2002.[27] We performed sufficient audit work to provide this report on the consolidated financial statements, internal control, and the results of our assessment of compliance with applicable laws and regulations.

We separately audited the following significant federal agency components:

- We audited and expressed an unqualified opinion on the Internal Revenue Service's (IRS) fiscal years 2003 and 2002 financial statements, which included approximately $2 trillion of tax revenue for both fiscal years; $300 billion and $281 billion of tax refunds for fiscal years 2003 and 2002, respectively; and $20 billion of net federal taxes receivable each year.[28] In fiscal year 2003, we continued to report numerous material internal control weaknesses, which resulted in ineffective internal controls. Our tests of compliance with selected provisions of laws and regulations disclosed two areas of noncompliance. We also found that IRS's financial management systems did not 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 the Department of the Treasury's (Treasury) Bureau of the Public Debt (BPD) for the fiscal years ended September 30, 2003 and 2002.[29] The schedules reported for these 2 fiscal years (1) approximately $3.9 trillion (2003) and $3.6 trillion (2002) of federal debt held by the public, comprising individuals,

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[25]31 U.S.C. 901(b), 3521(e), but see footnote 4.
[26]The 1994 act authorized the Office of Management and Budget to designate agency components that also would receive a financial statement audit. 31 U.S.C. 3515(c).
[27]For our report on the U.S. government's consolidated financial statements for fiscal year 2002, see U.S. Department of the Treasury, *Financial Report of the United States Government* (Washington, D.C.: March 2003), pp. 37-45, which can be found on GAO's Internet site at www.gao.gov.
[28]GAO-04-126.
[29]U.S. General Accounting Office, *Financial Audit: Bureau of the Public Debt's Fiscal Years 2003 and 2002 Schedules of Federal Debt,* GAO-04-177 (Washington, D.C.: Nov. 7, 2003).

corporations, state and local governments, the Federal Reserve Banks, and foreign governments and central banks; (2) about $2.9 trillion (2003) and $2.7 trillion (2002) of intragovernmental debt holdings, which represent federal debt issued by Treasury and held by certain federal government accounts such as the Social Security and Medicare trust funds; and (3) nearly $157 billion (2003) and $172 billion (2002) of interest on federal debt held by the public.[30] We reported that as of September 30, 2003, BPD had effective internal control over financial reporting and compliance with applicable laws and regulations relevant to the Schedule of Federal Debt. Further, we reported that there was no reportable noncompliance in fiscal year 2003 with laws we tested.

- We audited and expressed unqualified opinions on the December 31, 2003 and 2002, financial statements of the funds administered by the Federal Deposit Insurance Corporation (FDIC), including the Bank Insurance Fund, the Savings Association Insurance Fund, and the FSLIC Resolution Fund.[31] We reported that as of December 31, 2003, FDIC had effective internal control over financial reporting and compliance with laws and regulations. In addition, we performed audit procedures and tests of internal control over certain material balances of the funds administered by FDIC as of September 30, 2003.

We considered the CFO Act agencies' and certain other federal agencies' fiscal years 2003 and 2002 financial statements and the related auditors' reports prepared by the inspectors general or their contractors. Financial statements and audit reports for these agencies provide information about the operations of each of these entities. We did not audit, and we do not express an opinion on, any of these individual federal agency financial statements. We also considered the Department of Defense (DOD) assertion provided to the DOD inspector general that DOD management prepared and submitted pursuant to the provisions of the National Defense Authorization Act for Fiscal Year 2002. We performed our work in accordance with U.S. generally accepted government auditing standards.

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[30]On May 27, 2003, legislation was enacted to raise the statutory debt limit by $984 billion to $7.384 trillion. Pub. L. No. 108-24, 117 Stat. 710 (2003). In early February 2004, Treasury's acting Under Secretary for Domestic Finance noted that the government will reach its legally authorized debt ceiling between June and October 2004.

[31]U.S. General Accounting Office, *Financial Audit: Federal Deposit Insurance Corporation Funds' 2003 and 2002 Financial Statements,* GAO-04-429 (Washington, D.C.: Feb. 13, 2004).

APPENDIX II

PRIMARY EFFECTS CAUSED BY THE MATERIAL WEAKNESSES DESCRIBED IN THIS REPORT

Areas Involving Material Weaknesses	Primary Effects on the Fiscal Years 2003 and 2002 Consolidated Financial Statements and the Management of Government Operations
Property, plant, and equipment and inventories and related property	Without accurate asset information, the federal government does not fully know the assets it owns and their location and condition and cannot effectively (1) safeguard assets from physical deterioration, theft, or loss, (2) account for acquisitions and disposals of such assets, (3) ensure 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	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, improperly stated environmental and disposal liabilities and weak internal control supporting the process for their estimation affect the federal government's ability to determine priorities for cleanup and disposal activities and to allow for appropriate consideration of future budgetary resources needed to carry out these activities. In addition, when 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	Inaccurate 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. Improperly recorded disbursements could result in misstatements in the financial statements and in certain data provided by federal agencies for inclusion in the President's budget concerning obligations and outlays.
Accounting for and reconciliation of intragovernmental activity and balances	Problems in accounting for and reconciling intragovernmental activity and balances impair the government's ability to account for billions of dollars of transactions between governmental entities.
Net outlays	Until the differences between the total net outlays reported in federal agencies' Statements of Budgetary Resources and the records used by the Department of the Treasury to prepare the Statement of Changes in Cash Balance are reconciled, the effect that these differences may have on the U.S. government's consolidated financial statements will be unknown.
Preparation of consolidated financial statements	Because the federal government did not have adequate systems, controls, and procedures to prepare its consolidated financial statements, the federal government's ability to ensure that the consolidated financial statements are consistent with the underlying audited agency financial statements, balanced, and in conformity with U.S. generally accepted accounting principles was impaired.
Improper payments	Without a systematic measurement of the extent of improper payments, federal agency management cannot determine (1) if improper payment problems exist that require corrective action, (2) mitigation strategies and the appropriate amount of investments to reduce them, and (3) the success of efforts implemented to reduce improper payments.
Loans receivable and loan guarantee liabilities	Weaknesses in the processes and procedures for estimating credit program costs affect the 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.
Information security weaknesses	Information security weaknesses over computerized operations are placing enormous amounts of 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.
Tax collection activities	Weaknesses in controls over tax collection activities continue to affect the federal government's ability to efficiently and effectively account for and collect revenue. Additionally, weaknesses in financial reporting affect the federal government's ability to make informed decisions about collection efforts. As a result, the federal government is vulnerable to loss of tax revenue and exposed to potentially billions of dollars in losses due to inappropriate refund disbursements.

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Financial Statements of the United States Government for the Years Ended September 30, 2003, and September 30, 2002

Statements of Net Cost

These statements present the net cost of fiscal years 2003 and 2002 Government operations. For the purposes of this document, "Government" refers to the United States Government. It categorizes costs by Chief Financial Officer Act entities and other significant entities. Costs are presented by department on an accrual basis, while the budget presents costs by obligations and outlays based on functions on a cash basis. In the Statements of Net Cost, the costs are divided between the corresponding departments and entities mentioned above, providing greater accountability by showing the relationship of the agencies' net cost to the Governmentwide net cost. The focus of the budget of the United States is by agency. Budgets are prepared, defended, and monitored by agency. In reporting by agency, we are assisting the external users in assessing the budget integrity, operating performance, stewardship, and systems and control of the Federal Government.

These statements contain the following three components:

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

Because of their specific functions, most of the costs originally associated with the General Services Administration (GSA) and the Office of Personnel Management (OPM) have been allocated to and reflected in the costs of their user agencies. The remaining costs for GSA and OPM on the Statements of Net Cost are the administrative operating costs, the expenses from prior and past costs from health and pension plan amendments, and the actuarial gains and losses for these agencies. $123.4 billion has been allocated out of OPM to the agencies. This represents health and pension benefits that are not reported in the individual agency statements. The interest on Treasury securities held by the public is part of the Department of the Treasury's (Treasury) responsibilities, but because of its importance, and the dollar amounts, it is reported separately in these statements. Net cost for Governmentwide reporting purposes includes GSA and 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.

The Department of Homeland Security (DHS) Reorganization Plan was enacted on November 25, 2002, and beginning with this *2003 Financial Report of the United States Government (Financial Report)*, DHS is reported as a separate entity. Refer to Note 1A—Reporting Entity for further information. Also, refer to the Management's Discussion and Analysis section for information concerning DHS and the mission and organization of the components of the Government of the United States.

Statements of Operations and Changes in Net Position

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

Revenue

Individual income tax and tax withholdings consist of Federal Insurance Contributions Act (FICA)/Self-Employment Contributions Act (SECA) taxes and other taxes including payroll taxes collected from other agencies.

Excise taxes consist of taxes collected for various items, such as airline tickets, gasoline products, distilled spirits and imported liquor, tobacco, firearms, and others.

Miscellaneous earned revenues consist of earned revenues received from the public with virtually no associated cost. This category includes revenues generated by the Federal Communications Commission from the sale of spectrum licenses to promote open-air communication services to the public (spectrum auctions). It also includes rents and royalties on the Outer Continental Shelf Lands resulting from the leasing and development of mineral resources on public lands.

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.

Unreconciled Transactions Affecting the Change in Net Position

Unreconciled transactions are adjustments needed to bring the change in net position into balance due to unreconciled and unaccounted for differences in the consolidated financial statements. Refer to Note 16—Unreconciled Transactions Affecting the Change in Net Position 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.

Prior Period Adjustments

Prior period adjustments are revisions to adjust the beginning net position. Refer to Note 1B—Basis of Accounting and Revenue Recognition, and Note 17—Change in Accounting Principle and 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.

Reconciliations of Net Operating Cost and Unified Budget Deficit

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

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

Receipts and outlays in the President's budget are measured primarily on a cash basis and differ from the basis of accounting measures used in the *Financial Report*. These statements begin with the net results of operations (net operating cost), where operating revenues are reported on a modified cash basis of accounting and the net cost of Government operations on an accrual basis of accounting. Reconciling items to (1) operating revenues include net accrual related to taxes receivables and (2) net cost of Government operations include items such as changes in liabilities for military, veteran and civilian benefits, as well as depreciation expenses on fixed assets and changes in environmental liabilities.

Components of Net Operating Cost Not Part of the Budget Deficit

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

Components of the Budget Deficit Not Part of Net Operating Cost

This information includes the budget components, such as capitalized fixed assets, changes in accounts receivable, and increases in other assets not included in the operating results. These items are typically part of the balance sheets only, and are not part of the operating results.

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

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

These statements reconcile the unified budget deficit to the change in operating cash during the fiscal year, and explain how the budget deficits (fiscal years 2003 and 2002) are financed. A budget deficit is the result of expenditures exceeding receipts (revenue) during a particular fiscal year.

In depicting how the unified budget deficits were financed, these statements show that in fiscal years 2003 and 2002, the greatest amounts were net new borrowings from the public. Other transactions also required cash disbursements and are not part of the repayments of the debt. These other transactions, such as the issuance of student loans or premiums on early buyback of public debt, required cash payments and contributed to the use of the surplus or deficit. These statements show the differences between accrual and cash budgetary basis, mainly because of timing differences in the financial statements.

Balance Sheets

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

Assets

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

In May 2003, SFFAS No. 23, *Eliminating the Category National Defense Property, Plant, and Equipment*, removed national defense assets from Stewardship Information and included it on the balance sheet as part of inventories and related property, net and property, plant, and equipment, net. Refer to Note 1B—Basis of Accounting and Revenue Recognition; Note 6—Inventories and Related Property, Net; and Note 7—Property, Plant, and Equipment, Net for further information.

Selected assets are highlighted in the Stewardship Information section of this report to demonstrate the Government's accountability for these assets. Stewardship assets include stewardship land and heritage assets.

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 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 disclosed in the Statements of Social Insurance in the Stewardship Information section, and a wide range of other programs under which the Government provides benefits and services to the people of this Nation, and certain future loss contingencies.

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

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

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

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

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United States Government
Statements of Net Cost
for the Years Ended September 30, 2003, and September 30, 2002

(In billions of dollars)	Gross Cost 2003	Earned Revenue 2003	Net Cost 2003	Gross Cost 2002	Earned Revenue 2002	Net Cost 2002
Department of Agriculture[1]	95.6	10.7	84.9	80.5	9.6	70.9
Department of Commerce[1]	8.8	1.3	7.5	7.4	1.2	6.2
Department of Defense[1]	562.4	12.5	549.9	420.4	13.9	406.5
Department of Education	59.0	5.0	54.0	49.9	4.8	45.1
Department of Energy[1]	2.0	5.3	(3.3)	(3.0)	4.8	(7.8)
Department of Health & Human Services[1]	542.6	29.7	512.9	499.9	27.0	472.9
Department of Homeland Security	27.5	2.6	24.9	*	*	*
Department of Housing & Urban Development	44.1	2.0	42.1	36.3	2.2	34.1
Department of the Interior	16.0	4.7	11.3	15.0	0.7	14.3
Department of Justice[1]	30.7	1.3	29.4	29.5	2.3	27.2
Department of Labor	68.1	-	68.1	64.7	-	64.7
Department of State	12.7	1.4	11.3	10.9	0.9	10.0
Department of Transportation[1]	64.2	1.2	63.0	65.4	1.6	63.8
Department of the Treasury[1]	75.0	2.6	72.4	66.0	3.6	62.4
Interest on Treasury securities held by the public	156.8	-	156.8	175.4	-	175.4
Department of Veterans Affairs	175.7	2.1	173.6	218.4	2.6	215.8
U.S. Agency for International Development	10.3	0.1	10.2	8.0	-	8.0
Environmental Protection Agency	9.5	0.4	9.1	8.2	0.5	7.7
Federal Emergency Management Agency[1]	2.5	0.8	1.7	6.2	1.8	4.4
General Services Administration[1]	0.8	0.3	0.5	(0.1)	0.3	(0.4)
National Aeronautics & Space Administration	12.9	0.1	12.8	14.7	0.1	14.6
National Science Foundation	4.8	-	4.8	4.2	-	4.2
U.S. Nuclear Regulatory Commission	0.7	0.5	0.2	0.6	0.4	0.2
Office of Personnel Management	0.3	-	0.3	0.2	-	0.2
Small Business Administration	3.8	0.7	3.1	1.3	0.5	0.8
Social Security Administration	512.6	0.3	512.3	492.9	0.3	492.6
Export-Import Bank of the United States	0.1	0.3	(0.2)	(1.2)	0.3	(1.5)
Federal Communications Commission	7.1	1.2	5.9	6.8	1.1	5.7
Federal Deposit Insurance Corporation	(0.2)	0.2	(0.4)	1.8	0.7	1.1
National Credit Union Administration	0.2	0.5	(0.3)	0.2	0.5	(0.3)
Pension Benefit Guaranty Corporation	12.3	1.2	11.1	12.7	0.9	11.8
Railroad Retirement Board	9.6	-	9.6	9.3	-	9.3
Tennessee Valley Authority	8.2	7.0	1.2	7.9	6.8	1.1
United States Postal Service	81.5	67.6	13.9	83.1	66.4	16.7
All other entities	32.1	1.2	30.9	22.8	0.8	22.0
Total	2,650.3	164.8	2,485.5	2,416.3	156.6	2,259.7

[1] These agencies reorganized and transferred various programs and operations to the newly created Department of Homeland Security.
* 2002 numbers have not been restated (see Note 1A—Reporting Entity).

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, 2003, and September 30, 2002

(In billions of dollars)	2003	2002
Revenue:		
Individual income tax and tax withholdings	1,481.3	1,538.6
Corporation income taxes	128.2	143.7
Unemployment taxes	31.2	26.2
Excise taxes	67.6	67.9
Estate and gift taxes	21.9	26.4
Customs duties	19.0	18.3
Other taxes and receipts	39.8	49.3
Miscellaneous earned revenues	7.0	7.3
Total revenue	1,796.0	1,877.7
Less net cost of Government operations	2,485.5	2,259.7
Unreconciled transactions affecting the change in net position (Note 16)	24.5	17.1
Net operating cost	(665.0)	(364.9)
Net position, beginning of period	(6,820.2)	(6,458.8)
Change in accounting principle (Note 17)	383.1	
Prior period adjustments (Note 17)	(2.6)	3.5
Net operating cost	(665.0)	(364.9)
Net position, end of period	(7,104.7)	(6,820.2)

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, 2003, and September 30, 2002

(In billions of dollars)	2003	2002
Net operating cost	(665.0)	(364.9)
Components of Net Operating Cost Not Part of the Budget Deficit:		
Increase in Liability for Military Employee Benefits (Note 11):		
Increase in military pension liabilities	9.0	21.7
Increase in military health liabilities	91.0	11.1
Increase/(decrease) in other military benefits	1.1	(0.4)
Increase in liability for military employee benefits	101.1	32.4
Increase in Liability for Veterans Compensation and Burial Benefits (Note 11):		
Increase in liability for veterans	93.3	147.7
Increase in liability for survivors	12.5	9.0
(Decrease)/increase in liability for burial benefits	(0.2)	0.6
Increase in liability for veterans compensation	105.6	157.3
Increase in Liability for Civilian Employee Benefits (Note 11):		
Increase in civilian pension liabilities	56.6	16.9
Increase in civilian health liabilities	23.0	16.2
Increase in other civilian benefits	0.3	5.8
Increase in liability for civilian employee benefits	79.9	38.9
Decrease in Environmental Liabilities (Note 12):		
(Decrease) in energy's environmental liabilities	(26.2)	(28.7)
Increase/(decrease) in all others' environmental liabilities	3.1	(5.1)
(Decrease) in environmental liabilities	(23.1)	(33.8)
Depreciation expense	71.2	20.5
Property, plant, and equipment disposals and revaluations	13.0	-
Increase in benefits due and payable (Note 13)	4.7	9.3
(Increase) in taxes receivable (Note 5)	(1.5)	(0.3)
Increase in other liabilities (Note 14)	25.1	13.8
Premium on early buyback of public debt	-	3.8
Seigniorage and sale of gold	(0.6)	(1.0)
Increase/(decrease) in accounts payable (Note 9)	6.4	(0.4)
Components of the Budget Deficit Not Part of Net Operating Cost:		
Capitalized Fixed Assets:		
Department of Defense	(67.5)	(18.1)
Civilian agencies	(34.5)	(22.8)
Total capitalized fixed assets	(102.0)	(40.9)
(Increase)/decrease in accounts receivable (Note 3)	(1.8)	2.2
Decrease/(increase) in inventory (Note 6)	17.5	(8.4)
Increase in other assets (Note 8)	(12.3)	(2.0)
Principal repayments of precredit reform loans	9.1	8.2
Net amount of all other differences	(3.5)	1.0
Other:		
Prior period adjustments (Note 17)	1.4	6.6
Unified budget deficit	(374.8)	(157.7)

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

United States Government
Statements of Changes in Cash Balance from Unified Budget and Other Activities for the Years Ended September 30, 2003, and September 30, 2002

(In billions of dollars)	2003			2002		
Budget receipts—actual		1,782.1			1,853.3	
Budget outlays—actual		(2,156.9)			(2,011.0)	
Unified budget deficit			(374.8)			(157.7)
Adjustments for Noncash Outlays Included in the Budget:						
Interest accrued by Treasury on debt held by the public		(143.3)			(152.0)	
Subsidy expense (Note 4)		11.8			4.9	
Items Affecting the Cash Balance Not Included in the Budget:						
Net Transactions from Financing Activity:						
Repayment of debt held by the public	3,914.7			3,570.2		
Borrowings from the public	(4,289.1)			(3,791.0)		
Total		(374.4)			(220.8)	
Net Transactions from Monetary Activity:						
Increase in special drawing rights	0.4			0.8		
Increase/(decrease) in other monetary assets	(4.3)			14.2[1]		
Increase in loans to the IMF	3.2			2.4[1]		
Total		(0.7)			17.4	
Net Transactions from Other Activities:						
Net direct loan activity	1.2			13.7		
Interest paid by Treasury on debt held by the public	144.4			158.6		
Premium on early buyback of public debt	-			3.8		
Net guaranteed loan activity	(5.8)			(2.3)		
Decrease in miscellaneous assets	(0.4)			(0.9)		
Increase in allocations of special drawing rights	(0.5)			(0.2)[1]		
Increase in deposit fund balances	(2.8)			(0.4)		
Decrease in miscellaneous liabilities	.8			3.3[1]		
Seigniorage and other equity	(.6)			(1.0)		
Reclassification of aged unreconciled accounts	0.1			-		
NRRIT non-Federal securities[2]	21.3			1.5[1]		
Total		157.7			176.1	
Disposition of Deficit			(348.9)			(174.4)
Increase/(decrease) in operating cash balance			(25.9)			16.7
Operating Cash: (Note 2)						
Operating cash balance beginning of period			60.9			44.2
Operating cash balance end of period			35.0			60.9

[1] Reclassified/restated.

[2] For more information, see Railroad Retirement in the Stewardship Information section (page 86).

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

United States Government
Balance Sheets
as of September 30, 2003, and September 30, 2002

(In billions of dollars)	2003	2002
Assets:		
Cash and other monetary assets (Note 2)	119.6	141.6
Accounts receivable, net (Note 3)	33.8	32.0
Loans receivable, net (Note 4)	221.1	219.2
Taxes receivable, net (Note 5)	22.9	21.4
Inventories and related property, net (Note 6)	241.2	192.2
Property, plant, and equipment, net (Note 7)	658.2	324.7
Other assets (Note 8)	97.1	65.4
Total assets	1,393.9	996.5
Liabilities:		
Accounts payable (Note 9)	62.2	55.8
Federal debt securities held by the public and accrued interest (Note 10)	3,944.9	3,573.2
Federal employee and veteran benefits payable (Note 11)	3,880.0	3,589.4
Environmental and disposal liabilities (Note 12)	249.9	273.0
Benefits due and payable (Note 13)	100.0	95.3
Loan guarantee liabilities (Note 4)	34.6	28.1
Other liabilities (Note 14)	227.0	201.9
Total liabilities	8,498.6	7,816.7
Contingent liabilities (Note 18) and Commitments (Note 19)		
Net position	(7,104.7)	(6,820.2)
Total liabilities and net position	1,393.9	996.5

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

United States Government Stewardship Information (Unaudited) for the Years Ended September 30, 2003, and September 30, 2002

Stewardship Responsibilities

The social insurance programs were developed to provide income security and health care coverage to citizens under specific circumstances as a responsibility of the Government. Because taxpayers rely on social insurance in their long-term planning, social insurance programs should show their sustainability as currently constructed, 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 insurance program benefits sometimes are redistributed intentionally toward lower-wage workers. In addition, each social insurance program has a uniform set of entitling events and schedules that apply to all participants.

Statements of Social Insurance

These statements present estimates for several key indicators of the status of the Social Security and Medicare programs.[1] These estimates are based on long-range actuarial projections for persons who are participants or eventually will participate in the programs as contributors (workers) or beneficiaries (retired workers, survivors, and disabled) during a 75-year time period. Refer to the footnotes at the bottom of these statements for the projection valuation date.

[1] In our 2002 report, we were able to include an update of selected key data elements from the 2003 Annual Reports of the Boards of Trustees of the OASDI and Medicare Trust Funds that became available subsequent to the detailed social insurance disclosures in that report. Due to the accelerated issuance of our report this year, updated information from the 2004 Annual Reports of the Trustees is not available. Data from those reports will be used to prepare the social insurance disclosures in our 2004 report.

United States Government
Statements of Social Insurance
Present Value of Long-Range Actuarial Projections

(In billions of dollars)	2003	2002	2001	2000
Federal Old-Age, Survivors and Disability Insurance (Social Security):				
Contributions and Earmarked Taxes from:				
Participants who have attained age 62	359	348	309	266
Participants ages 15-61	13,576	13,048	12,349	11,335
Future participants (under age 15 and births during period)	12,213	11,893	11,035	10,088
All current and future participants	26,147	25,289	23,693	21,689
Expenditures for Scheduled Future Benefits for:				
Participants who have attained age 62	4,662	4,401	4,256	4,020
Participants ages 15-61	21,015	20,210	18,944	17,217
Future participants (under age 15 and births during period)	5,398	5,240	4,700	4,297
All current and future participants	31,075	29,851	27,900	25,534
Present value of future expenditures less future revenue	4,927[1]	4,562[2]	4,207[3]	3,845[4]
Federal Hospital Insurance (Medicare Part A):				
Contributions and Earmarked Taxes from:				
Participants who have attained eligibility age	128	125	113	97
Participants who have not attained eligibility age	4,510	4,408	4,136	3,757
Future participants	3,773	3,753	3,507	3,179
All current and future participants	8,411	8,286	7,756	7,033
Expenditures for Scheduled Future Benefits for:				
Participants who have attained eligibility age	1,897	1,747	1,693	1,681
Participants who have not attained eligibility age	10,028	9,195	8,568	6,702
Future participants	2,653	2,470	2,225	1,349
All current and future participants	14,577	13,412	12,487	9,732
Present value of future expenditures less future revenue	6,166[1]	5,126[2]	4,730[3]	2,699[4]
Federal Supplementary Medical Insurance (Medicare Part B):				
Premiums:				
Participants who have attained eligibility age	284	252	258	234
Participants who have not attained eligibility age	2,148	1,856	1,845	1,527
Future participants	688	600	593	404
All current and future participants	3,120	2,708	2,696	2,165
Expenditures for Scheduled Future Benefits for:				
Participants who have attained eligibility age	1,306	1,132	1,159	1,051
Participants who have not attained eligibility age	8,845	7,463	7,415	6,094
Future participants	2,622	2,238	2,206	1,514
All current and future participants	12,773	10,833	10,780	8,659
Present value of future expenditures less future revenue	9,653[1]	8,125[2]	8,084[3]	6,494[4]
Railroad Retirement *present value of future expenditures less future revenue*	22[1]	20[2]	19[5]	8[6]
Black Lung (Part C) *present value of future expenditures less future revenue*	(4)[7]	(5)[8]	(4)[9]	(4)[10]

1 The projection period is 1/1/2003 - 12/31/2077 and the valuation date is 1/1/2003.
2 The projection period is 1/1/2002 - 12/31/2076 and the valuation date is 1/1/2002.
3 The projection period is 1/1/2001 - 12/31/2075 and the valuation date is 1/1/2001.
4 The projection period is 1/1/2000 - 12/31/2074 and the valuation date is 1/1/2000.
5 The projection period is 1/1/2001 - 12/31/2076 and the valuation date is 1/1/2001.
6 The projection period is 9/30/2000 - 12/31/2073 and the valuation date is 12/31/1998.
7 The projection period is 9/30/2003 - 9/30/2040 and the valuation date is 6/30/2003.
8 The projection period is 9/30/2002 - 9/30/2040 and the valuation date is 6/30/2002.
9 The projection period is 9/30/2001 - 9/30/2040 and the valuation date is 6/30/2001.
10 The projection period is 9/30/2000 - 9/30/2040 and the valuation date is 6/30/2000.

Note: Details may not add to totals due to rounding.
The following notes are an integral part of this statement.

Notes to the Statements of Social Insurance

Actuarial present values of the projections are computed based on the economic and demographic assumptions believed most likely to occur (the intermediate assumptions) as set forth in the relevant Trustees' reports and in the relevant agency performance and accountability reports for Railroad Retirement and Black Lung.

Contributions and earmarked taxes consist of payroll taxes from employers, employees, and self-employed persons; revenue from Federal income taxation of OASDI and railroad retirement benefits; railroad work-hour tax; excise tax on coal (Black Lung); and premiums from participants in Medicare Part B. Income for all programs is presented from a consolidated perspective. Interest payments and other intragovernmental transfers have been eliminated. The Centers for Medicare & Medicaid Services' (CMS) 2003 Financial Report presents income from the trust fund's perspective, not a Governmentwide perspective. Therefore, CMS' Financial Report includes $9,653 billion for the present value of transfers from the general fund of the Treasury to the Medicare Part B Trust Fund that have been eliminated in this *Financial Report*. Expenditures include scheduled benefit payments and administrative expenses. The term "scheduled" is used to signify that projected benefits are those intended under current program rules if financing were adequate to pay those benefits in full. Current Social Security law does not provide for full benefit payments after the trust funds are exhausted.

Future participants include births during the period and individuals below age 15 as of January 1 of the valuation year.

The present values of future expenditures less future revenues is the current amount of funds needed to cover projected shortfalls, excluding the starting trust fund balances, over the projection period. They are calculated by subtracting the actuarial present values of future scheduled contributions and tax income by and on behalf of current and future participants from the actuarial present value of the future scheduled benefit payments to them or on their behalf. For these calculations, the trust fund balances at the beginning of the valuation period are not included. The trust fund balances at the beginning of 2003, 2002, 2001, and 2000, respectively, were (in billions of dollars): $1,378, $1,213, $1,049, and $896—Social Security; $234.8, $208.7, $177.5, and $141.4—Medicare Part A; $34.3, $41.3, $44.0, and $44.8—Medicare Part B; $22, $24, $19, and $17—Railroad Retirement, and the Black Lung Trust Fund, which had negative balances of $8.2, $7.7, $7.2, and $6.7.

The projection period for future participants covers the next 75 years for the Social Security and Medicare programs. The projection period for current participants (i.e., those age 15 and over on January 1 of the valuation year, referred to as the "closed group") would theoretically cover all of their working and retirement years, a period that could be greater than 75 years in a few instances.

For Social Security and Medicare, further information can be obtained from the Social Security Administration (SSA) (*The 2003 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds)* and from the Department of Health and Human Services (HHS) (*The 2003 Annual Report of the Boards of the Trustees of the Federal Hospital Insurance and the Federal Supplementary Medical Insurance Trust Funds)*.

Social Security and Medicare

Social Security

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

The primary receipts 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, employer and employee have each paid 6.2 percent of covered earnings. The self-employed pay 12.4 percent of covered earnings. Payroll taxes are computed on wages and net earnings from self-employment up to a specified maximum annual amount ($87,000 in 2003) that increases each year with economy-wide wages.

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

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

Medicare

The Medicare program, created in 1965, also has two components, each with its own trust fund: the Hospital Insurance (HI, Medicare Part A) and Supplementary Medical Insurance (SMI, Medicare Part B) Trust Funds.[2] 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. Though the events that trigger benefit payments are quite similar, HI and SMI have very different earmarked financing structures. Like 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 income. Other income 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 the U. S. Treasury securities held in the HI Trust Fund.

For SMI, transfers from the general fund of the Treasury represent the largest source of income, covering about 75 percent of program costs. Beneficiaries pay monthly premiums that finance about 25 percent of costs. As with HI, interest due on the U. S. Treasury securities held in the SMI Trust Fund is credited to the fund, although in the case of SMI, this is quite small.

Social Security, Medicare, and Governmentwide Finances

The current and future financial status of the separate Social Security and Medicare Trust Funds is the focus of the Trustees' Reports, a focus that may appropriately be referred to as the "trust fund perspective." In contrast, the Federal Government primarily uses the *unified budget* concept as the framework for budgetary analysis and presentation. It represents a comprehensive display of all Federal activities, regardless of fund type or on- and off-budget status, 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 shows a simplified graphical depiction of the interaction of the Social Security and Medicare Trust Funds with the rest of the Federal budget.[3] 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 explain how the various sources of program revenue flow through the budget to beneficiaries. The general approach is to group revenues and expenditures that are linked specifically to Social Security and/or Medicare separately from those for other Federal programs. (For ease of understanding, these other Federal programs are referred to here as *other Government* programs.)

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[2] Recent Medicare legislation (see page 76) creates a new account (Medicare Part D) in the SMI Trust Fund to track the finances of a new prescription drug benefit that will begin in 2006. As in the case of Medicare Part B, approximately three-quarters of revenues to the Part D account will come from general revenues. Consequently, the nature of the relationship between the SMI Trust Fund and the Federal budget described below will be largely unaffected by the presence of the Part D account.

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

Each of the trust funds has its own sources and types of revenue. With the exception of general fund transfers to SMI, each of these revenue sources is earmarked specifically for the respective trust fund, and cannot be used for other purposes. In contrast, personal income taxes go into the general fund of the Treasury and are drawn down for any Government program for which Congress has approved spending.[4] The arrows from the boxes on the left represent the flow of these revenues into the trust funds and other Government accounts.

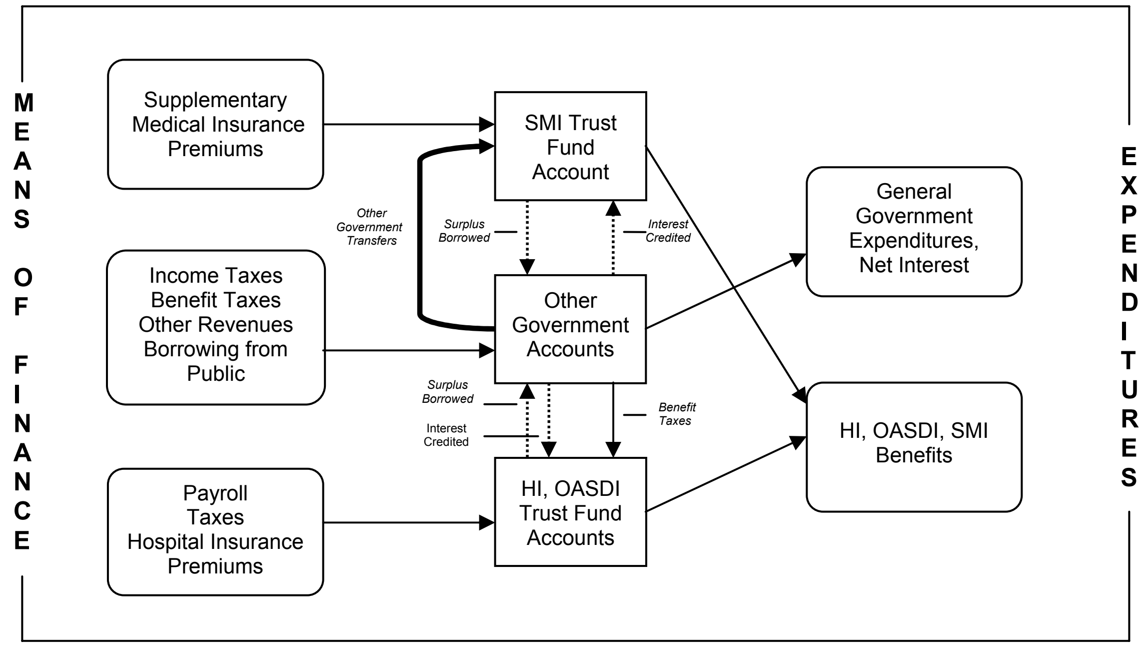
The Medicare SMI Trust Fund is shown separately in the center column from the two Social Security trust funds (OASI and DI) and the Medicare HI Trust Fund to highlight the unique financing of SMI. SMI is currently the only one of the four programs that receives large transfers from the general fund of the Treasury, which is part of the other Government accounts. (This transfer is represented by the arrow marked *Other Government Transfers* in the diagram.) These funds make up roughly three-fourths of SMI program expenses. The transfers are automatic; their size depends on how much the program spends, not on how much revenue comes into the Treasury. All the nondedicated sources of revenue contribute to the transfer: personal and corporate income taxes, custom duties, excise taxes, etc. If nondedicated 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—and as shown below, they are projected to increase significantly in coming years—then Congress must either raise taxes, cut other Government spending, or reduce SMI benefits.

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 that the general fund has to borrow from the public to finance a deficit (or likewise increase the amount of debt paid off if there is a surplus). But the general fund has to credit interest on the loans from the trust fund programs, just as if it borrowed the money from the public. The credits lead to future obligations for the general fund (which is part of the other Government accounts). These transactions are indicated in Figure 1 by the vertical arrows labeled *Interest Credited*. The credits increase trust fund income exactly as much as they increase credits (future obligations) in the general fund. So from the standpoint of the Government as a whole, at least in an accounting sense, these interest credits are a wash.

It is important to understand the additional implications of this borrowing from the trust funds. When the trust funds loan excess revenue to the general fund, they in turn receive additional authority to spend on benefits and other program expenses. (This additional authority takes the form of an increase in the assets in the trust funds and an increase in liability for the general fund.) The general fund, in turn, has taken on the obligation of repaying the principal of those loans with interest 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.

[4] 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 *Federal Trust and Other Earmarked Funds*, GAO-01-199SP, January 2001. In the figure and the discussion that follows, we group all other programs, including these other earmarked trust fund programs, under “Other Government Accounts” to simplify the description and maintain the focus on Social Security and Medicare.

Figure 1
Social Security, Medicare, and Governmentwide Finances



Actual dollar amounts for the flows presented in Figure 1 are shown in Table 1 for fiscal year 2003. Income for each account is shown as a positive number and expenditures as negative (shown in parentheses). The rightmost column has column totals. The unified, or Governmentwide, deficit is the sum of the trust fund and other Government account figures shown in the last column. Note that in the combined column, transfers of $81.4 billion and interest of $101.4 billion each appear twice, once as revenue (credits) to the trust funds and again as expenditures/credits to the other Government accounts, and are thus offsetting. These two intragovernmental transfers are key to the differences between the two perspectives.

The trust fund perspective is captured in each of the three trust fund columns that contain data from the respective trustees' reports. For HI, total revenues exceeded total expenditures by $22.1 billion in 2003, as shown at the bottom of the first column. This surplus would be added to the beginning trust fund (not shown) that creates budget obligations in future years. For SMI, total revenues of $110.2 billion ($26.8+$83.4), including $80.9 billion transferred from other Government accounts (the general fund), fell short of total expenditures by $13.9 billion. Transfers to the SMI program from other Government accounts (the general fund) amounting to about 75 percent of program costs are obligated under current law and therefore appropriately viewed as revenue from the trust fund perspective. For OASDI, total revenues of $630.2 billion ($546.7+$83.5), including interest and a small amount of other Government transfers, exceeded total expenditures of $474.7 billion by $155.5 billion.

From the Governmentwide perspective, only revenues received from the public 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 such revenues ($160.6 billion) and total expenditures made to the public ($153.8 billion) was $6.8 billion in 2003, indicating that HI had a positive 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 2003. The difference, -$97.3 billion, resulted in a net draw on the overall budget balance in that year. For OASDI, the difference between revenues from the public ($546.7 billion) and total expenditures was $72.0 billion in 2003, indicating that OASDI had a positive effect on the overall budget outcome *in that year*.

Table 1
Annual Revenues and Expenditures for Medicare and Social Security Trust Funds and the Federal Budget, Fiscal Year 2003

(In billions of dollars)	Trust Funds HI[1]	SMI[1]	OASDI[2]	Other Govern-ment[3]	Total
Trust Fund:					
Revenues from public	160.6	26.8	546.7		734.1
Payroll & benefit taxes	158.2	-	546.7		704.9
Premiums, other	2.4	26.8	-		29.2
Revenues/credits from other Government accounts	15.3	83.4	83.5		182.2
Transfers	0.5	80.9	-		81.4
Interest credits	14.8	2.5	83.5		100.8
Expenditures to Public:					
Benefits & admin. costs	(153.8)	(124.1)	(474.7)		(752.6)
Other Government:					
Revenues from public				1,048.0	1,048.0
Expenditures to public[4]				(1,404.3)	(1,404.3)
General Government				(1,251.3)	(1,251.3)
Interest on debt held				(153.0)	(153.0)
Expenditures/credits to trust fund Accounts				(182.8)	(182.8)
Transfers				(81.4)	(81.4)
Interest credits				(101.4)	(101.4)
Net Results for Governmentwide (Budget) Perspective					
Revenues from public less expenditures to public	6.8	(97.3)	72.0	(356.3)	(374.8)
Net Results for Trust Fund Perspective					
Revenues from public plus revenues/credits from other Government less expenditures to public	22.1	(13.9)	155.5		163.7

Data sources:
[1] Data from the 2003 Medicare Trustees' Report.
[2] Data from the 2003 OASDI Trustees' Report.
[3] Financial Management Service's, *Final Monthly Treasury Statement of Receipts and Outlays of the United States Government*, September 2003, Tables 1 and 9.
[4] The OASDI number includes $3.7 billion in transfers to the Railroad Retirement Board.

Cashflow Projections

Background

Economic and Demographic Assumptions. The Boards of Trustees[5] of the OASDI and Medicare Trust Funds provide in their annual reports to Congress short-range (10-year) and long-range (75-year) actuarial estimates of each trust fund. Because of the inherent uncertainty in estimates for 75 years into the future, the Boards use three alternative sets of economic and demographic assumptions to show a range of possibilities. Assumptions are made about many economic and demographic factors, including gross domestic product (GDP), earnings, the consumer price index (CPI), the unemployment rate, the fertility rate, immigration, mortality, disability incidence and terminations and, for the Medicare projections, health care cost growth. The assumptions used for the most recent set of projections shown in Table 2 are generally referred to as the "intermediate assumptions," and reflect the best estimate of expected future experience.

Table 2
Social Security and Medicare Demographic and Economic Assumptions

	Demographic Assumptions					Economic Assumptions			
Year	Total Fertility Rate[1]	Age-Sex Adjusted Death Rate[2]	Life Expect At Birth Male[3]	Life Expect At Birth Female[3]	Net Immi-gration (persons)	Product-ivity, total economy (percent change)	Real Wage Differ-ential[4] (percent)	CPI[5] (percent change)	Average Annual Interest Rate[6] (percent)
2003	2.04	796.0	74.3	79.5	1,200,000	1.9	1.5	2.4	5.1
2005	2.03	786.6	74.6	79.6	1,150,000	2.1	1.6	2.7	6.3
2010	2.01	758.1	75.2	80.0	1,025,000	1.7	1.2	3.0	6.0
2020	1.98	697.1	76.3	80.9	950,000	1.6	1.1	3.0	6.0
2030+	1.95	641.5	77.3	81.8	900,000	1.6	1.1	3.0	6.0

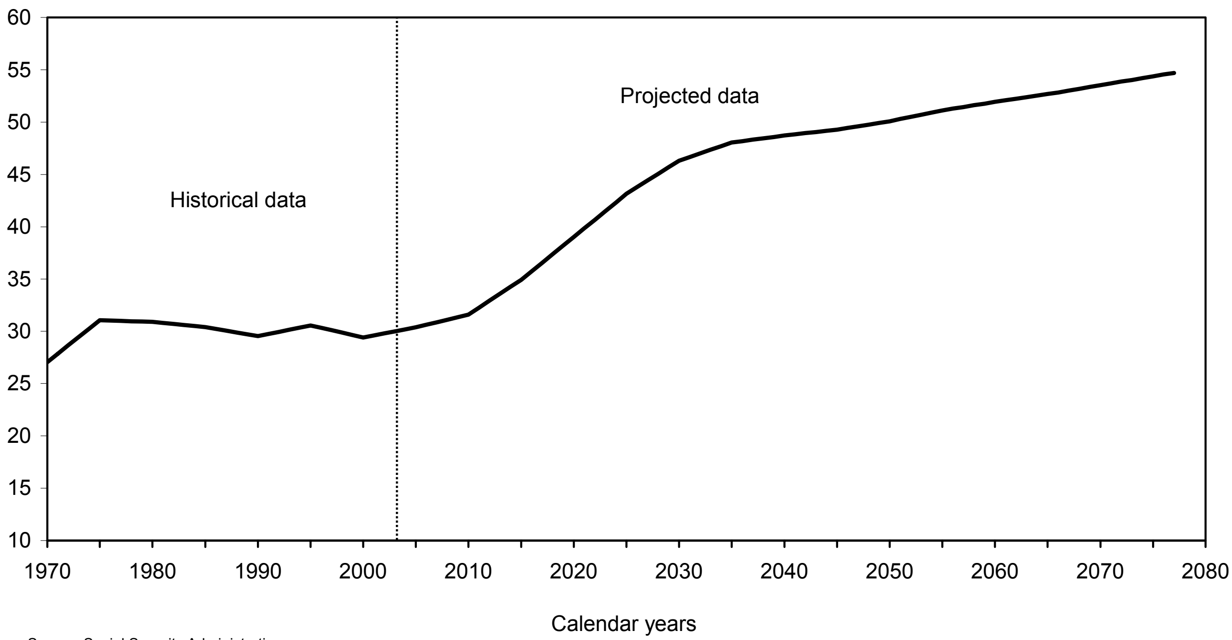
[1] The total fertility rate for any year is the average number of children who would be born to a woman in her lifetime if she were to experience the birth rates by age observed in, or assumed for, the selected year, and if she were to survive the entire childbearing period. The ultimate total fertility rate is assumed to be reached in 2027.
[2] The age-sex-adjusted death rate is a weighted average of age-sex-specific death rates in a year where the weights are the number of people in the corresponding age-sex group as of April 1, 1990. The death rate is a summary measure and not a basic assumption. Note that after 2030, the death rate continues to fall, to 447.9 by 2080.
[3] The period life expectancy for a group of persons born in a given year is the average that would be attained by such persons if the group were to experience in succeeding years the death rates by age observed in, or assumed for, the given year. It is a summary measure and not a basic assumption; it summarizes the effects of the basic assumptions from which it is derived. Life expectancy continues to increase, to 81.6 for males and 85.5 for females by 2080.
[4] The real-wage differential is the difference between the percentage increases, before rounding, in the average annual wage in covered employment, and the average annual CPI.
[5] The CPI is the annual average value for the calendar year of the CPI for urban wage earners and clerical workers.
[6] 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.

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 workers for the historical period and

[5] There are six trustees: the Secretaries of Treasury (managing trustee), Health and Human Services, and Labor; the Commissioner of the Social Security Administration; and two public trustees who are appointed by the President and confirmed by the Senate for a 4-year term. By law, the public trustees are members of two different political parties. The two current public trustees are John Palmer, Syracuse University, and Thomas Saving, Texas A&M University. Palmer and Saving began their term on 10/28/2000.

estimated for the next 75 years. In 2002, there were about 30 beneficiaries for every 100 workers. By 2030, there will be about 46 beneficiaries for every 100 workers. A similar demographic pattern confronts the Medicare program. For example, for the HI program, there were about 26 beneficiaries for every 100 workers in 2002; by 2030 there are expected to be about 42 beneficiaries for every 100 workers. This ratio will continue to increase after the baby-boom generation has moved through the Social Security system due to declining birth rates and increasing longevity.

Chart 1—Beneficiaries per 100 Covered Workers 1970-2077

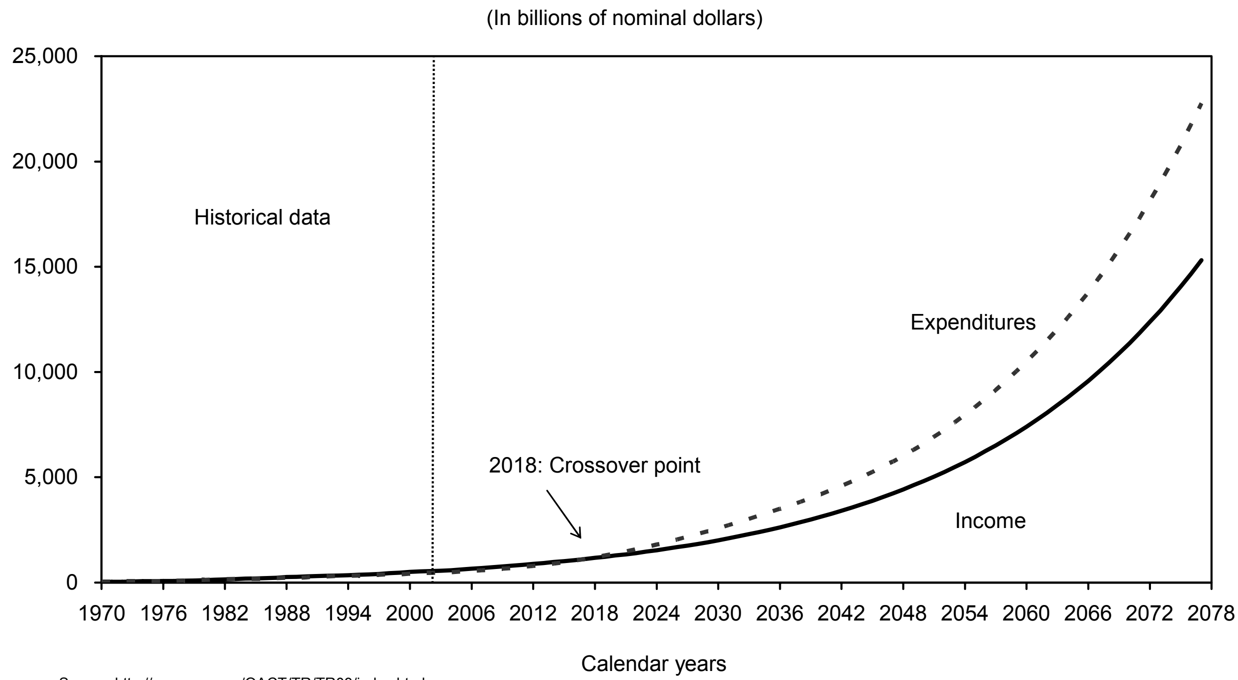


Source: Social Security Administration

Social Security Projections

Nominal Income and Expenditures. Chart 2 shows actuarial estimates of combined OASDI annual income (excluding interest) and expenditures for 1970-2077 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.

Chart 2—OASDI Income (Excluding Interest) and Expenditures 1970-2077



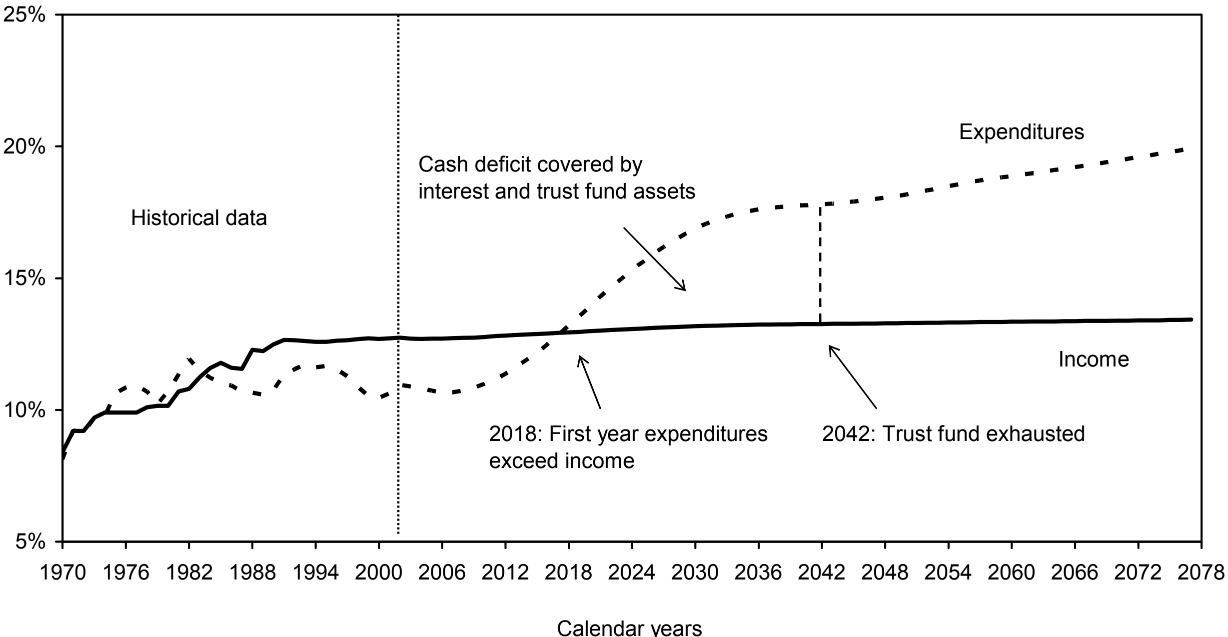
Source: http://www.ssa.gov/OACT/TR/TR03/index.html

Currently, Social Security tax revenues exceed benefit payments and will continue to do so until 2018, when revenues are projected to fall below benefit payments, after which the gap between expenditures and revenues continues to widen.

Income and Expenditures as Percent of Taxable Payroll. Chart 3 shows estimated 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 amount by which income exceeds payroll tax income reflects revenue from the Federal income-taxation of OASDI benefits that is transferred to the trust funds.

The OASDI cost rate is projected to decline slightly and then remain flat for the next several years. It then begins to increase rapidly and first exceeds the income rate in 2018, producing cashflow deficits thereafter. As described above, surpluses that occur prior to 2018 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 2018, 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 2042, 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 73 percent of scheduled benefits after trust fund exhaustion in 2042 and 65 percent of scheduled benefits in 2077.

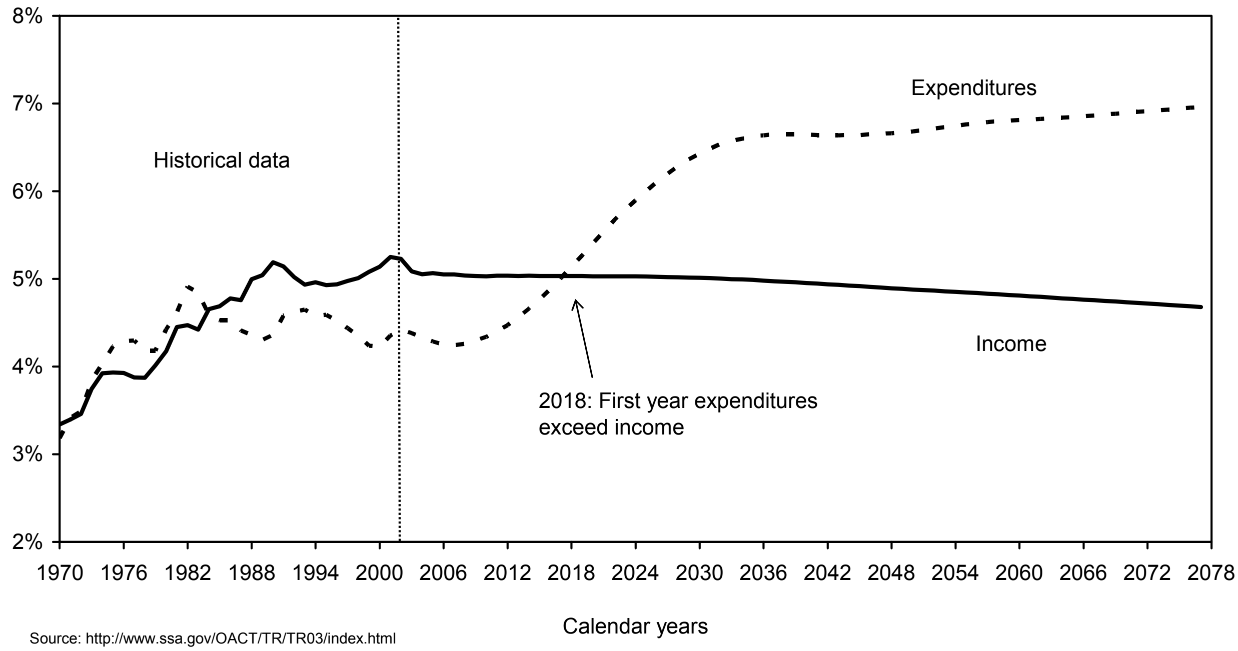
Chart 3—OASDI Income (Excluding Interest) and Expenditures as a Percent of Taxable Payroll 1970-2077



Source: http://www.ssa.gov/OACT/TR/TR03/index.html

Income and Expenditures as a Percent of GDP. Chart 4 shows estimated annual income (excluding interest) and expenditures, expressed as percentages of GDP, the total value of goods and services produced in the United States. This alternative perspective shows the size of the OASDI program in relation to the capacity of the national economy to sustain it. The gap between expenditures and income widens continuously with expenditures growing as a share of GDP and income declining slightly relative to GDP. Social Security's expenditures are projected to grow from 4.4 percent of GDP in 2002 to 7.0 percent of GDP by 2077. In 2077, expenditures are projected to exceed income by 2.3 percent of GDP.

Chart 4—OASDI Income (Excluding Interest) and Expenditures as a Percent of GDP 1970-2077



Source: http://www.ssa.gov/OACT/TR/TR03/index.html

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. 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.

Table 3 shows the effects of changing various assumptions on the present value of estimated OASDI expenditures in excess of income (the *shortfall* of income relative to expenditures in present value terms).[6] The assumptions are shown in parentheses. For example, the intermediate assumption for the annual rate of *reduction in*

[6] Present values recognize that a dollar next year is worth less than a dollar today, because a dollar today could be saved and earn a year's-worth of interest. To calculate a present value, future amounts are thus reduced using an assumed interest rate, and those reduced amounts are summed. The resulting present value is the amount that would have to be put in the bank today at the assumed interest rate to fund the future cashflows.

age-sex-adjusted death rates is 0.76 percent. For the low cost alternative, a slower reduction rate (0.35 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 $4,927 billion to $3,635 billion, a 26 percent smaller shortfall. The high cost death rate assumption (1.33 percent) results in an increase in the shortfall, from $4,927 billion to $6,478 billion, a 31 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 1.95 to 2.2 results in a 10 percent smaller shortfall (i.e., expenditures less income), from $4,927 billion to $4,457 billion.

Higher real wage growth results in faster income growth relative to expenditure growth. Table 3 shows that a real wage differential that is 0.5 greater than the intermediate assumption of 1.1 results in a drop in the shortfall from $4,927 billion to $4,219 billion, a 14 percent decline.

The CPI change assumption operates in a somewhat counterintuitive manner, as seen in Table 3. 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 2 percent rather than 3 percent, the shortfall rises about 7 percent, from $4,927 billion to $5,290 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 an 8 percent drop in the shortfall, from $4,927 billion to $4,526 billion, relative to the intermediate case; and the high-cost assumption results in a 6 percent higher shortfall.

Finally, Table 3 shows the sensitivity of the shortfall to variations in the real interest rate or, in present value terminology, the sensitivity to alternative discount rates. A higher discount rate reduces future values relative to a lower rate. As seen in the table, the shortfall is $1,379 billion lower (28 percent lower) if the real interest rate is 3.7 percent rather than 3.0 percent and $2,253 billion higher (46 percent higher) if the real interest rate is 2.2 percent rather than 3.0 percent.

Table 3
Present Values of Estimated OASDI Expenditures in Excess of Income Under Various Assumptions, 2003-2077

(In billions of dollars)

Assumption	Low Cost (Alternative I)	Intermediate (Alternative II)	High Cost (Alternative III)
Average annual reduction in death rates ..	3,635 (0.35)	4,927 (0.76)	6,478 (1.33)
Total fertility rate..	4,457 (2.2)	4,927 (1.95)	5,397 (1.7)
Real wage differential................................	4,219 (1.6)	4,927 (1.1)	5,418 (0.6)
CPI change..	5,290 (2.0)	4,927 (3.0)	4,522 (4.0)
Net immigration	4,526 (1,300,000)	4,927 (900,000)	5,217 (672,500)
Real interest rate	3,548 (3.7)	4,927 (3.0)	7,180 (2.2)

Source: 2003 OASDI Trustees Report and SSA. Numbers in parentheses are the values of the assumptions used in the respective scenario.

Medicare Projections

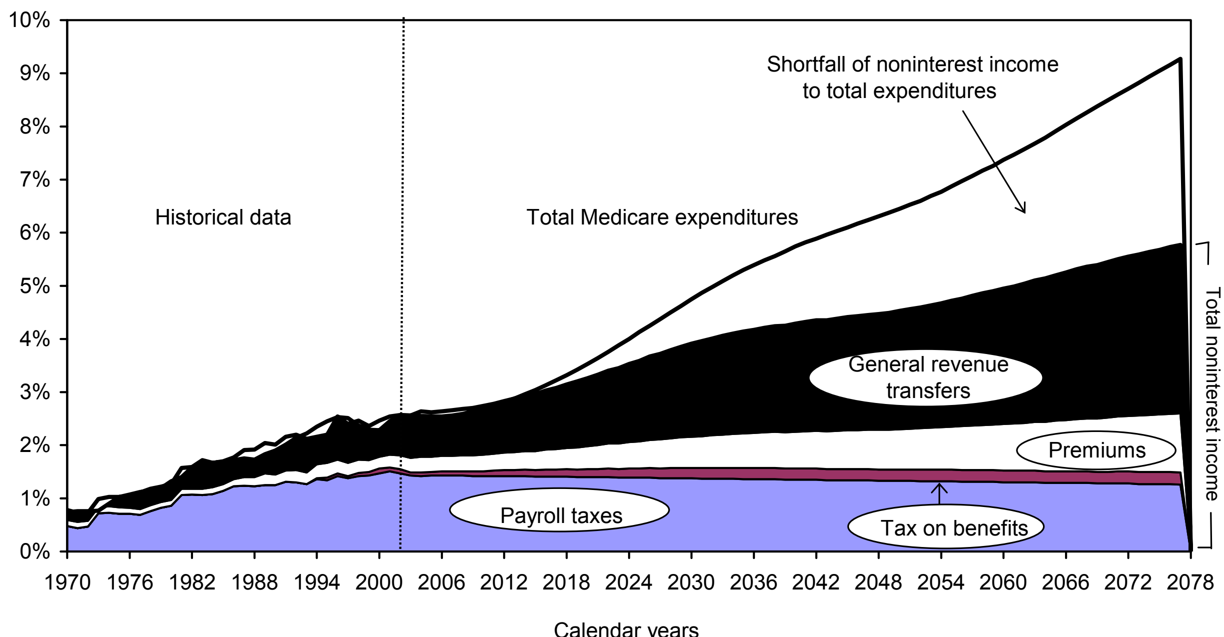
New Medicare Legislation. On December 8, 2003, President Bush signed into law the Medicare Prescription Drug, Improvement, and Modernization Act of 2003. The new law will have a major impact on the operations and finances of Medicare. The new law adds a prescription drug benefit to Medicare beginning in 2006 and a new prescription drug account in the SMI Trust Fund. The benefit could be obtained through a private drug-only plan, a private preferred-provider organization or health maintenance organization, or through an employer-sponsored retiree health plan. The preferred-provider organizations will be new to the Medicare program and will operate on a regional basis. The Federal Government will assume 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, an income-related Medicare Part B premium, and an expansion of tax-deductible health savings accounts. The new bill is expected to have a significant effect on future Medicare finances. This will be reflected in the next Medicare Trustees Report and the next *Financial Report*.

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

Total Medicare. It is important to recognize the rapidly increasing long-range cost of Medicare and the large role of general revenues and beneficiary premiums in financing the SMI program. Chart 5 shows expenditures and current law noninterest revenue sources for HI and SMI combined as a percentage of GDP. The total expenditure line shows Medicare costs rising to 9.3 percent of GDP by 2077. Revenues from taxes and premiums are expected to increase from 1.8 percent to only 2.6 percent of GDP, while general revenue contributions are projected to rise from 0.8 percent to 3.2 percent of GDP. Thus, revenues from taxes and premiums will fall substantially as a share of total noninterest Medicare income (from 69 percent to 45 percent) while general revenues will rise (from 31 percent to 55 percent). Payroll tax income declines gradually as a percent of GDP as growth in the number of workers paying such taxes slows. The gap between total noninterest Medicare income and expenditures steadily continues to widen, reaching 3.5 percent of GDP by 2077.

Chart 5—Total Medicare (HI and SMI) Expenditures and Noninterest Income as a Percent of GDP 1970-2077

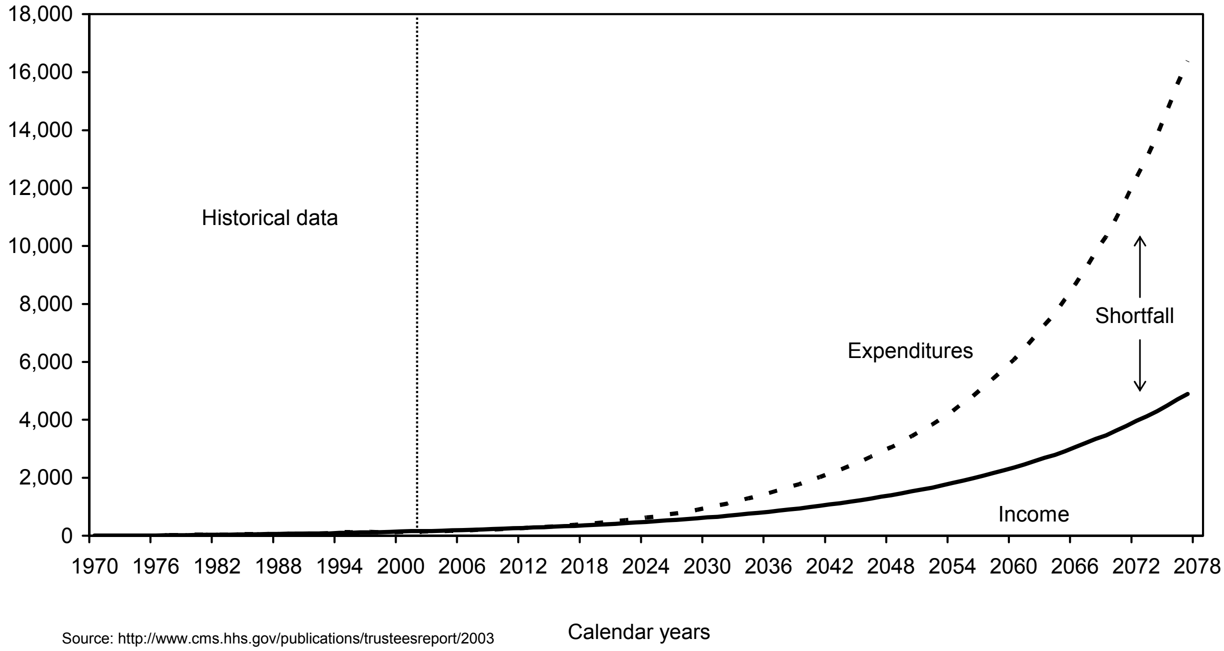


Source: http://www.ssa.gov/OACT/TRSUM

Medicare, Part A (Hospital Insurance)—Nominal Income and Expenditures. Chart 6 shows actuarial estimates of HI annual income (excluding interest) and expenditures for 1970-2077 in nominal dollars. The estimates are for the open-group population. The figure reveals a widening gap between income and expenditures after 2013.

Chart 6—Medicare Part A Income (Excluding Interest) and Expenditures 1970-2077

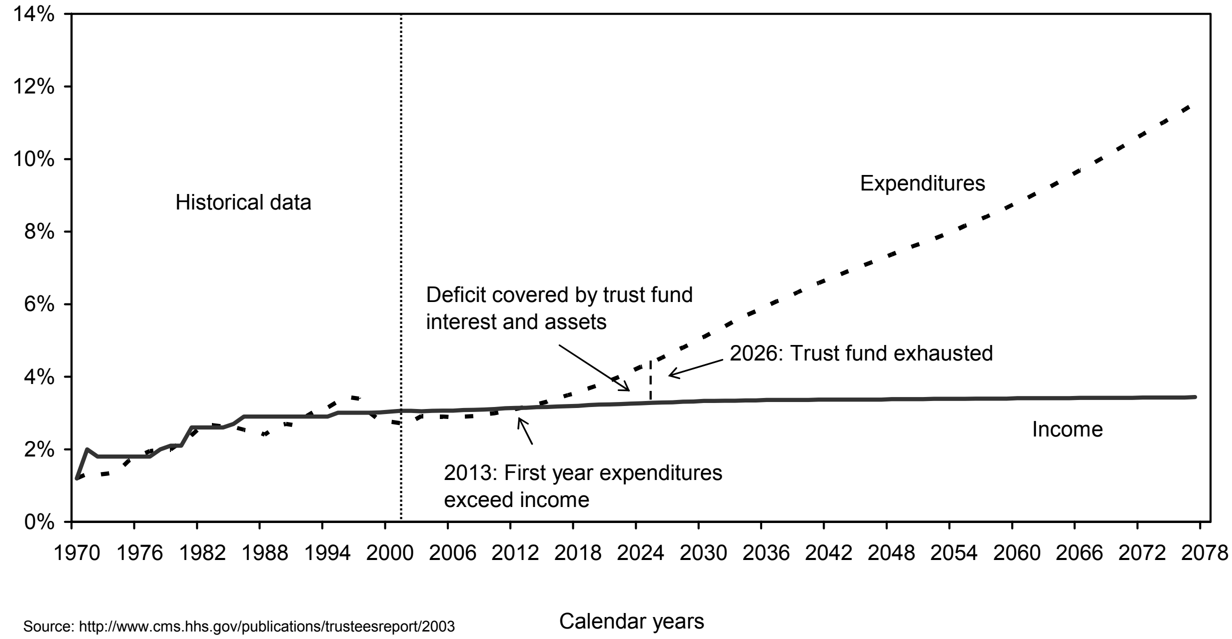
(In billions of nominal dollars)



Source: http://www.cms.hhs.gov/publications/trusteesreport/2003

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 income rate exceeds the expenditure rate until 2013, and cash deficits continue thereafter. Trust fund interest earnings and assets authorize continuation of full benefit payments until 2026 with general revenues making up the difference between cash income and expenditures during that period. Pressures on the Federal budget will thus emerge well before 2026. Present tax rates would be sufficient to pay 73 percent of scheduled benefits after trust fund exhaustion in 2026 and 30 percent of scheduled benefits in 2077.

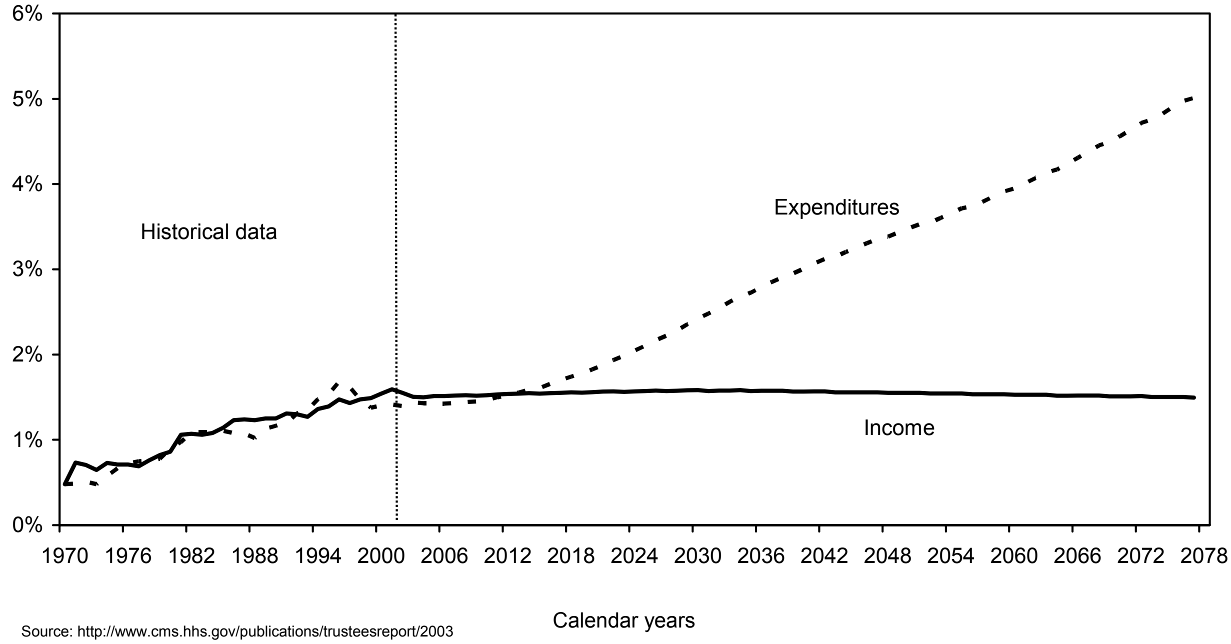
Chart 7—Medicare Part A Income (Excluding Interest) and Expenditures as a Percent of Taxable Payroll 1970-2077



Source: http://www.cms.hhs.gov/publications/trusteesreport/2003

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. Medicare Part A's expenditures are projected to grow from 1.5 percent of GDP in 2002 to 5.0 percent of GDP by 2077.

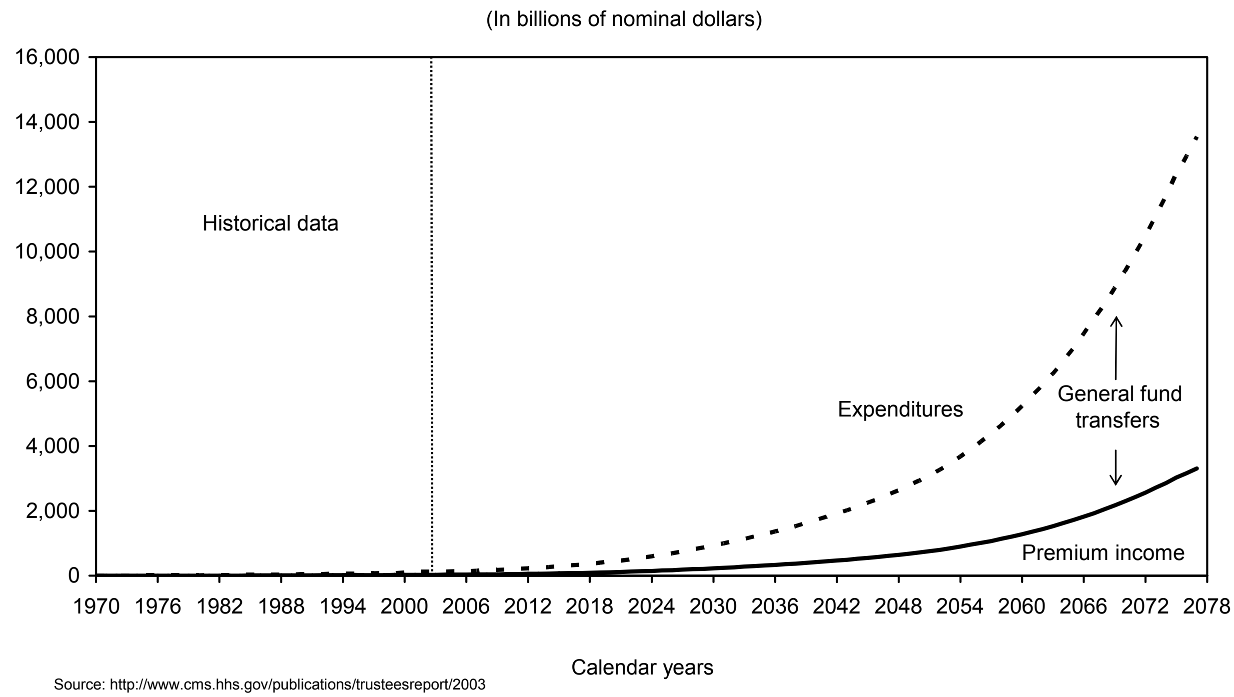
Chart 8—Medicare Part A Income (Excluding Interest) and Expenditures as a Percent of GDP 1970-2077



Source: http://www.cms.hhs.gov/publications/trusteesreport/2003

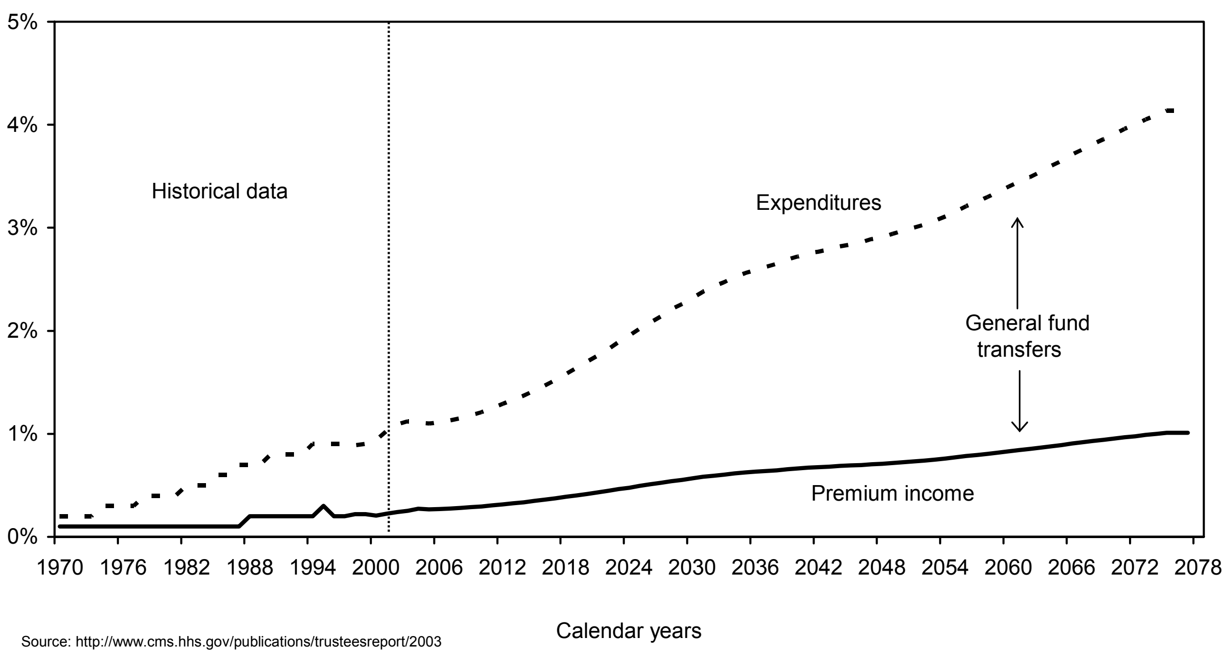
Medicare, Part B (Supplementary Medical Insurance). Chart 9 shows the actuarial estimates of Medicare Part B premiums and expenditures for each of the next 75 years, in nominal dollars. The gap between premiums and expenditures, a gap that will be filled with transfers from general revenues, grows throughout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

Chart 9—Medicare Part B Premium Income and Expenditures 1970-2077



Medicare Part B Premium Income and Expenditures as a Percent of GDP. Chart 10 shows expenditures for the Medicare Part B program over the next 75 years expressed as a percentage of GDP. In 2002, Medicare Part B expenditures were $113.2 billion, which was 1.1 percent of GDP. After 2005, this percentage is projected to increase steadily, reflecting growth in the volume and intensity of Medicare Part B services provided per beneficiary throughout the projection period, together with the effects of the baby boom retirement.

Chart 10—Medicare Part B Premium Income and Expenditures as a Percent of GDP 1970-2077



Source: http://www.cms.hhs.gov/publications/trusteesreport/2003

Medicare Sensitivity Analysis. This section presents estimates that illustrate the sensitivity of long-range cost and income long-range 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 (Alternative I) and high cost (Alternative III) projections.

Table 4 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 $6,166 billion to $1,583 billion, an almost 75 percent smaller shortfall. The high cost assumption results in a more than doubling of the shortfall, from $6,166 billion to $13,684 billion.

Variations in the next four assumptions in Table 4 result in relatively minor changes in net HI expenditures. The higher or lower fertility assumptions cause a roughly 2-1/2 percent change in the shortfall relative to the intermediate case. Higher or lower real wage growth results in about a 6 percent change in the expenditure shortfall and CPI changes have very little effect on net HI expenditures.

The low-cost assumption for net immigration results in a 5 percent drop in net expenditures, from $6,166 billion to $5,849 billion, relative to the intermediate case and the high-cost assumption results in a 3-1/2 percent higher shortfall.

Table 4 also shows that net HI expenditures are $1,665 billion lower (27 percent lower) if the real interest rate is 3.6 percent rather than 2.9 percent and $2,796 billion higher (45 percent higher) if the real interest rate is 2.1 percent rather than 2.9 percent.

Table 4
Present Values of Estimated Medicare Part A Expenditures in Excess of Income Under Various Assumptions, 2003-2077

(In billions of dollars)

Assumption[1]	Low Cost (Alternative I)	Intermediate (Alternative II)	High Cost (Alternative III)
Average annual growth in health costs[2]	1,583	6,166	13,684
Total fertility rate[3]	6,014 (2.2)	6,166 (1.95)	6,323 (1.7)
Real wage differential	5,816 (1.6)	6,166 (1.1)	6,538 (0.6)
CPI change	6,189 (2.0)	6,166 (3.0)	6,182 (4.0)
Net immigration	5,849 (1,300,000)	6,166 (900,000)	6,379 (672,500)
Real interest rate	4,501 (3.6)	6,166 (2.9)	8,962 (2.1)

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

Table 5 shows the effects of various assumptions about the growth in health care costs on the present value of estimated SMI expenditures in excess of income.[7] 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 growth in health costs causes the shortfall to drop from $9,653 billion to $6,746 billion, an almost 30 percent smaller shortfall. The high cost assumption results in a shortfall of $14,303 billion, an almost 50 percent increase.

[7] The SMI sensitivity analysis should cover the same set of assumptions as the HI sensitivity analysis. Next year's report is expected to satisfy this requirement.

Table 5
Present Values of Estimated Medicare Part B Future Expenditures Less Premium Income Under Various Assumptions, 2003-2077

(In billions of dollars)

Assumption	Low Cost (Alternative I)	Intermediate (Alternative II)	High Cost (Alternative III)
Average annual growth in health costs[1]	6,746	9,653	14,303

[1] 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 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 2003 Medicare Trustees Report, the HI Trust Fund is projected to remain solvent until 2026 and, according to the 2003 Social Security Trustees Report, the OASDI Trust Funds are projected to remain solvent until 2042. 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 funds are drawn down 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. A common way to present future cashflows is in terms of their *present value*. This approach recognizes that a dollar next year is worth less than a dollar today, because a dollar today could be saved and earn a year's-worth of interest (see footnote 5).

Table 6 shows the magnitudes of the primary expenditures and sources of financing for the three major trust funds computed on an open-group basis for the next 75 years and expressed in present values. The data are consistent with the Statement of Social Insurance. For HI, revenues from the public are projected to fall short of total expenditures by $6,166 billion in present value terms.[8] From the budget or Governmentwide perspective, that is the additional amount needed in order to pay scheduled benefits over the next 75 years. From the trust fund perspective, the amount needed is smaller by the value of the existing trust fund (an asset to the trust fund account but an intragovernmental transfer to the overall budget). For SMI, revenues from the public are $9,653 billion less than total expenditures, an amount that, from a budget perspective, will be needed to keep the 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 equal.[9] For OASDI, revenues from the public fall short of total expenditures by $4,927 billion in present value dollars and, from the trust fund perspective, by $3,550 billion.

From the Governmentwide perspective, the present value of the total resources needed for the three programs equals $20,747 billion. These resources needed from the budget are in addition to payroll taxes, benefit taxes, and premium payments. From the trust fund perspective, which counts the trust funds and the general revenue transfers to the SMI program as dedicated funding sources, in order to meet projected costs for the next 75 years the three programs will require additional resources of $9,447 billion in present value terms, beyond the $9,653 billion in present value of required general revenue transfers to the SMI program.

[8] Interest income is not a factor in this table as dollar amounts are in present value terms.
[9] The SMI Trust Fund also has a very small amount of existing assets.

Table 6
Present Values of Revenue and Expenditure Components of 75-Year Open Group Obligations HI, SMI, and OASDI

(In billions of dollars as of 1/1/2003)	HI	SMI	OASDI	Total
Revenues from the Public:				
Taxes	8,411	-	26,147	34,558
Premiums	-	3,120	-	3,120
Revenues from other Government transfers	-	9,653	-	9,653
Total revenues	8,411	12,773	26,147	47,331
Total expenditures	14,577	12,773	31,075	58,425
Net Results for Governmentwide (Budget) Perspective				
Revenues from the public less total expenditures	(6,166)	(9,653)	(4,927)	(20,747)
Net Results for Trust Fund Perspective				
Trust fund in 1/1/2003	235	34	1,378	1,647
Total revenues less total expenditures plus trust fund	(5,931)	34	(3,550)	(9,447)

Infinite Horizon

The 75-year horizon represented in Table 6 is consistent with the focus of the Social Security and Medicare Trustees' Reports. For the OASDI program, for example, an additional $4.9 trillion in present value will be needed above currently scheduled taxes to pay for scheduled benefits ($3.5 trillion from the trust fund perspective). Yet, a 75-year projection does not portray the financial status of the program for the infinite future. 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 complete and unbiased estimate of the long-run unfunded obligations of the programs, estimates can be extended to the infinite horizon. The open-group infinite horizon obligation is, in current dollars, the present value of all expected future program outlays less the present value of all expected future program tax revenues. Such a measure is provided in Table 7 for the OASDI program (the data in Table 7 are from the 2003 OASDI Report).

The first line of Table 7 shows, from a budget perspective, the present value of future expenditures less future taxes over the infinite horizon for all current, past, and future participants. The $11.9 trillion obligation is the value of resources needed to finance the current system into the infinite future. This resource need can be satisfied only through increased borrowing, higher taxes, reduced program spending, or some combination.

The second and third lines of Table 7 reveal that the shortfall is due to current and past participants since future participants (under age 15 and births during period), as a whole, are projected to pay, in present value, taxes that are approximately equal to the cost of providing the benefits that they are scheduled to receive over the infinite future.

The fourth line shows the value of the trust fund at the beginning of 2003, which, from the trust fund perspective, represents the extent to which the program is funded. From that perspective, when the trust fund is subtracted, an additional $10.5 trillion is needed to sustain the program into the infinite future. This can be accomplished through program changes that raise additional revenue or reduce benefits (or some combination) for current and future participants so that the present value of the additional revenue or reduced benefits for the infinite future equals $10.5 trillion.

In comparison to the analogous 75-year number for OASDI in Table 6, $4.9 trillion, extending the calculations beyond 2077 captures the full lifetime benefits and taxes of all current and future participants. The $7 trillion difference ($11.9-$4.9) indicates that a significant financing gap is not captured by the 75-year horizon. The shorter horizon understates the gap 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 7
Present Values of OASDI Expenditures Less Tax Revenue through the Infinite Horizon (Present values as of January 1, 2003)

(In trillions of dollars)

Present value of future expenditures less future taxes (net obligations) over the infinite horizon	11.9
Equals net obligations for past and current participants[1]	11.9
Plus net obligations for future participants	0.0
Current trust fund	1.4
Net obligations for the infinite future less the current trust fund	10.5

[1] This concept is also referred to as the closed-group obligation. The number is slightly higher than the closed-group number in the Statement of Social Insurance (SOSI) because the computation is done over a 100-year time horizon in the table above and a 75-year horizon for SOSI.

Railroad Retirement, Black Lung, and Unemployment Insurance

Railroad Retirement

Railroad retirement pays full annuities at age 60 to workers with 30 years of service. For those with less than 30 years of service, reduced annuities are payable at age 62 and unreduced annuities are payable at full retirement age, which is gradually rising from 65 to 67, depending on year of birth. The Railroad Retirement 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 Social Security beneficiaries.

The Railroad Retirement Board (RRB) and SSA share jurisdiction over the payment of retirement and survivor benefits. RRB has jurisdiction over the payment of retirement benefits if the employee had at least 5 years (if performed after 1995) of railroad service. Additionally, 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. SSA treats them as Social Security credits.

Payroll taxes paid by railroad employers and their employees provide the 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 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). The financial interchange income is trust fund income (intragovernmental income) derived from the financial interchange with the Social Security trust funds. This transaction is intended to put the Federal Old-Age, Survivors, and Disability Insurance Trust Funds and the Centers for Medicare & Medicaid Services' Federal Hospital Insurance Trust Fund in the same position they would have been had railroad employment been covered under the Social Security Act and FICA.

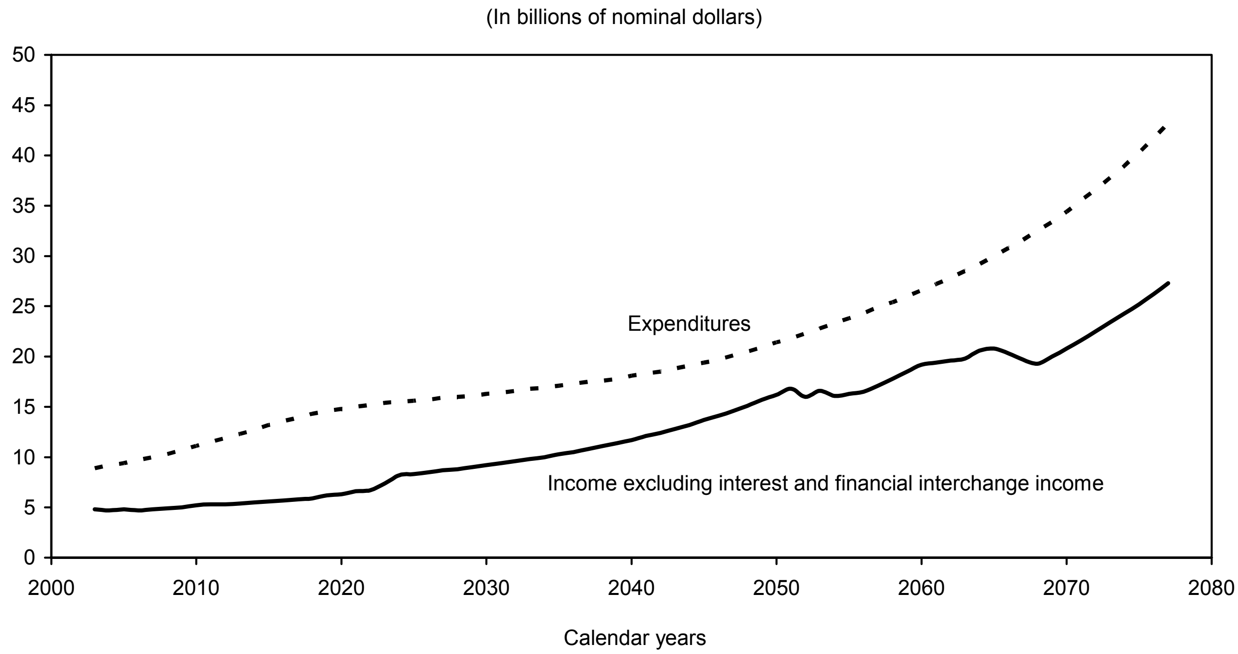
The Railroad Retirement and Survivors Improvement Act (RRSIA), enacted into law on December 21, 2001, provided several changes in benefit and financing provisions, including the transfer of investment responsibility from the Railroad Retirement System trust funds managed by the RRB to the newly-created National Railroad Retirement Investment Trust (NRRIT).

The sole purpose of the NRRIT is to manage and invest railroad retirement assets. The trust is a tax-exempt entity independent from the Federal Government. It is domiciled in and subject to the laws of the District of Columbia. The RRSIA authorizes the trust to invest the assets of the Railroad Retirement Account in a diversified investment portfolio in the same manner as those of private sector retirement plans. Prior to the Act, investment of Railroad Retirement Account assets was limited to U.S. Government securities. In addition, to carry out its mandate, the trust's Board of Trustees is authorized to make rules to govern its operations, to employ professional staff, and to contract with outside advisors to provide legal, accounting, investment advisory or other services necessary for the proper administration of the trust. Administrative expenses of the trust are paid out of trust assets. The Board of Trustees is comprised of seven trustees, three selected by railroad labor unions and three by railroad companies. The seventh trustee is an independent trustee selected by the other six trustees. The trustees' terms are for 3 years and are staggered. The Act provides that on the initial Board, one each of the Labor and Management members would be selected for 3-year terms, one each for 2-year terms, and one each for a 1-year term. Thereafter, all terms are 3 years. The independent trustees' initial and succeeding terms are 3 years.

During fiscal year 2003, the RRB transferred $19.2 billion to the NRRIT for investment.

Chart 11 shows the estimated railroad retirement income (excluding interest and financial interchange income) and expenditures for the period 2003-2077. 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 will 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
2003-2077



As Chart 11 shows, expenditures exceed the income the entire projection period. Without financial interchange income and interest, annual expenditures are expected to always be greater than annual income. Reasons for this pattern include participant demographics, the assumed drop in railroad employment, and the automatic tier II tax rate adjustment mechanism. The combined balance of the NRRIT, Railroad Retirement Account and SSEB Account never becomes negative largely because (1) a sufficient balance exists at the beginning of the projection period, and (2) tier II tax rates respond automatically to changing account balances.

Table 8 presents an actuarial analysis of the financial position of the Railroad Retirement Program as of January 1, 2003. The figures in the table are based on the Twenty-Second Actuarial Valuation extended through calendar year 2077. The present values in the table are based on estimates of contributions and expenditures through the year 2077. The estimates include contributions and expenditures related to future participants as well as to former and present railroad employees. The present values are computed on the basis of economic and demographic assumptions and employment assumption 2, the intermediate employment assumption, as used in the Twenty-Second Actuarial Valuation.

The economic assumptions include a cost-of-living increase of 3.0 percent, an interest rate of 8.0 percent, and a wage increase of 4 percent. The demographic assumptions include rates of mortality and total termination rates, remarriage rates for widows, retirement rates, and withdrawal rates. For details on the demographic assumptions and other assumptions, refer to the RRB 2003 Annual Report, Twenty-Second Actuarial Valuation Technical Supplement. The average railroad employment is assumed to be 227,000 in 2002. The employment assumption 2, based on a model developed by the Association of American Railroads, assumes that (1) passenger employment will remain at the level of 44,000 and (2) the employment base, excluding passenger employment, will decline at a constant 3.0 percent annual rate for 25 years, at a reducing rate over the next 25 years, and remain level thereafter.

Table 8
Railroad Retirement Program Actuarial Surplus (or Deficiency) [1, 2]
Under Employment Assumption 2
75-Year Projection as of January 1, 2003

(In billions of present-value dollars)

Estimated Future Income (Excluding Interest) [3] Received from or on Behalf of:	
Current participants who have attained retirement age	3.7
Current participants not yet having attained retirement age	39.5
Those expected to become participants	41.4
All participants	84.6
Estimated Future Expenditures: [4]	
Current participants who have attained retirement age	80.4
Current participants not yet having attained retirement age	73.0
Those expected to become participants	13.8
All participants	167.1
Estimated future excess of income over expenditures	82.6
Railroad Retirement program assets, stated at market (mostly investments)	22.4
Net estimated future excess of income over expenditures	60.2

[1] Represents combined values for the Railroad Retirement Account, SSEB Account, and NRRIT.
[2] The data used reflect the provisions of RRSIA of 2001.
[3] Future income (excluding interest) includes tier I taxes, tier II taxes, income taxes on benefits and non-governmental investments income.
[4] Future expenditures include benefit and administrative expenditures.

Note: The fund balance as of 1/1/2003 was $22 billion.
Detail may not add to totals due to rounding. Employee and beneficiary status are determined as of 1/1/2002, whereas present values are as of 1/1/2003.

Black Lung

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

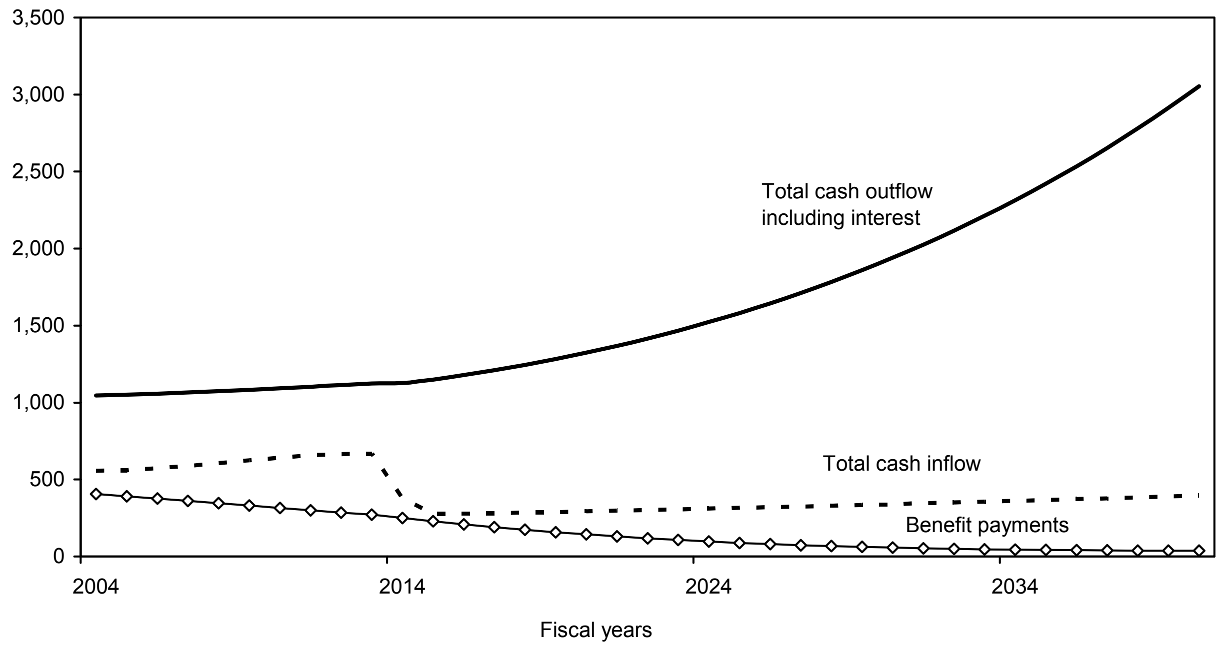
Excise taxes on coal mine operators, based on the sale of coal, partially fund the black lung disability payments and the related administrative and interest expenditures. Intragovernmental advances to the BLDTF, which must be repaid with interest, fund the shortfall.

Under current conditions, analysts project that scheduled reduction in taxes on coal sales will decrease cash inflows for the year 2014 and beyond. Between the years 2013 and 2015, projections estimate a 58 percent decrease in excise tax collections. By the year 2040, the rate reduction is expected to decrease cash inflows by more than $12.5 billion.

Chart 12 shows the estimated black lung expenditures (excluding interest payments) and excise tax collections for the period 2004-2040. Under the intermediate assumptions for the next 37 years, the Black Lung Trust Fund will collect $15.1 billion in excise taxes on coal and pay $6.1 billion for benefits and administrative expenditures. However, this favorable cashflow will not be sufficient to repay the intragovernmental debt that resulted from previous deficits. Currently this debt is $8.2 billion. Cumulative net cash outflows including interest payments on the debt are projected to reach $60.6 billion by the year 2040, increasing the debt to $53.8 billion on September 30, 2040.

Chart 12—Estimated Black Lung Total Cash Outflow, Inflow, and Outflow Before Interest 2004-2040

(In millions of nominal dollars)



The significant assumptions used in the black lung projections are coal production estimates, the tax rate structure, number of beneficiaries, life expectancy, medical costs and the interest rate on new repayable advances from Treasury. These projections are sensitive to changes in the tax rate and changes in interest rates on repayable advances from Treasury.

Unemployment Insurance

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

The program is financed through the collection of Federal and State unemployment taxes that are credited to the Unemployment Trust Fund 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 also are used to maintain a loan account within the Unemployment Trust Fund, from which insolvent State accounts may borrow funds to pay unemployment insurance benefits.

Table 9 shows the Unemployment Trust Fund contributions and expenditures over the next 10 years under expected economic conditions. 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 Unemployment Trust Fund investments.

These projections, excluding interest earnings, indicate net cash outflows in fiscal year 2004, then net cash inflows for the next 5 years indicating that States have replenished their funds to desired levels. There is a crossover back to net outflows in fiscal year 2010. The result is that the fund must rely on interest earnings to keep growing. As indicated in Table 9, net contributions are expected to total $7.9 billion over the next 10 years.

Table 9
Estimated Unemployment Trust Fund Contributions and Expenditures
September 30, 2003–September 30, 2013
(Expected Economic Conditions)

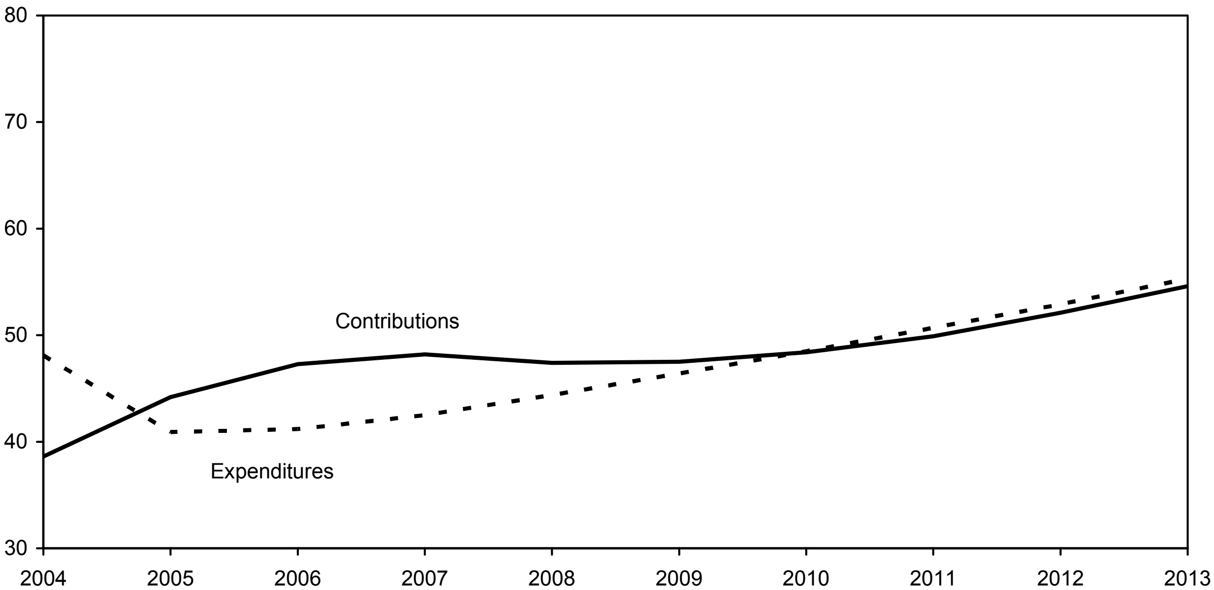
(In billions of nominal dollars)

Contributions to September 30, 2013	478.7
Expenditures to September 30, 2013	470.8
Contributions in excess of expenditures	7.9

Charts 13 through 15 demonstrate the effect on accumulated Unemployment Trust Fund assets of projected cash inflows, excluding interest, and cash outflows over a 10-year period ending September 30, 2013, under expected economic conditions, and mild recessionary and deep recessionary unemployment scenarios. Each scenario uses an open group that includes current and future participants of the Unemployment Insurance Program. For expected economic conditions, the estimates are based on an expected unemployment rate of 5.70 percent during fiscal year 2004, decreasing to 5.10 percent in fiscal year 2008 and thereafter. Under the mild recessionary scenario, the expected unemployment rate will peak at 7.43 percent in fiscal year 2005, and for the deep recession scenario, the expected unemployment rate will rise to 10.15 percent in fiscal year 2006.

Chart 13—Estimated Unemployment Fund Cashflow Using Expected Economic Conditions 2004-2013

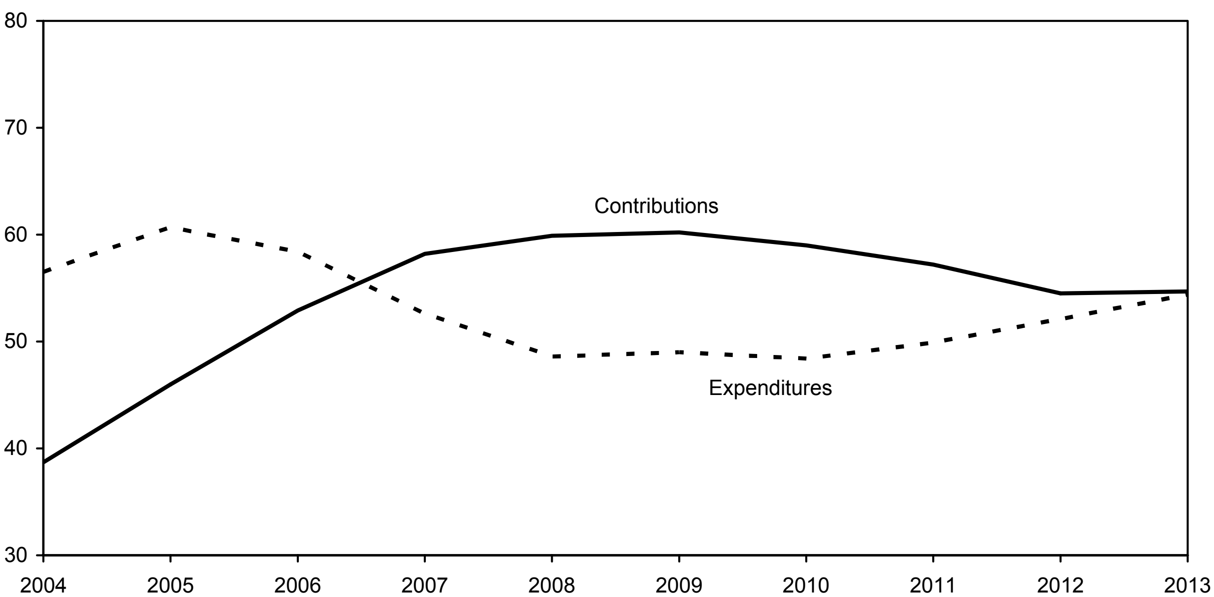
(In billions of nominal dollars)



Fiscal years

Chart 14—Estimated Unemployment Fund Cashflow Using a Mild Recessionary Unemployment Rate 2004-2013

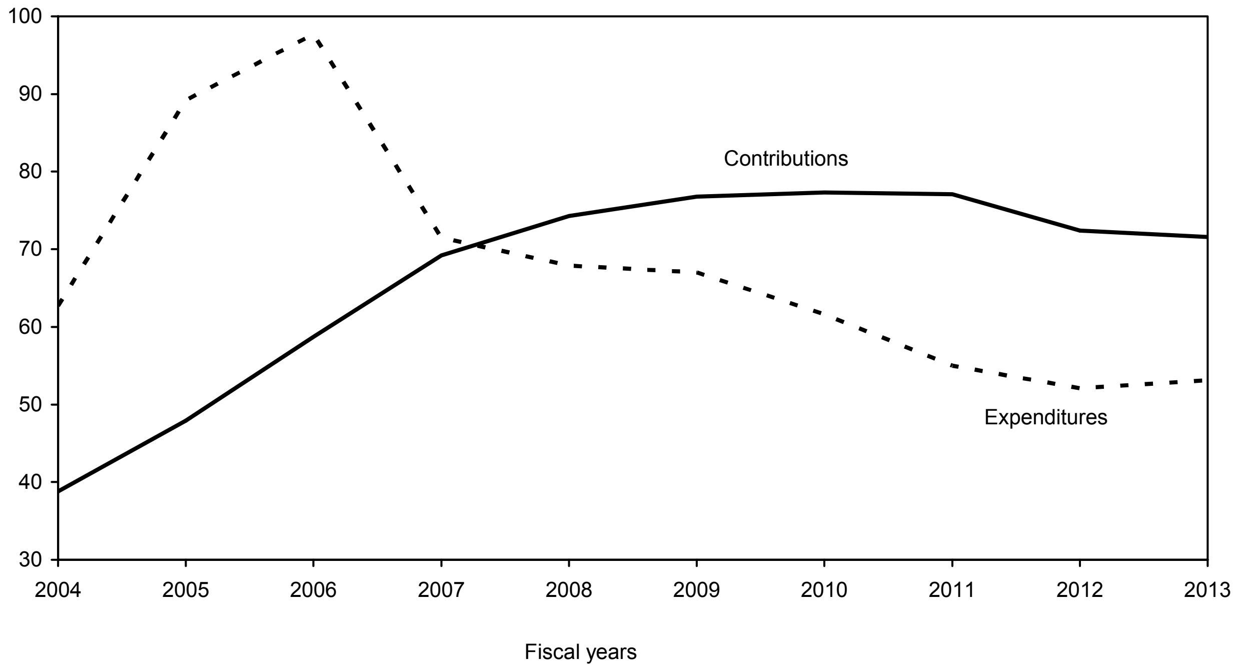
(In billions of nominal dollars)



Fiscal years

**Chart 15—Estimated Unemployment Fund Cashflow
Using a Deep Recessionary Unemployment Rate
2004-2013**

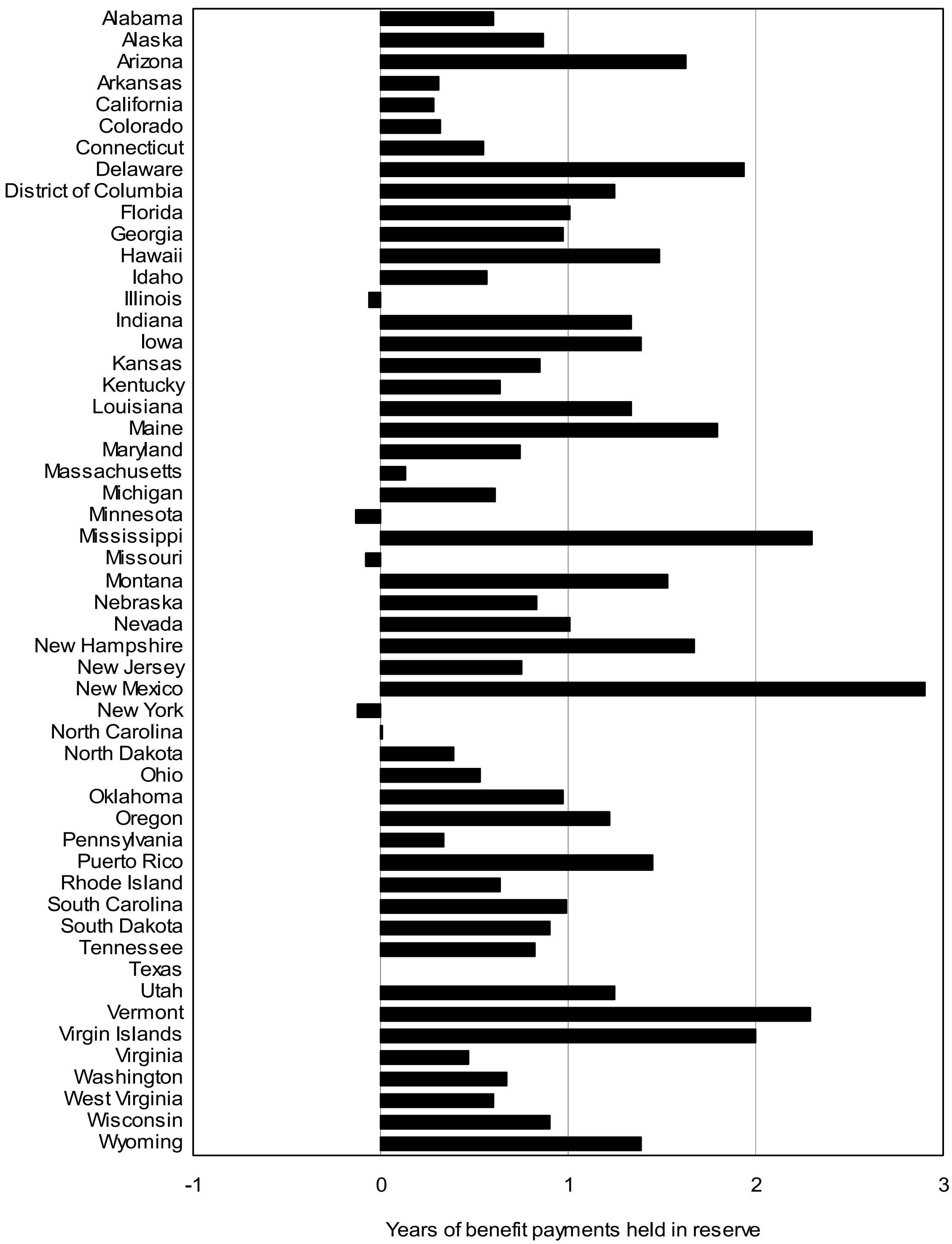
(In billions of nominal dollars)



Unemployment Trust Fund Solvency

Chart 16 shows the adequacy of each State's accumulated Unemployment Trust Fund assets to provide for future unemployment benefits. To be considered minimally solvent, a State's reserve balance should provide for one year's projected benefit payment needs based on the highest level of benefit payments experienced by the State. States below this level are vulnerable to exhausting their funds in a recession. States exhausting their reserve balance must borrow funds from the Federal Unemployment Account (FUA) to make benefit payments. During periods of high sustained unemployment, balances in the FUA may be depleted. In these circumstances, FUA is authorized to borrow from the Treasury general fund. As Chart 16 illustrates, 32 states failed to maintain minimal solvency at September 30, 2003. The solvency is not computed for Texas because the bulk of its fund balance represents proceeds from the sale of bonds.

Chart 16—Unemployment Trust Fund Solvency as of September 30, 2003



Stewardship Assets

The Government holds stewardship assets for the benefit of the Nation. Because the Government has been entrusted with, and made accountable for, these resources and responsibilities, they are recognized in this *Financial Report*.

When acquired, stewardship assets are generally treated as expenses in the financial statements. This section provides more detailed stewardship information on these resources to highlight their long-term benefit and to demonstrate accountability. This information facilitates the understanding of the operations and financial condition of the Government.

Stewardship Land

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

Most stewardship land managed by the Government was once part of the 1.8 billion acres of public domain land acquired between 1781 and 1867. Stewardship land accounts for 28 percent of the current U.S. landmass. Stewardship land acquired totaled $329.6 million and $212.4 million for the years ended September 30, 2003, and 2002, respectively. Table 10 depicts the stewardship land owned by the Government and administered by the Department of the Interior (DOI), the Department of Defense (DOD), and the Department of Agriculture (USDA). Detailed information concerning stewardship land can be obtained in the financial statements of DOI, DOD, and USDA.

Table 10
United States Government Stewardship Land as of September 30

Agency	Predominate Use	Millions of Acres		Percentage	
		2003	2002	2003	2002
Bureau of Land Management	Public land	262.0	261.5	39.9	40.5
U.S. Forest Service	National forest system	192.5	192.3	29.3	29.8
U.S. Fish and Wildlife Service	National wildlife refuge system	95.9	90.1	14.6	14.0
National Park Service	National park system	84.2	79.0	12.8	12.2
Department of Defense	Defense facilities	16.7	16.8	2.5	2.6
Bureau of Reclamation	Water, power, and recreation	5.9	5.8	0.9	0.9
Total acres		657.2	645.5	100.0	100.0

Heritage Assets

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

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

The cost of heritage assets often is not determinable or relevant to their significance. Like stewardship land, the Government does not expect to use these assets to meet its obligations. The most relevant information about heritage assets is nonfinancial. The public entrusts the Government with these assets and holds it accountable for their preservation. Examples of heritage assets include Mount Rushmore National Memorial, Yosemite National Park, and museum objects on display at the Smithsonian Institution. 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.

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

The Government classifies heritage assets into three broad categories:

- Collection-type.
- Natural.
- Cultural.

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

Collection-Type Heritage Assets

The Smithsonian Institution holds some of the most prominent Federal museum collections. The Smithsonian acquires, protects, and preserves approximately 143 million individual objects for public exhibition, education, and research.

Similarly, the Library of Congress holds the world's largest library collection, comprising more than 126 million items. The Library of Congress receives two copies of every book, pamphlet, map, print, photograph, and piece of music registered for copyright in the United States.

The National Archives holds about 2.9 million cubic feet of records. These records ensure ready access to essential information documenting the rights of citizens, the actions of Federal officials, and the effects of those actions on the national experience. These records include text and legislative records; cartographic and architectural records; motion picture, sound, and video records; and still pictures and graphics. The National Archives also maintains historically important documents such as the U.S. Constitution and the Louisiana Purchase Treaty.

Collection-type heritage assets acquired totaled $21.2 million and $187.8 million for the years ended September 30, 2003, and 2002, respectively.

Natural Heritage Assets

Congress has designated several wilderness areas to preserve their natural conditions. DOI manages approximately 70.1 million acres of these wilderness areas comprised of almost 73 percent of the Nation's more than 96 million wilderness acres. The Cebolla Wilderness in New Mexico is one such area.

The national wild and scenic rivers system includes protected free-flowing rivers. The Government protects these areas because of their fish and wildlife, or for their scenic, recreational, geologic, historic, or cultural value. DOI manages 73 percent of these 11,000 river miles, including the Bluestone National Scenic River in West Virginia.

The Government also sets aside natural landmarks that exemplify a region's natural characteristics. The U.S. Fish and Wildlife Service manages 9 national historic landmarks, the Bureau of Land Management manages 22 natural historic landmarks, and the National Park Service manages 153 national natural landmarks, such as the Grand Coulee Gorge in Washington State.

The U.S. Forest Service manages 155 national forests and 20 national grasslands on more than 192 million acres of public land. These areas encompass significant heritage resources. Examples include the White Mountain National Forest in New Hampshire and the Thunder Basin National Grassland in Wyoming.

Natural heritage assets acquired totaled $263.1 million and $313.0 million for the years ended September 30, 2003, and 2002, respectively.

Any acreage cited above for natural heritage assets, such as wilderness areas, are also included in the acreage cited in the Stewardship Land section.

Cultural Heritage Assets

The National Register of Historic Places lists historic sites and structures. This is America's official list of cultural resources worthy of preservation. Official properties include districts, sites, buildings, structures, and objects significant to American history. It also includes significant architectural, archaeological engineering, and cultural properties. Forest Service land encompasses 2,834 such properties.

The Nation's monuments and memorials include the Washington Monument, the Vietnam Veterans Memorial, and the Jefferson Memorial in Washington, D.C. The National Park Service manages these. In addition, the American Battle Monuments Commission administers, operates, and maintains 24 permanent American Military Cemeteries on foreign soil and 25 stand-alone memorials, monuments, and markers around the world. This includes the Belleau Wood Marine Monument in France.

Archeological and historical sites contain the remains of human activity. DOI manages numerous archaeological sites. The National Park Service manages approximately 58,000 archeological and historical sites; the Bureau of Land Management, the U.S. Fish and Wildlife Service and the Bureau of Reclamation manage approximately 277,000 archaeological and historical properties. The ancient earthen mounds at the Hopewell Culture National Historic Site in Ohio are a notable example.

National cemeteries include the Arlington National Cemetery in Virginia and the Fort Logan National Cemetery in Colorado. The Department of the Army (Army) manages the Arlington National Cemetery. The Department of Veterans Affairs (VA) manages Fort Logan National Cemetery and other cemeteries.

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.

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. The amounts reported in fiscal year 2002 for investments in prior years (fiscal years 2002-1999) have been restated because agencies are continuously reviewing, correcting, and updating this data.

Table 11
Stewardship Investments
for the Years Ended September 30

(In billions of dollars)	Fiscal Year 2003	Restated Fiscal Year 2002	Restated Fiscal Year 2001	Restated Fiscal Year 2000	Restated Fiscal Year 1999
Investments in non-Federal physical property	44.5	44.4	38.8	34.9	30.5
Investments in human capital	71.8	62.1	50.8	42.8	45.4
Research and development:					
Investments in basic research	22.9	23.2	20.1	18.9	17.8
Investments in applied research	19.4	21.4	19.0	16.8	16.5
Investments in development	46.2	44.7	40.9	39.1	41.0
Total investments	204.8	195.8	169.6	152.5	151.2

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.

Research and Development

Federal investments in research and development 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.

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United States Government Notes to the Financial Statements for the Years Ended September 30, 2003, and September 30, 2002

Note 1. Summary of Significant Accounting Policies

A. Reporting Entity

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

Material intragovernmental transactions are eliminated in consolidation, except as described in Note 16—Unreconciled Transactions Affecting the Change in Net Position. The financial reporting period ends September 30 and is the same as used for the annual budget.

On November 25, 2002, the DHS Reorganization Plan was enacted. The Reorganization Plan was submitted pursuant to Section 1502 of the Department of Homeland Security Act of 2002. The new DHS has three primary missions: to prevent terrorist attacks, reduce America’s vulnerability to terrorism, and minimize the damage from potential attacks and natural disasters. DHS is funded with prior monies assigned to the entities transferred to DHS, as requested by the President, from the fiscal year 2003 budget. Future savings should be achieved through eliminations of redundancies inherent in the current structure. The reorganization plan submitted includes two basic categories: the transfer of agencies, personnel, assets and obligations to DHS; and the consolidation, reorganization, or streamlining of agencies transferred to DHS. The majority of the assets and expenses transfers have taken place in fiscal year 2003.Based on this reorganization plan, DHS has established its structure, classifying the transferred agencies according to their nature (the list below shows, in parentheses, the starting point of the transferred entities):

Chemical, Biological, Radiological, and Nuclear Countermeasures
Civilian Biodefense Research Programs (HHS)
Lawrence Livermore National Laboratory (DOE)
National Bio-Weapons Defense Analysis Center (DOD)
Plum Island Animal Disease Center (USDA)
Information Analysis and Infrastructure Protection
Critical Infrastructure Assurance Office (Commerce)
Federal Computer Incident Response Center (GSA)
National Communications System (DOD)
National Infrastructure Protection Center (DOJ/FBI)
National Infrastructure Simulation and Analysis Center (DOE)
Border and Transportation Security
Immigration and Naturalization Service (DOJ)
Customs Service (Treasury)
Animal and Plant Health Inspection Service (USDA)
Coast Guard (DOT)
Federal Protective Services (GSA)
Transportation Security Agency (DOT)
Emergency Preparedness and Response
Federal Emergency Management Agency (reported as stand-alone from 8/1/02 to 3/1/03, rest as DHS)
Chemical, Biological, Radiological, and Nuclear Response Assets (HHS)
Domestic Emergency Support Team (DOJ)
Nuclear Incident Response (DOE)
Office of Domestic Preparedness (DOJ)
National Domestic Preparedness Office (DOJ/FBI)

B. Basis of Accounting and Revenue Recognition

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

- Expenses are generally recognized when incurred except that the costs of social insurance programs including Social Security, Medicare, Railroad Retirement, Black Lung, and Unemployment are recognized only for amounts currently due and payable.
- Nonexchange (unearned) revenues including taxes, duties, fines, and penalties, are recognized when collected, 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.

This 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. See the Reconciliations of Net Operating Cost and Unified Budget Deficit in the Financial Statements section.

In fiscal year 2003, the Government implemented the provisions of SFFAS No. 25 *Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment (CSA)*. This standard eliminated the requirement for the CSA.

C. Direct Loans and Loan Guarantees

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

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

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

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

D. Accounts and Taxes Receivable

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

The category taxes receivable consists primarily of uncollected tax assessments, penalties, and interest when taxpayers have agreed the amounts are owed, or a court has determined the assessments are owed. The balance sheets do not include unpaid assessments when neither taxpayers nor a court have agreed that the amounts are owed (compliance assessments) or the Government does not expect further collections due to factors such as the taxpayer's death, bankruptcy, or insolvency (writeoffs). Taxes receivable are reported net of an allowance for the estimated portion deemed to be uncollectible.

E. Inventories and Related Property

Inventories within the Government are valued using historical cost, net realizable value, and latest acquisition cost (see Note 6—Inventories and Related Property, Net). Historical cost methods include first-in-first-out, weighted average, and moving average. Estimated repair costs reduce the value of inventory held for repair. Excess, obsolete, and unserviceable inventories are valued at estimated net realizable values. When latest acquisition cost is used to value inventory held for sale, it is adjusted for holding gains and losses in order to approximate historical cost.

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

Effective for accounting periods beginning after September 30, 2002, (SFFAS) No. 23, *Eliminating the Category National Defense Property, Plant, and Equipment* removes national defense assets from Stewardship Information and includes them on the balance sheet, some of those assets are now classified as part of inventories and related property.

F. Property, Plant, and Equipment

Property, plant, and equipment used in Government operations are carried at cost. 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 is recognized using the straight-line method over the estimated useful lives of the assets. Effective for accounting periods beginning after September 30, 2002, (SFFAS) No. 23, *Eliminating the Category National Defense Property, Plant, and Equipment* removes national defense assets from Stewardship Information and includes them on the balance sheet, most national defense assets are now classified as property, plant, and equipment. Stewardship land and heritage assets remain in the Stewardship Information section.

G. Federal Employee and Veteran Benefits Payable

Federal employee and veteran benefits payable are recorded during the time employee services are rendered. The related liabilities for defined benefit pension plans and post-retirement health benefits are recorded at estimated present value of future benefits, less the estimated present value of future normal cost contributions.

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

H. Environmental and Disposal Liabilities

Environmental and disposal liabilities are recorded at the estimated current cost of removing, containing and/or disposing of hazardous waste and environmental contamination, 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 hazardous waste, only the estimable portion of the liability, typically safe containment, is recorded.

I. Deferred Maintenance

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

J. Contingent Liabilities

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

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

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

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

K. Commitments

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

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

L. Social Insurance

A liability for social insurance programs (Social Security, Medicare, railroad retirement, black lung, and unemployment) is recognized for any unpaid amounts due as of the reporting date. No liability is recognized for future benefit payments not yet due. For further information, see the Stewardship Information section on Stewardship Responsibilities, and Note 20—Dedicated Collections.

M. Related Party Transactions

Federal Reserve banks (FRBs), and private banks, which are not part of the reporting entity, serve as the Government's depositary and fiscal agent. They process Federal payments and deposits to Treasury's account and service Treasury securities. FRBs owned $654 billion and $603 billion of Treasury securities held by the public as of September 30, 2003, and 2002, respectively. FRB earnings that exceed statutory amounts of surplus established for FRBs are paid to the Government and are recognized as nonexchange revenue. Those earnings totaled $21.9 billion and $23.7 billion for the years ended September 30, 2003, and 2002, respectively. The primary source of these earnings is from interest earned on Treasury securities held by the FRBs. Also, as described in Note 14—Other Liabilities, the FRB holds certificates and special drawing rights certificates.

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

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

Note 2. Cash and Other Monetary Assets

Cash and Other Monetary Assets as of September 30

(In billions of dollars)	2003	2002
Operating cash	35.0	60.9
Other cash	27.2	28.3
Total cash	62.2	89.2
International monetary assets	46.2	41.0
Gold	10.9	10.9
Domestic monetary assets	0.3	0.5
Total cash and other monetary assets	119.6	141.6

Cash

Total cash consists of:

- Operating cash of the Government representing balances from tax collections; customs duties; other revenues; Federal debt receipts; and other various receipts, net of checks outstanding that are held in the Federal Reserve banks, foreign and domestic financial institutions, and in the U.S. Treasury tax and loan accounts.
- Other cash representing the balances of petty cash and other funds held in agencies' books, plus time deposits in financial institutions.

The Government maintains formal arrangements with numerous financial institutions for holding time deposits known as "compensating balances." These balances, which are included in other cash, totaled $22.2 billion and $27.4 billion as of September 30, 2003, and 2002, respectively. The earnings from the investment of these balances compensate financial institutions for services provided to the Government, such as maintaining zero-balance accounts for the collection of public monies.

As of September 30, 2003, $15.0 billion of the total time deposit balances are invested by Treasury in nonmarketable Depositary Compensation Securities. The remainder of the balances of the time deposit accounts, in the amount of $7.2 billion, are invested at the financial institutions' discretion.

Operating cash and the other cash of the Government are either insured (for balances up to $100,000) by the Federal Deposit Insurance Corporation (FDIC), or collateralized by securities pledged by financial institutions.

International Monetary Assets

International monetary assets include the U.S. reserve position in the International Monetary Fund (IMF), U.S. holdings of Special Drawing Rights (SDRs), and official reserves of foreign currency and gold.

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

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

The balance available under the letter of credit totaled $28.9 billion and $28.2 billion for the years ended September 30, 2003, and 2002, respectively. The U.S. reserve position in the IMF has a U.S. dollar equivalent of $24.1 billion and $20.9 billion for the years ended September 30, 2003, and 2002, respectively.

SDRs are international monetary reserves issued by the IMF. These interest-bearing assets can be obtained by IMF allocations, transactions with IMF member countries, interest earnings on SDR holdings, or U.S. reserve position in the IMF. SDR holdings are an asset of Treasury's Exchange Stabilization Fund (ESF), which held SDRs totaling $12.1 billion and $11.7 billion equivalent for the years ended September 30, 2003, and 2002, respectively.

The IMF allocates SDRs to its members in proportion to each member's quota in the IMF. The SDR Act of 1968 authorized the Secretary of the Treasury to issue SDR Certificates (SDRCs) to the Federal Reserve in exchange for dollars. The amount of SDRCs outstanding cannot exceed the dollar value of SDR holdings. The Secretary of the Treasury determines when Treasury will issue or redeem SDRCs. SDRCs outstanding totaled $2.2 billion for the years ended September 30, 2003, and 2002, respectively, and are included in Note 14—Other Liabilities.

As of September 30, 2003, and 2002, other liabilities included $7 billion and $6.5 billion, respectively, of interest-bearing liability to the IMF for SDR allocations. The SDR allocation item represents the cumulative total of SDRs distributed by the IMF to the United States in allocations that occurred in 1970, 1972, 1979, 1980, and 1981.

Gold

Gold is valued at the statutory price of $42.2222 per fine troy ounce. The number of fine troy ounces was 258,713,310 as of September 30, 2003, and 2002. The market value of gold on the London Fixing as of the reporting date was $388.0 and $323.70 per fine troy ounce for the years ended September 30, 2003, and 2002, respectively. Gold totaling $10.9 billion for each year ended September 30, 2003, and 2002, was pledged as collateral for gold certificates issued and authorized to the FRBs by the Secretary of the Treasury. Treasury may redeem the gold certificates at any time. See Note 14—Other Liabilities.

Domestic Monetary Assets

Domestic monetary assets consist of liquid assets, other than cash, that are based on the U.S. dollar, including coins, silver bullion, and other coinage metals.

Note 3. Accounts Receivable, Net

The category of accounts receivable that includes related interest receivable of $4.6 billion and $3.9 billion for the years ended September 30, 2003, and 2002, respectively, represents claims to cash or other assets from entities outside the Government. An allowance for estimated losses due to uncollectible amounts is established when it is more likely than not the receivables will not be totally collected. The allowance method varies among the agencies in the Government. Methods include statistical sampling of receivables, specific identification and intensive analysis of each case, aging methodologies, and percentage of total receivables based on historical collection. Accounts receivable are net of an allowance for uncollectible accounts. The allowance amounts are $16.1 billion and $15.3 billion for the years ended September 30, 2003, and 2002, respectively.

Accounts Receivable as of September 30

(In billions of dollars)	2003	2002
Department of Defense	7.3	6.4
Social Security Administration	5.8	5.7
Department of Energy	4.4	4.4
Department of Health and Human Services	2.8	4.1
Department of Agriculture	1.9	1.9
Department of the Interior	1.2	1.3
Export-Import Bank of the United States	1.0	-
Tennessee Valley Authority	1.0	0.6
Department of Veterans Affairs	0.9	1.2
United States Postal Service	0.8	0.7
Department of Labor	0.8	0.6
Department of Housing and Urban Development	0.8	0.8
Federal Communications Commission	0.7	0.5
Pension Benefit Guaranty Corporation	0.5	0.4
Environmental Protection Agency	0.5	0.5
Department of Homeland Security	0.3	-
All other departments	3.1	2.9
Total accounts receivable, net	33.8	32.0

Note 4. Loans Receivable and Loan Guarantee Liabilities, Net

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

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

Direct Loans and Loan Guarantees as of September 30

(In billions of dollars)	Face Value of Loans Outstanding		Long-term Cost of Loans and Guarantees Outstanding		Net Loans Receivable		Amount Guaranteed by the Government		Subsidy Expense for the Fiscal Year Ended September 30	
	2003	2002	2003	2002	2003	2002	2003	2002	2003	2002
Direct Loan Programs:										
Federal Direct Student Loans	84.5	80.0	(2.1)	(4.8)	86.6	84.8			4.7	0.9
Rural Utilities Service	40.1	39.5	4.1	3.1	36.0	36.4			0.6	0.2
Rural Housing Service	27.3	28.2	7.5	7.2	19.8	21.0			-	(0.3)
Federal Family Education Loans	17.7	17.8	6.9	11.5	10.8	6.3			-	-
Housing and Urban Development	7.5	8.5	-	0.5	7.5	8.0			-	-
Export-Import Bank Loans	7.8	7.5	1.2	(0.2)	6.6	7.7			-	0.1
U.S. Agency for International Development	8.5	9.0	3.2	3.3	5.3	5.7			-	-
Food for Progress credits	9.8	10.2	5.3	5.5	4.5	4.7			0.2	(0.3)
Direct Loans for Spectrum auction sales	5.1	5.3	0.7	-	4.4	5.3			0.4	-
Agricultural Credit Insurance Fund	4.6	4.4	0.7	1.4	3.9	3.0			(0.6)	0.1
Export Credit Guarantees	6.7	6.9	3.2	3.2	3.5	3.7			-	-
Disaster Loan programs	3.0	3.2	0.4	(0.6)	2.6	3.8			0.3	0.1
All other programs	28.7	28.4	(0.9)	(0.4)	29.6	28.8			(0.3)	0.3
Total	251.3	248.9	30.2	29.7	221.1	219.2			5.3	1.1
Guaranteed Loan Programs:										
Federal Family Education Loans	213.0	182.0	15.4	11.7			209.0	179.0	2.5	4.5
Veterans Housing Benefit program	213.2	216.1	4.8	5.6			67.6	69.5	(1.5)	(0.1)
Subsidized Federal Housing Administration Loans	101.2	106.8	4.1	5.5			85.6	95.8	0.1	(0.6)
Small Business Loans	53.6	50.1	2.5	1.5			43.4	40.4	2.2	0.7
Unsubsidized Federal Housing Administration Loans	434.0	501.3	2.1	(1.7)			404.4	467.7	2.5	(2.6)
Export-Import Bank guarantees	32.9	30.3	1.8	1.7			32.9	30.3	0.3	1.8
Israeli Loan Guarantee program	10.8	9.2	0.7	0.7			10.8	9.2	-	-
Overseas Private Investment Corporation Credit program	3.0	3.0	0.6	0.5			3.0	3.0	-	-
Urban and Environmental program	2.0	2.1	0.5	0.4			2.0	2.1	-	-
Rural Housing Service	13.8	13.9	0.4	0.3			12.4	12.5	0.1	(0.1)
Health Education Assistance Loans	2.5	2.7	0.4	0.3			2.5	2.7	0.2	-
Export Credit Guarantee programs	4.8	4.9	-	0.4			4.7	4.7	(0.1)	-
All other programs	23.0	22.0	1.3	1.2			20.1	19.3	0.2	0.2
Total	1,107.8	1,144.4	34.6	28.1			898.4	936.2	6.5	3.8

Net loans receivable includes related interest and foreclosed property, and is included in the assets section of the balance sheets.

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

Major Loan Programs

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

USDA, Rural Utilities Service loans are for the construction and operation of electric generating plants, transmission and distribution lines, telecommunication lines, and related systems. These loans carry an average maturity of greater than 20 years and are usually secured.

The major Federal rural housing programs are funded through the Rural Housing Insurance Fund Program account. These programs include:

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

Loan programs are limited to rural areas that include towns, villages, and other places not part of an urban area. The majority of these loans mature in excess of 25 years and are secured by the property of the borrower.

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

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

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

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

Repayment terms for these loans are usually 1 to 7 years.

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

Other loan programs include the Small Business Administration (SBA) general business loan guarantees and disaster loans; and the Farm Service Agency's farm ownership, emergency, and disaster loans.

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

Note 5. Taxes Receivable, Net

Taxes receivable are the gross tax receivables net of allowance for doubtful accounts. The allowance for doubtful accounts is based on projections of collectibility from a statistical sample of taxes receivable. The interest receivable related to taxes receivable totaled $1.6 billion and $0.1 billion for the years ended September 30, 2003, and 2002, respectively.

Taxes Receivable as of September 30

(In billions of dollars)	2003	2002
Gross taxes receivable	94.4	89.4
Allowance for doubtful accounts	(71.5)	(68.0)
Taxes receivable, net	22.9	21.4

Note 6. Inventories and Related Property, Net

Inventories and Related Property as of September 30

(In billions of dollars)	Defense 2003	All Others 2003	Total 2003	Defense 2002	All Others 2002	Total 2002
Inventory purchased for resale	70.2	0.5	70.7	59.4	0.5	59.9
Inventory held in reserve for future sale	-	-	-	2.8	-	2.8
Inventory and operating material and supplies held for repair	45.9	0.4	46.3	42.0	0.8	42.8
Inventory—excess, obsolete and unserviceable	3.8	-	3.8	4.5	-	4.5
Operating materials and supplies held for use	117.8	4.8	122.6	74.9	4.6	79.5
Operating materials and supplies held in reserve for future use	5.1	0.1	5.2	5.1	0.1	5.2
Operating materials and supplies—excess, obsolete and unserviceable	3.7	0.1	3.8	1.9	0.1	2.0
Stockpile materials	1.8	40.0	41.8	2.1	38.3	40.4
Other related property	1.9	3.0	4.9	2.3	3.7	6.0
Total allowance for inventories and related property	(56.0)	(1.9)	(57.9)	(48.9)	(2.0)	(50.9)
Total inventories and related property, net	194.2	47.0	241.2	146.1	46.1	192.2

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.

The inventory and related property for DOD had a net increase this year of $48.6 billion ($66.5 billion due to the transfer of operating materials and supplies from stewardship's national defense assets to the balance sheet, minus $17.9 billion of operating materials and supplies used during the year). These transfers are not a reconciling item on the Reconciliations of Net Operating Cost and Unified Budget Deficit.

Inventory purchased for resale is the cost or value of tangible personal property purchased by an agency for resale. DOD, which accounts for nearly all of the inventory purchased for resale and future sale in the Government, generally uses the Latest Acquisition Cost (LAC) method, which is revalued for holding gains and losses.

Inventory held in reserve for future sale is inventory not readily available, or inventory that will be needed in the future.

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

Inventory—excess, obsolete, and unserviceable:

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

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

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

Operating materials and supplies held in reserve for future use are materials retained because they are not readily available in the market or because they will not be used in the normal course of operations, but there is more than a remote chance that they will eventually be needed. DOD, which accounts for most of the reported operating materials and supplies held for use, uses LAC and Standard Price under the purchase and consumption methods of accounting and does not adjust for holding gains and losses, which does not approximate historical cost. A net addition of $48.6 billion was added to operating materials and supplies, the majority of this increase as a result of SFFAS No. 23, *Eliminating the Category National Defense Property, Plant, and Equipment* effective in May 2003.

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

- 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, does not value excess, obsolete, and unserviceable operating materials and supplies at net realizable value.

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 amount reported by the DOD is stockpile materials held for sale, and the amount reported in all others is stockpile materials held in reserve, and is reported by the Department of Energy (DOE).

Other related property:

- Commodities include items of commerce or trade that have an exchange value used to stabilize or support market prices.
- Seized monetary instruments are comprised of only 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 included as a Government asset. It is accounted for in agency property-management records until the property is forfeited, returned, or otherwise liquidated.
- 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.
- Other property not classified above.

Note 7. Property, Plant, and Equipment, Net

The category of property, plant, and equipment consists of tangible assets including land, buildings, structures, automated data processing software, and other assets used to provide goods and services.

SFFAS No. 23, *Eliminating the Category National Defense Property, Plant, and Equipment* was effective in May 2003. This standard, which is effective for accounting periods beginning after September 30, 2002, establishes generally accepted accounting principles for valuing and reporting DOD's military equipment (e.g., ships, aircraft, combat vehicles, weapons) in Federal financial statements. The standard requires the capitalization and depreciation of the cost of DOD's military equipment, including the cost of modifications and upgrades. National defense assets have been removed from Stewardship Information and most are included on the balance sheet as part of property, plant, and equipment. Due to DOD's large asset increase from last year, the total property, plant, and equipment information has been separated into two tables by fiscal year.

Property, plant, and equipment increased by $333.5 billion (102.71 percent) from yearend fiscal year 2002, mostly due to military equipment transferred from Stewardship that increased by $316.6 billion (book value) and equipment with a book value of $8.5 billion added during the year. DOD has estimated the total acquisition cost of military equipment at $1,123.5 billion with an accumulated depreciation of $798.4 billion, for a net book value of $325.1 billion.

Property, Plant, and Equipment as of September 30, 2003

(In billions of dollars)	Cost		Accumulated Depreciation/ Amortization		Net	
	Defense	All Others	Defense	All Others	Defense	All Others
Buildings, structures, and facilities	159.5	168.0	83.1	80.3	76.4	87.7
Furniture, fixtures, and equipment	1,163.1	152.3	825.2	82.6	337.9	69.7
Construction in progress	19.4	37.5	N/A	N/A	19.4	37.5
Land	9.7	10.1	N/A	N/A	9.7	10.1
Automated data processing software	5.0	5.2	2.6	1.5	2.4	3.7
Assets under capital lease	0.6	1.4	0.3	0.4	0.3	1.0
Leasehold improvements	0.2	3.4	0.1	1.7	0.1	1.7
Other property, plant, and equipment	0.1	0.5	-	-	0.1	0.5
Subtotal	1,357.6	378.4	911.3	166.5	446.3	211.9
Total property, plant, and equipment, net		1,736.0		1,077.8		658.2

Property, Plant, and Equipment as of September 30, 2002

(In billions of dollars)	Cost		Accumulated Depreciation/ Amortization		Net	
	Defense	All Others	Defense	All Others	Defense	All Others
Buildings, structures, and facilities	151.8[1]	166.8[1]	78.3[1]	76.3[1]	73.5[1]	90.5[1]
Furniture, fixtures, and equipment	33.4	144.0	22.8	76.2	10.6	67.8
Construction in progress	26.8	34.7	-	-	26.8	34.7
Land	9.5[1]	4.2[1]	-[1]	-[1]	9.5[1]	4.2[1]
Automated data processing software	3.5	3.4	2.1	1.1	1.4	2.3
Assets under capital lease	0.6	1.3	0.3	0.4	0.3	0.9
Leasehold improvements	0.2	3.1	0.1	1.5	0.1	1.6
Other property, plant, and equipment	0.1	0.4	-	-	0.1	0.4
Subtotal	225.9	357.9	103.6	155.5	122.3	202.4
Total property, plant, and equipment, net		583.8		259.1		324.7

[1] Reclassified.

Note 8. Other Assets

Other Assets as of September 30

(In billions of dollars)	2003	2002
Securities and investments:		
All other	37.7	28.5[1]
NRRIT[2]	19.4	-
Advances and prepayments	26.1	22.9
Other	13.9	14.0[1]
Total other assets	97.1	65.4

[1] Reclassified.
[2] For more information, see Railroad Retirement in the Stewardship Information section (page 86).

Securities and investments are presented at cost, net of unamortized premiums and discounts. The increase in securities and investments was primarily related to the transfer of Railroad Retirement Program funds to the NRRIT and the conversion of nonmarketable intragovernmental securities to public securities purchased on the open market. As discussed in the Stewardship Information section of this report, the NRRIT manages and invests railroad retirement assets that are to be used to pay retirement benefits to the Nation's railroad workers under the Railroad Retirement Program, a social insurance program.

Note 9. Accounts Payable

Accounts Payable as of September 30

(In billions of dollars)	2003	2002
Department of Defense	28.4	24.9
Department of Agriculture	3.6	3.1
United States Postal Service	3.3	2.3
Department of Energy	3.1	3.3
Department of Veterans Affairs	3.0	2.6
National Aeronautics and Space Administration	2.2	2.4
General Services Administration	2.2	2.0
Department of Justice	2.1	2.4
Department of Homeland Security	2.0	-
Agency for International Development	1.8	1.1
Department of Housing and Urban Development	1.5	1.4
Department of Transportation	1.0	2.5
Tennessee Valley Authority	1.0	1.3
Department of Health and Human Services	0.9	0.7
Department of the Treasury - excluding interest on debt	0.5	1.2
Executive Office of the President	0.1	0.1
All other departments	5.5	4.5
Total accounts payable	62.2	55.8

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

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

Definitions of Debt

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

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

Federal Debt Securities Held by the Public and Accrued Interest

(In billions of dollars)	Balance September 30, 2002	Net Change During Fiscal Year 2003	Balance September 30, 2003	Average Interest Rate 2003	Average Interest Rate 2002
Treasury Securities (Public):					
Marketable securities					
Treasury bills	868.2	50.0	918.2	1.0%	1.7%
Treasury notes	1,615.3	304.2	1,919.5	3.8%	4.7%
Treasury bonds	637.8	(15.1)	622.7	7.8%	8.0%
Total marketable Treasury securities	3,121.3	339.1	3,460.4		
Non-marketable securities	431.8	31.9	463.7	5.3%	6.0%
Net unamortized premium/ (discounts)	(39.3)	2.5	(36.8)		
Total Treasury securities, net (public)	3,513.8	373.5	3,887.3		
Agency Securities:					
Tennessee Valley Authority	24.9	(0.3)	24.6		
All other agencies	1.6	(0.4)	1.2		
Total agency securities, net of unamortized premiums and discounts	26.5	(0.7)	25.8		
Accrued interest payable	32.9	(1.1)	31.8		
Total Federal debt securities held by the public and accrued interest	3,573.2	371.7	3,944.9		

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.

This table details Government borrowing to finance operations and shows marketable and non-marketable 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, and bonds).
- Interest-bearing nonmarketable securities (foreign series, State and local government series, domestic series, depositary compensation securities, and savings bonds).
- Non interest-bearing marketable and nonmarketable securities (matured and other).

Section 3111 of Title 31, 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. During fiscal year 2002, the Secretary of the Treasury authorized the redemption of $12.5 billion of outstanding unmatured marketable Treasury securities at a premium of $3.8 billion. These early redemption transactions are known as Treasury “buybacks.” There were no buyback operations in fiscal year 2003. The net change of the Federal debt securities held by the public and accrued interest includes $12.5 billion during fiscal year 2002, related to these buybacks.

As of September 30, 2003, and 2002, respectively, $6,737.6 billion and $6,161.4 billion of debt was subject to a statutory limit (31 U.S.C. § 3101). That limit was $7,384 billion and $6,400 billion as of September 30, 2003, and 2002, respectively. The debt subject to the limit includes Treasury securities held by the public and Government guaranteed debt of Federal agencies (shown in the table above) and intragovernmental debt holdings (shown in the table below).

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

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

(In billions of dollars)	Balance 2002	Net Change During Fiscal Year 2003	Balance 2003
Social Security Administration, Federal Old-Age and Survivors Insurance	1,173.7	139.7	1,313.4
Office of Personnel Management, civil service retirement and disability	573.7	28.0	601.7
Department of Health and Human Services, Federal Hospital Insurance	228.9	22.4	251.3
Department of Defense, military retirement	162.4	10.0	172.4
Social Security Administration, Federal Disability Insurance	155.3	15.5	170.8
Department of Labor, unemployment	68.3	(20.1)	48.2
Federal Deposit Insurance Corporation funds	44.5	0.9	45.4
Office of Personnel Management, Employees' Life Insurance	25.3	1.5	26.8
Department of Energy, nuclear waste disposal	23.4	2.5	25.9
Department of Health and Human Services, Federal Supplementary Medical Insurance	38.8	(13.9)	24.9
Housing and Urban Development, Federal Housing	21.3	2.5	23.8
Department of Veterans Affairs	13.9	(0.2)	13.7
Department of Transportation, Highway Trust Fund	18.8	(5.2)	13.6
Department of Transportation, Airport and Airway Trust Fund	11.0	(0.5)	10.5
Railroad Retirement Board	25.3	(24.1)	1.2
All other programs and funds	90.4	25.2	115.6
Subtotal	2,675.0	184.2	2,859.2
Unamortized net (discounts)/premiums	(1.5)	1.2	(0.3)
Total intragovernmental debt holdings, net	2,673.5	185.4	2,858.9

Note 11. Federal Employee and Veteran Benefits Payable

The Government offers its employees life and health insurance, as well as retirement and other benefits. These benefits apply to civilian and military employees.

The Federal Government administers more than 40 pension plans. OPM administers the largest civilian plan. DOD, meanwhile, administers the largest military plan. Other significant pension plans with more than $10 billion in accrued benefits payable include those of the Coast Guard and the Foreign Service. The changes in the accrued post-retirement pension and health benefit liability and components of related expense for the years ended September 30, 2003, and 2002, respectively, are presented below.

Federal Employee and Veteran Benefits Payable as of September 30

(In billions of dollars)	Civilian[1] 2003	Civilian[1] 2002	Military 2003	Military 2002	Total[1] 2003	Total[1] 2002
Pension and accrued benefits	1,190.4	1,129.8	739.0	730.0	1,929.4	1,859.8
Post-retirement health benefits	244.4	221.4	683.0	592.0	927.4	813.4
Veterans compensation and burial benefits	N/A	N/A	954.8	849.2	954.8	849.2
Liability for other benefits	47.2	46.9	21.2	20.1	68.4	67.0
Total Federal employee and veteran benefits payable	1,482.0	1,398.1	2,398.0	2,191.3	3,880.0	3,589.4

[1] Does not include U.S. Tax Court and judicial branch.

Change in Actuarial Accrued Pension Liability and Components of Related Expenses

(In billions of dollars)	Civilian[1]	Military	Total[1]
Actuarial accrued pension liability as of September 30, 2002	1,129.8	730.0	1,859.8
Prior period adjustments[2]	4.0	-	4.0
Adjusted accrued pension liability	1,133.8	730.0	1,863.8
Pension Expense:			
Normal costs	25.0	13.5	38.5
Plan amendment and assumption change liability		(3.7)	(3.7)
Interest on liability	70.0	44.8	114.8
Actuarial (gains)/losses	11.9	(9.9)	2.0
Total pension expense	106.9	44.7	151.6
Less benefits paid	50.3	35.7	86.0
Actuarial accrued pension liability as of September 30, 2003	1,190.4	739.0	1,929.4

[1] Does not include U.S. Tax Court and judicial branch.
[2] See Note 17—Change in Accounting Principle and Prior Period Adjustments.

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

(In percentages)	Civilian 2003	Civilian 2002	Military 2003	Military 2002
Rate of interest	6.25%	6.75%	6.25%	6.25%
Rate of inflation	3.25%	3.75%	1.40%	3.0%
Projected salary increases	4.00%	4.25%	4.10%	3.5%

Change in Actuarial Accrued Post-Retirement Health Benefits Liability and Components of Related Expenses

(In billions of dollars)	Civilian	Military	Total
Actuarial accrued post-retirement health benefits liability, as of September 30, 2002	221.4	592.0	813.4
Liability transfer	(9.5)	9.5	-
Adjusted beginning post-retirement health benefits liability	211.9	601.5	813.4
Post-Retirement Health Benefits Expense:			
Normal costs	9.5	14.4	21.1
Interest on liability	14.4	37.5	51.9
Actuarial (gains)/losses	17.6	41.4	61.8
Total post-retirement health benefits expense	41.5	93.3	134.8
Less claims paid	9.0	11.8	20.8
Actuarial accrued post-retirement health benefits liability, as of September 30, 2003	244.4	683.0	927.4

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

	Civilian		Military	
(In percentages)	2003	2002	2003	2002
Rate of interest	6.25%	6.75%	6.25%	6.25%
Rate of health care cost inflation	7.00%	7.00%	6.25%	2.1-16.73%

Separate boards of actuaries for OPM and DOD determine the actuarial assumptions used in calculating the pension liability and the post-retirement health benefit liability for the civilian and military personnel. Both boards use generally accepted actuarial methodologies. The board for OPM uses a fixed rate of inflation and projected salary increases over all years for both the pension and post-retirement health benefit liabilities. These rates are shown in the tables above. The board for DOD uses a range of rates for the inflation and the projected salary increases, with an ultimate rate for the long term. The board for DOD also uses different health care cost inflation rates for inpatient, outpatient, and prescription drugs. The long-term ultimate rate is shown in the tables above.

The long-term ultimate rate for fiscal year 2003 of 6.25 percent is shown in the tables above. For disclosure and comparison purposes, DOD's estimate of a single equivalent fixed rate of health care cost inflation for fiscal year 2003 is 7.0 percent, which is an approximation of the single equivalent rate that would produce that same actuarial liability as the actual rates used.

Civilian Employees

Pensions

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

CSRDF monies are generated primarily from employees' contributions, agency contributions, payments from the general fund, and interest on investments in Treasury securities. See Note 20—Dedicated Collections.

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

Treasury securities held in the G-Fund are included and classified as Treasury securities held by the public. FERS employees may contribute up to 13 percent of base pay to the plan, which the Government matches up to 5 percent. CSRS employees may contribute up to 8 percent of base pay with no Government match.

The G-Fund held $51.1 billion and $44.9 billion in nonmarketable Treasury securities on September 30, 2003, and 2002, respectively. The Federal Government's related liability is included in total Federal debt securities held by the public and accrued interest in the balance sheets.

Health Benefits

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

Other Benefits

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

Military Employees (Including Veterans)

Pensions

The DOD Military Retirement Fund finances military retirement and survivor benefit programs.

The military retirement system consists of a funded, noncontributory, defined benefit plan. It applies to the Departments of the Army, Navy, Air Force, and Marine Corps. This system includes non-disability retirement pay, disability retirement pay, and retirement pay for reserve service and survivor annuity programs.

Military personnel (Army, Navy, Marine Corps, and Air Force) who remain on active duty for 20 years or longer are eligible for retirement. There are three different retirement systems that are currently being used by the military: Final Pay, High–3 Year Average, and the Military Retirement Reform Act of 1986 (REDUX). The date each individual enters the military determines which retirement system they would fall under and if they have the option to pick their retirement system.

Final Pay Retirement System: Final Pay applies to individuals who entered the Service before September 8, 1980. Each year of service is worth 2.5 percent towards the retirement multiplier. The longer an individual stays on active duty, the higher the multiplier and the higher the retirement income, up to the maximum of 75 percent. This multiplier is applied against the final basic pay of the individual's career. A cost of living adjustment (COLA) is given annually based on the increase in the CPI.

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

CSB/REDUX Retirement System: The REDUX applies to those who entered the Service on or after August 1, 1986, and who elected to receive the $30,000 CSB at their 15th year of service. Under the CSB/REDUX retirement system, each of the first 20 years of service is worth 2.0 percent towards the retirement multiplier and each year after 20 years of service is worth 3.5 percent. The retirement multiplier under this retirement system is applied against the average basic pay for the highest 36 months of the individual's basic pay. A COLA is given annually based on the increase in the CPI minus 1 percent.

Health Benefits

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

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

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

In addition to the health care benefits for civilian and military retirees and their dependents, the VA also provides medical care to veterans on an "as available" basis, subject to the limits of the annual appropriations. In accordance with 38 CFR 17.36 (c), VA's Secretary makes an annual enrollment decision that defines the veterans, by priority, who will be treated for that fiscal year subject to change based on funds appropriated, estimated collections, usage, the severity index of enrolled veterans, and changes in cost. VA recognizes the medical care expenses in the period the medical care services are provided. For the time period 2000-2003, the average medical cost per year was $21.2 billion.

Compensation and Burial Benefits

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

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

The liability for veteran's compensation and burial benefits payable increased by $105.6 billion and $157.3 billion in fiscal years 2003 and 2002, respectively. The primary factors contributing to this increase were changes in interest rate and other actuarial assumptions.

Veterans Compensation and Burial Benefits as of September 30

(In billions of dollars)	2003	2002
Veterans	815.0	721.7
Survivors	136.6	124.1
Burial benefits	3.2	3.4
Total compensation and burial benefits payable	954.8	849.2

Other Benefits

Veterans insurance includes the following programs:

- United States Government Life Insurance, established in 1919 to handle new issues and the conversion of World War I Risk Term Insurance.
- National Service Life Insurance, established in 1940 to meet the needs of World War II service personnel.
- Veterans Special Life Insurance, established in 1951 for Korean veterans who did not have service-connected disabilities.
- Service-Disabled Veterans Insurance, established in 1951 for veterans with service-connected disabilities.
- Veterans Reopened Insurance, which established a 1-year reopening in 1965 of National Service Life Insurance for certain disabled World War II and Korean veterans.

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-connected causes. The actuarial present value of the liability for future 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 as of September 30, 2003, and 2002 were $102.7 and $91.6 billion, respectively.

Note 12. Environmental and Disposal Liabilities

Environmental and Disposal Liabilities as of September 30

(In billions of dollars)	2003	2002
Department of Energy:		
Environmental management baseline estimates	134.8	161.8
Active and surplus facilities—other programs	27.5	26.6
High-level waste and spent nuclear fuel disposition	14.9	14.8
Other	6.2	6.5
Total Department of Energy	183.4	209.7
Department of Defense:		
Training ranges and non-range unexploded ordnance	18.8	13.6[1]
Active installations	12.5	13.6[1]
Chemicals weapons disposal	10.8	12.8
Nuclear powered aircraft carriers and submarines	10.7	10.0[1]
Other	8.7	9.3[1]
Total Department of Defense	61.5	59.3
All other agencies	5.0	4.0
Total environmental and disposal liabilities	249.9	273.0

[1] Reclassified.

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

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

Of those environmental liabilities, this report presents only cleanup costs from Federal operations known to result in hazardous waste that the Government is required to clean up by Federal, State, or local statutes and/or regulations. Two of these statutes are the Nuclear Waste Policy Act of 1992, which provides for permanent disposal of the Nation's high-level radioactive waste and spent nuclear fuel; and Public Law 105-204, which requires a plan for the conversion of depleted uranium hexaflouride.

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

Estimated cleanup costs at sites for which there are no current feasible remediation approach are excluded from the baseline estimates, although applicable stewardship and monitoring costs for these sites are included. Significant projects not included are:

- Nuclear explosion test areas (e.g., Nevada test site).
- Large surface water bodies (e.g., Clinch and Columbia Rivers).
- Most ground water (even with treatment, future use will be restricted).

Estimating the department's environmental cleanup liability requires making assumptions about future activities and is inherently uncertain (see the decrease in environmental management baseline estimates for fiscal year 2003). The future course of the department's environmental management program will depend on a number of fundamental technical and policy choices to be made in the future. The sites and facilities could be restored to a pristine condition suitable for any desirable use, or could be restored to a point where they pose no near-term health risks. Achieving pristine conditions would have a higher cost but may, or may not, warrant the costs and potential ecosystem disruption, or be legally required. The environmental liability estimates are dependent on annual funding levels and achievement of work as scheduled.

DOD is required to clean up contamination resulting from waste disposal practices, leaks, spills, and other activities that have created a public health or environmental risk. The department is also required to recognize closure and post closure costs for its general property, plant, and equipment and environmental corrective action costs for current operations. 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 is required by law to adhere to the Comprehensive Environmental Response, Compensation Liability Act (CERCLA) and Superfund Amendment and Reauthorization Act to clean up contamination resulting from past waste disposal practices, leaks, spills, and other activities which have created a risk to public health or the environment. The Army is DOD's executive agent for cleaning up contamination at sites formerly used by DOD. CERCLA requires the Army to cleanup contamination in coordination with regulatory agencies, other responsible parties, and current property owners.

DOD is currently using two independently validated estimating models, in addition to engineering estimates, to report its environmental liabilities. The models are the Remedial Action Cost Engineering Requirements and the Department of Navy Cost to Complete module. These two methods of valuation are used in this note's table.

DOD has not identified any unamortized portion of the estimated total cleanup cost associated with general property, plant, and equipment. The department's financial management regulation requires the unamortized cleanup cost associated with property, plant, and equipment to be recognized. The department is working with the military departments to ensure the regulation is properly implemented.

Note 13. Benefits Due and Payable

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

Benefits Due and Payable as of September 30

(In billions of dollars)	2003	2002
Federal Old-Age and Survivors Insurance	35.9	34.1
Grants to States for Medicaid	17.8	16.3
Federal Disability Insurance	12.0	12.2
Federal Supplementary Medical Insurance (Medicare Part B)	15.3	14.1
Federal Hospital Insurance (Medicare Part A)	15.0	14.1
Unemployment insurance	1.5	2.1
Supplemental security income	1.5	1.4
Railroad retirement	0.8	0.8
Other benefits	0.2	0.2
Total benefits due and payable	100.0	95.3

Note 14. Other Liabilities

Other Liabilities as of September 30

(In billions of dollars)	2003	2002
Insurance Programs:		
Pension Benefit Guaranty Corporation	44.7	28.6[1]
All other insurance programs	25.2	25.3[1]
Deferred revenue	27.3	26.0
Accrued wages and benefits	27.3	28.2
Gold certificates	10.9	10.9
Exchange stabilization fund	9.2	8.7
Other debt	8.6	9.3
Deposit funds and undeposited collections	8.2	6.6
Advances from foreign governments	5.2	5.4
Accrued grant liability	3.7	2.3
Contractual services	3.6	3.9
Carriers claim payable	2.9	2.6
Advances from others	2.4	3.7
Federal aid highway grant accruals	2.3	2.1
Energy Employees Occupational Illness Compensation Act	2.2	2.8
Nuclear waste fund	2.0	2.0
Other miscellaneous liabilities	41.3	33.5
Total other liabilities	227.0	201.9

[1] Reclassified.

Insurance programs include bank and savings and loan institutions (thrifts) deposit insurance, guarantees of pension benefits, and life and medical insurance. They also include insurance against damage to property (home, crops, and airplanes) caused by perils such as flooding and other natural disasters, risk of war, and insolvency. The increase in Pension Benefit Guaranty Corporation insurance programs in fiscal year 2003 is due to employment terminations during the current year, and future benefits payable for probable employment terminations as a result of industry closings and bankruptcies. Fiscal year 2002's all other insurance programs was restated to classify bank deposits and crop insurance originally included in "Other miscellaneous liabilities."

The following are descriptions of some of the other categories (i.e., those under $5 billion) classified as other liabilities:

- Deferred revenue refers to revenue received but not yet earned, such as payments received in advance from outside sources for future delivery of products or services.
- Accrued wages and benefits consist of the estimated liability for civilian and military salaries and wages earned but unpaid. They also include funded annual leave and other employee benefits that have been earned but are unpaid.
- Gold certificates include monetized portions of gold and certificates deposited in FRBs.
- Exchange stabilization fund includes SDR certificates issued to the FRBs and allocations from the IMF.
- Other debt includes Government obligations, whether secured or unsecured, not included in public debt.
- Deposit funds are deposits held and maintained by the Government on behalf of a third party and include unclassified deposited funds that are amounts offsetting undeposited collections, as well as funds deposited in clearing accounts and suspense accounts that await disposition or reclassification.
- Advances from foreign governments consist of amounts received from foreign governments for goods and services to be provided.
- Other miscellaneous liabilities include amounts accrued for contingent liabilities, mainly from DOL, DOE, DOI, DOD and FDIC, and other liabilities from the Department of Transportation (DOT), VA, USDA, and Treasury.

Note 15. Collections and Refunds of Federal Revenue

Collections of Federal Revenue for the Year Ended September 30, 2003

(In billions of dollars)	Federal Revenue Collections	Tax Year to Which Collections Relate			
		2003	2002	2001	Prior Years
Individual income tax and tax withholdings	1,670.2	1,098.0	547.9	13.1	11.2
Corporation income taxes	194.3	124.3	59.5	.9	9.6
Estate and gift taxes	22.8	.1	18.7	1.3	2.7
Excise taxes	69.6	50.9	18.2	.1	.4
Customs duties	20.2	20.2	-	-	-
Unemployment taxes	31.4	23.7	7.7	-	-
Railroad retirement taxes	4.4	3.3	1.1	-	-
Federal Reserve earnings	21.9	16.0	5.9	-	-
Fines, penalties, interest, and other taxes	2.2	1.5	.7	-	-
Subtotal	2,037.0	1,338.0	659.7	15.4	23.9
Less: Amounts collected for Non-Federal entities	(.4)				
Total	2,036.6				

Collections of Federal Revenue for the Year Ended September 30, 2002

(In billions of dollars)	Federal Revenue Collections	Tax Year to Which Collections Relate 2002	2001	2000	Prior Years
Individual income tax and tax withholdings	1,713.4	1,104.1	584.2	15.3	9.8
Corporation income taxes	211.0	112.9	88.8	1.0	8.3
Estate and gift taxes	27.2	0.1	23.6	1.4	2.1
Excise taxes	69.0	50.6	18.0	0.1	0.3
Custom duties	19.8	19.8	-	-	-
Unemployment taxes	26.3	19.6	6.6	-	0.1
Railroad retirement taxes	4.6	3.5	1.1	-	-
Federal Reserve earnings	23.7	18.1	5.6	-	-
Fines, penalties, interest, and other taxes	3.0	2.3	0.7	-	-
Subtotal	2,098.0	1,331.0	728.6	17.8	20.6
Less: Amounts collected for Non-Federal entities	0.4				
Total	2,097.6				

Treasury is the Government's principal revenue-collecting agency.

Collections of individual income tax and tax withholdings consist of FICA/SECA and other taxes including payroll taxes collected from other agencies.

Individual income and tax withholdings include refunds and Earned Income Tax Credit (EITC) payments. EITC is a refundable credit for taxpayers who work and whose earnings fall below the established ceiling. A refundable credit is first used to offset any individual taxes owed; any remaining amounts are issued to the taxpayer. In fiscal year 2003, the IRS issued $31.8 billion in EITC refunds; $63 million were applied to advance EITC, and an additional $5 billion of the EITC credits were applied to reduce taxpayer liability. (In fiscal year 2002, the IRS issued $27.8 billion in EITC refunds; $66 million were applied to advance EITC, and an additional $4.7 billion of the EITC credits were applied to reduce taxpayer liability.) All of these EITC amounts are included in gross cost in the Statements of Net Cost as a component of Treasury. Amounts reported for corporate income taxes in tax year 2003 include corporate taxes of $5 billion for tax year 2003. (Similarly, amounts reported for corporate income taxes collected in fiscal year 2002 include corporate taxes of $5 billion for tax year 2002.) Taxes collected are reported in the Revenue section of the Statements of Operations and Changes in Net Position, and are presented on a modified cash basis. On the other hand, collections reported in the table in Note 15—Collections and Refunds of Federal Revenue are reported on a gross cash basis.

The Statement of Operations and Changes in Net Position reports total revenue of $1,796.0 billion and $1,877.7 billion for fiscal years 2003 and 2002, respectively. The difference between collections, net of refunds, and total revenue is primarily due to changes in taxes receivable, imputed revenue for the EITC and Child Tax Credit, other collecting entities, and other earned revenue.

Federal Tax Refunds Disbursed for the Year Ended September 30, 2003

(In billions of dollars)	Refunds Disbursed	Tax Year to Which Refunds Relate			
		2003	2002	2001	Prior Years
Individual income tax and tax withholdings	232.4	.6	211.6	13.1	7.1
Corporation income taxes	66.1	2.0	11.1	10.8	42.2
Unemployment taxes	.1	-	.1	-	-
Excise taxes	.9	.2	.3	.1	.3
Estate and gift taxes	.9	-	.2	.4	.3
Custom duties	.7	.7	-	-	-
Total	301.1	3.5	223.3	24.4	49.9

Federal Tax Refunds Disbursed for the Year Ended September 30, 2002

(In billions of dollars)	Refunds Disbursed	Tax Year to Which Refunds Relate			
		2002	2001	2000	Prior Years
Individual income tax and tax withholdings	212.4	0.5	194.2	12.5	5.2
Corporation income taxes	67.4	2.2	15.6	14.3	35.2
Unemployment taxes	0.1	-	0.1	-	-
Excise taxes	1.1	0.3	0.5	0.1	0.3
Estate and gift taxes	0.8	-	0.2	0.3	0.3
Custom duties	1.5	0.8	0.2	0.1	0.4
Total	283.3	3.8	210.8	27.3	41.4

Note 16. Unreconciled Transactions Affecting the Change in Net Position

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 unreconciled transactions needed to bring the change in net position into balance amounted to a net value of $24.5 billion and $17.1 billion for the years ended September 30, 2003, and 2002, respectively.

The three primary factors affecting this out-of-balance situation are:

- Improper recording of intragovernmental transactions by agencies.
- Transactions affecting balance sheet assets and liabilities not identified properly by agencies as prior period adjustments.
- Timing differences and errors in reporting transactions.

The Federal financial community considers the identification and accurate reporting of these unreconciled transactions a priority.

Note 17. Change in Accounting Principle and Prior Period Adjustments

Change in Accounting Principle and Prior Period Adjustments to Fiscal Years 2003 and 2002

	Increases to Net Position		Reconciliations of Net Operating Cost	
(In billions of dollars)	2003	2002	2003	2002
Change in Accounting Principle:				
Department of Defense	383.1			
Prior Period Adjustments:				
Department of Treasury	(4.0)	(3.1)	-	-
All other corrections of errors	1.4	6.6	1.4	6.6
Total corrections of errors	(2.6)	3.5	1.4	6.6

Prior period adjustments for fiscal year 2003 consist of $383.1 billion for a change in accounting principle and $2.6 billion net adjustments to correct errors in prior periods.

Significant components of these net adjustments include:

Change in accounting principle:

- A $383.1 billion net adjustment by DOD, resulting from changes in accounting principle that eliminated the category of national defense property, plant, and equipment in accordance with SFFAS No. 23, and included these assets in property, plant, and equipment for $316.6 billion and inventory for $66.5 in the balance sheet.

Prior period adjustments:

- A ($4.0) billion adjustment to recognize the pension liability not previously recorded for the Secret Service and now transferred to DHS.
- The other $1.4 billion includes: a $0.9 billion net adjustment by DOT to property, plant, and equipment, $0.2 net adjustments by DOD to property, plant, and equipment, and $0.3 billion adjustments from different agencies.

Prior period adjustments for fiscal year 2002 consist of $3.5 billion in net adjustments to correct errors in prior periods.

Significant components of these net adjustments include:

Correction of errors:

- A ($3.1) billion adjustment by Treasury to operating cash to correct the balance in outstanding checks.
- The other $6.6 billion includes: a $2.9 billion net correction by the National Aeronautics and Space Administration (NASA) to property, plant, and equipment; a $2.0 billion net adjustment by DOD for correction of errors to unexpended appropriations, progress payments, environmental liabilities, and inventory valuation; a ($1.3) billion net adjustment by USDA for correction of errors to property, plant, and equipment and accounts payable; a $1.3 billion net adjustment by DOT for corrections of errors to environmental liabilities and legal claims; a $1.2 billion adjustment by DOL for correction of errors to equity; and a $0.5 billion net adjustment resulting from corrections of smaller errors from different agencies.

Note 18. Contingent Liabilities

Financial Treatment of Contingent Liabilities

Contingent liabilities that are assessed to be at least reasonably possible are disclosed in this note. Contingent liabilities involve situations where there is an uncertainty of a possible loss. The reporting of contingent liabilities 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. Contingent liabilities that are assessed as probable and measurable are accrued in the financial statements. Contingent liabilities that are assessed as remote are not reported in the financial statements, nor disclosed in the notes. All other material contingent liabilities are disclosed in this note. For an overview of the standards that provide criteria for how Federal agencies are to account for contingent liabilities, based on the likelihood of the loss and measurability,[1] see table below.

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

The Government is subject to contingent liabilities which include litigation cases. These contingent liabilities 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 litigation described in the next paragraph.

Numerous litigation cases are pending involving, among many other matters, supervisory goodwill at savings and loan institutions, access to and participants in farm programs, individual Native American money accounts and tribal accounts revenues. While it is likely that the United States will have to pay some amount of damages on these claims, it is difficult to predict the outcome of litigation and, therefore, the ultimate total costs cannot be reasonably estimated at this time.

A Federal District Court ruled that DOE's plan to reclassify a portion of its radioactive waste violated provisions of the Nuclear Waste Policy Act of 1982. If DOE is not successful in its appeal of this court ruling or its proposal to modify provisions of the Act, DOE's increase in environmental liabilities could exceed $100 billion.

[1] In addition, a third condition must be met to be a contingent liability: a past event or an exchange transaction must occur.
[2] For contingent liabilities related to litigation, probable is defined as a future confirming event(s) that are likely to occur.

Contingent Liabilities as of September 30

(In billions of dollars)	2003	2002
Insurance:		
Pension Benefit Guaranty Corporation	85.6	35.5
Federal Deposit Insurance Corporation	5.9	7.3
Other insurance programs	1.0	0.5
Total insurance programs	92.5	43.3
Unadjudicated Claims:		
Department of Homeland Security	3.9	-
Department of Defense	3.0	-
Department of the Interior	0.4	1.4
Other unadjudicated claims	1.5	3.5
Total unadjudicated claims	8.8	4.9[1]
Other Contingent Liabilities:		
Department of Army	10.3	10.2
Other contingencies	0.8	7.1
Total other contingent liabilities	11.1	17.3

[1] Restated.

Note 19. Commitments

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

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

Commitments as of September 30

(In billions of dollars)	Capital Leases 2003	Operating Leases 2003	Capital Leases 2002	Operating Leases 2002
General Services Administration	0.3	19.9	0.3	17.4
U.S. Postal Service	1.0	8.7	0.8	9.6
Department of Justice	0.1	6.6	0.1	10.9
Department of Health and Human Services	0.1	1.9	0.1	1.7
Department of Veterans Affairs	-	1.6	-	1.4
Other long-term leases	1.1	5.4	1.1	4.3[1]
Total long-term leases	2.6	44.1	2.4	45.3[1]

	Undelivered Orders 2003	Undelivered Orders 2002
Department of Housing and Urban Development	76.8	83.7
Department of Health and Human Services	68.4	51.2
Department of Transportation	63.6	63.8
Department of the Treasury	47.2	47.7
Other defense agencies	45.8	33.1
Department of the Navy	45.3	48.6
Department of the Air Force	42.2	34.0
Department of Education	40.7	35.3
Department of the Army	33.8	25.2
Department of Agriculture	24.6	23.7
Department of Homeland Security	15.9	-
Department of Justice	11.0	12.4
Environmental Protection Agency	10.5	10.9
Department of Energy	9.9	9.1
U.S. Agency for International Development	9.0	8.8
General Service Administration	7.4	6.7
Department of Labor	7.0	7.8
National Science Foundation	6.3	5.6
Department of State	6.0	5.2
Other undelivered orders	24.3	26.0
Total undelivered orders	595.7	538.8

	Other Commitments 2003	Other Commitments 2002
Callable capital subscriptions for multi-lateral development banks	61.5	69.8
Department of Agriculture	23.0	23.3
National Oceanic and Atmospheric Administration satellites and weather systems	7.0	7.4
Tennessee Valley Authority	5.0	9.1
Department of Transportation	4.5	4.3
Real property activities	3.4	3.2
All other programs	2.6	1.5
Total other commitments	107.0	118.6

[1] Restated.

Other Commitments and Risks

Treaties and other international agreements entered into by the United States Government may involve non-quantifiable obligations that affect the financial position of the United States Government. The Department of State issued a list of such agreements (as of January 1, 2003) in a document entitled *Treaties in Force* (see the document at http://www.state.gov/s/l/18531.htm). The title *Treaties in Force* uses the term treaty in the generic sense as defined in the Vienna Convention on the Law of Treaties, i.e., an international agreement "governed by international law, whether embodied in a single instrument or in two or more related instruments and whatever its particular designation." The term treaty in its restricted usage in the United States denotes international agreements made by the President with the advice and consent of the Senate in accordance with Article II, Section 2 of the Constitution of the United States. In addition to such treaties, the publication *Treaties in Force* covers international agreements in force for the United States that have been concluded by the Executive (a) pursuant to or in accordance with existing legislation or a prior treaty, (b) subject to congressional approval or implementation, and/or (c) under and in accordance with the President's Constitutional powers.

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

Note 20. Dedicated Collections

Dedicated Collections as of September 30*

	Receipts		Disbursements		Trust Fund Net Assets		Less Intra-governmental Net Assets		Consolidated Assets	
(In billions of dollars)	2003	2002	2003	2002	2003	2002	2003	2002	2003	2002
Federal Old-Age and Survivors Insurance Trust Fund	543.0	530.4	404.5	389.6	1,334.5	1,193.3	1,332.5	1,192.2	2.0	0.8
Civil Service Retirement and Disability Fund	78.4	80.1	50.4	49.0	611.5	583.7	611.2	583.4	0.3	0.3
Federal Hospital Insurance Trust Fund (Medicare Part A)	175.9	177.9	152.8	147.9	257.9	235.3	256.4	233.6	1.5	1.7
Military Retirement Fund...	42.2	42.4	35.6	35.1	182.6	176.5	182.6	176.5	-	-
Federal Disability Insurance Trust Fund..	88.2	86.2	72.3	66.5	175.7	159.2	173.7	157.6	2.0	1.6
Unemployment Trust Fund............................	37.8	32.7	57.8	51.1	50.4	70.8	49.1	69.6	1.3	1.2
Federal Supplementary Medical Insurance Trust Fund (Medicare Part B).......	110.0	105.6	124.0	108.9	30.3	40.8	28.9	39.5	1.4	1.3
Medicare-Eligible Retiree Health Care Fund (MERHCF)	22.8	-	4.3	-	18.5	-	18.5	-	-	-
Highway Trust Fund.....	35.1	32.2	39.1	37.7	16.1	22.0	16.1	21.0	-	1.0
Railroad Retirement Trust Fund	4.2	4.7[1]	8.7	8.9	4.9	22.8	4.9	22.8	-	-
Airport and Airway Trust Fund	9.4	9.6	10.0	11.3	11.2	11.7	10.5	11.0	0.7	0.7
Hazardous Substance Superfund..................	0.7	1.0	1.5	1.5	2.5	3.3	2.5	3.3	-	-
Black Lung Disability Trust Fund	0.5	0.6	1.0	1.0	-	0.1	-	-	-	0.1

*By law, certain expenses (costs) related to the administration of the above funds are not charged to the funds and are financed by other sources.
[1] Restated.

The table above depicts selected trust funds that have been chosen based on their financial activity. Additionally, the Federal Government has many other dedicated collections and trust 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.

Trust fund net assets represent the unexpended balance from all sources of receipts and amounts due the trust 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).

Intragovernmental net assets are comprised of investments in Federal debt securities, related accrued interest, and fund balances with Treasury. These amounts were eliminated in preparing these financial statements.

Consolidated assets represent only the net assets from activity with individuals and organizations outside the Government. All related Governmental balances are removed to present the Government’s position as a whole.

Most of the trust fund assets are invested in intragovernmental debt holdings. 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.

Depicted below is a description of all the funds included in the table Dedicated Collections as of September 30, which also includes the names of the Government agencies that administer each particular fund. For detailed information concerning liabilities, revenues by type, program expenses, other expenses, and other financial sources, as well as other changes in fund balance, please refer to the financial statements of the corresponding administering agencies. For information on the actuarial and other liabilities associated with the funds in this report, see Note 11—Federal Employee and Veteran Benefits Payable and Note 13—Benefits Due and Payable.

Federal Old-Age and Survivors Insurance Trust Fund

This trust fund provides assistance and protection against the loss of earnings due to retirement or death in the form of money payments. SSA administers the Federal Old-Age and Survivors Insurance Trust Fund.

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 paid 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.

Civil Service Retirement and Disability Fund

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

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

Federal Hospital Insurance Trust Fund (Medicare Part A)

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

The Federal Hospital Insurance Trust Fund is financed primarily by payroll taxes, including those paid by Federal agencies. It also receives income from interest earnings on Treasury securities and a portion of income taxes paid 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.

Military Retirement Fund

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

Federal Disability Insurance Trust Fund

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

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

Unemployment Trust Fund

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

Taxes on employers primarily fund the Unemployment Trust Fund. However, interest earned on investments in Treasury securities also provides income to the fund. Appropriations have supplemented the fund’s income during periods of high and extended unemployment. The law establishing the Unemployment Trust Fund and authorizing the depositing of amounts to the credit of the trust fund is set forth in 42 U.S.C. § 1104.

Federal Supplementary Medical Insurance Trust Fund (Medicare Part B)

The Federal Supplementary Medical Insurance Trust Fund finances the Supplementary Medical Insurance program (Medicare Part B) that provides supplementary medical insurance for enrolled eligible participants to cover physician and outpatient services not covered by Medicare Part A. HHS administers the program.

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

Medicare-Eligible Retiree Health Care Fund

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

Highway Trust Fund

The Highway Trust Fund was established to promote domestic interstate transportation and to move people and goods. The fund provides Federal grants to States for highway construction, certain transit programs and related transportation purposes. DOT administers programs financed by the Highway Trust Fund. The law establishing the Highway Trust Fund and authorizing the depositing of amounts to the credit of the trust fund is set forth in 26 U.S.C. § 9503. Funding sources include earmarked taxes on gasoline and other fuels, certain tires, and vehicle and truck use, and interest on Treasury securities.

Railroad Retirement Trust Fund

The Railroad Retirement Trust Fund provides annuities and survivor benefits to eligible railroad employees and their survivors. The fund also pays disability annuities based on total or occupational disability. Payroll taxes paid by railroad employers and their employees provide the primary source of income for the Railroad Retirement Survivor Benefit program. The law establishing the Railroad Retirement Trust Fund and authorizing the depositing of amounts to the credit of the trust fund is set forth in 45 U.S.C. § 231n.

During fiscal year 2002, RRSIA, enacted on December 21, 2001, provided several changes in benefits and financing provisions for employees and widow(er)s. RRSIA also created NRRIT to administer the new fund, which is allowed to invest in Federal debt securities as well as other investments outside of the U.S. Government (see Railroad Retirement in the Stewardship Information section).

Airport and Airway Trust Fund

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

- Taxes received from transportation of persons and property in the air, as well as fuel used in non-commercial aircraft.
- International departure taxes.
- Interest earned on investments in Treasury securities.

Hazardous Substance Superfund

The Hazardous Substance Superfund was authorized to address public health and environmental threats from spills of hazardous materials and from sites contaminated with hazardous substances. The Environmental Protection

Agency (EPA) administers the fund. The law establishing the Hazardous Substance Superfund and authorizing the depositing of amounts to the credit of the trust fund is set forth in 26 U.S.C. § 9507. Funding sources include:

- Excise taxes collected on petroleum, chemicals, and imported substances (expired in 1995).
- Environmental taxes from corporations with alternative minimum taxable income in excess of $2 million (expired in 1995).
- Fines, penalties, and cost recoveries from responsible parties.
- Appropriations.
- Interest earned on investments in Treasury securities.

Black Lung Disability Trust Fund

The Black Lung Disability Trust Fund provides benefits to coal miners who are totally disabled due to pneumoconiosis (black lung disease). It also covers surviving dependents of miners who died due to pneumoconiosis.

Excise taxes on coal mine operators, based on the sale of coal, partially fund black lung disability payments as well as related administrative and interest costs. Intragovernmental advances to the BLDTF, which must be repaid with interest, fund the shortfall. DOL administers the BLDTF. The law establishing the BLDTF and authorizing the depositing of amounts to the credit of the trust fund is set forth in 26 U.S.C. § 9501.

Note 21. Indian Trust Funds

The Indian Trust Funds differ from other dedicated collections reported in Note 20—Dedicated Collections. DOI has responsibility for the assets held in trust on behalf of American Indian tribes and individuals.

DOI, through the Office of the Special Trustee's (OST's) Office of Trust Funds Management, holds trust funds in accounts for Indian tribes. It maintains approximately 1,400 accounts for Tribal and Other Special Trust Funds (including the Alaska Native Escrow Fund).

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

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

The table below depicts the U.S. Government as trustee for Indian Trust Funds held for Indian tribes and other special trust funds. The trust funds considered Federal funds are included in DOI's financial statements.

U.S. Government as Trustee for Indian Trust Funds Held for Indian Tribes and Other Special Trust Funds
Statement of Changes in Trust Fund Balances as of September 30
(Unaudited)

(In millions of dollars)	2003	2002
Receipts	378.5	434.7
Disbursements	354.7	383.4
Receipts in excess of disbursements	23.8	51.3
Trust fund balances, beginning of year	2,856.3	2,805.0
Trust fund balances, end of year	2,880.1	2,856.3

OST also maintains about 260,000 open Individual Indian Monies (IIM) accounts. The IIM fund is primarily a deposit fund for individuals who have a beneficial interest in the trust funds. The IIM account-holders realize receipts primarily from royalties on natural resource depletion, land use agreements, and enterprises that have a direct relationship to trust fund resources and investment income. Funds related to the IIM Trust Fund are included in the following table.

U.S. Government as Trustee for Indian Trust Funds Held for Individual Indian Monies Trust Funds
Statement of Changes in Trust Fund Balances as of September 30 (Unaudited)

(In millions of dollars)	2003	2002
Receipts	194.2	191.3
Disbursements	192.5	184.1
Receipts in excess of disbursements	1.7	7.2
Trust fund balances, beginning of year	411.3	404.1
Trust fund balances, end of year	413.0	411.3

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

Note 22. Subsequent Event/Medicare Prescription Drug Benefits (Unaudited)

On December 8, 2003, President Bush signed into law the Medicare Prescription Drug, Improvement, and Modernization Act of 2003. The new law will have a major impact on the operations and finances of Medicare. The new law adds a prescription drug benefit to Medicare beginning in 2006 and a new prescription drug account in the SMI Trust Fund. The benefit could be obtained through a private drug-only plan, a private preferred-provider organization or health maintenance organization, or through an employer-sponsored retiree health plan. The preferred-provider organizations will be new to the Medicare program and will operate on a regional basis. The Federal Government will assume some of the costs of providing prescription drug coverage to people eligible for Medicare and Medicaid. The HHS actuaries estimated that this legislation would result in direct spending outlays totaling $534 billion over the 2004-2013 period.

United States Government Supplemental Information (Unaudited) for the Years Ended September 30, 2003, and September 30, 2002

Deferred Maintenance

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

The amounts disclosed for deferred maintenance on the table below have been measured using the following three methods:

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

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

Deferred Maintenance as of September 30

	Deferred Maintenance Cost Range					
	Low Estimate		High Estimate		Critical Maintenance	
(In billions of dollars)	2003	2002	2003	2002	2003	2002
Asset Category:						
General property, plant, and equipment	12.1	18.3	18.3	26.4	3.6	3.3
Heritage assets	-	1.0	0.1	1.1	-	-
Total deferred maintenance	12.1	19.3	18.4	27.5	3.6	3.3

Unexpended Budget Authority

Unexpended budget authority is the sum of the unobligated and obligated, but unliquidated, budget authority.

Unobligated budget authority, including trust fund balances, is the cumulative amount of budget authority that is not obligated and that remains available for obligation. In 1-year accounts, the unobligated balance is not available for new obligations after the end of the fiscal year. In multiyear accounts, the unobligated balance may be carried forward and remains available for obligation for the period specified. In no-year accounts, the unobligated balance is carried forward until specifically rescinded by law or until the purposes for which it was provided have been accomplished. The total unobligated budget authority amount balance for fiscal years 2003 and 2002 are $383.0 billion and $342.8 billion, respectively.

Obligated budget authority is the cumulative amount of budget authority that has been obligated but not liquidated. This balance can be carried forward for a maximum of 5 years after the appropriation has expired. The total obligated budget authority amount balance for fiscal years 2003 and 2002 are $789.8 billion and $741.1 billion, respectively.

Tax Burden

The Internal Revenue Code provides for progressive tax rates, whereby higher incomes are generally subject to higher tax rates. The 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 Returns for Tax Year 2001

	Size of Adjusted Gross Income			
	Under $30,000	$30,000 under $75,000	$75,000 under $150,000	Greater than $150,000
Tax burden, percentage of gross income	6%	11%	15%	25%
Average tax per return	748	5,158	14,947	97,149
Percent of total deductions on taxable income	29%	31%	22%	18%
Percent of total credits against tax liability	23%	43%	17%	17%

Corporation Income Tax Returns for Tax Year 2000

	Size of Total Assets			
	Under $10 million	$10 million under $50 million	$50 million under $250 million	Greater than $250 million
Tax burden, percentage of gross income	.32%	.47%	.87%	1.34%
Average tax per return	3,243	148,636	692,552	1,540,014
Percent of total deductions on taxable income	25%	8%	7%	60%
Percent of total credits against tax liability	2%	0%	2%	96%

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 $6.5 billion and $4.7 billion for fiscal years 2003 and 2002, respectively. For those under appeal, the estimated payout is $7.6 billion and $8.4 billion for fiscal years 2003 and 2002, respectively. 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.

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Appendix: Significant Government Entities Included and Excluded from the Financial Statements

This *Financial Report* includes the executive branch with their corresponding departments and entities, the legislative and judicial branches, and other independent establishments and Government corporations. Excluded are privately owned Government-sponsored enterprises such as the Federal Home Loan Banks and the Federal National Mortgage Association. The Federal Reserve System is excluded because organizations and functions pertaining to monetary policy are traditionally separate from, and independent of, other central Government organizations and functions.

Significant Entities Included in these Statements:

Department of Agriculture (USDA)
www.usda.gov
Department of Commerce (DOC)
www.doc.gov
Department of Defense (DOD)
www.defenselink.mil
Department of Education (ED)
www.ed.gov
Department of Energy (DOE)
www.energy.gov
Department of Health and Human Services (HHS)
www.hhs.gov
Department of Homeland Security (DHS)
www.dhs.gov
Department of Housing and Urban Development (HUD)
www.hud.gov
Department of the Interior (DOI)
www.doi.gov
Department of Justice (DOJ)
www.usdoj.gov
Department of Labor (DOL)
www.dol.gov
Department of State (State)
www.state.gov
Department of Transportation (DOT)
www.dot.gov
Department of the Treasury (Treasury)
www.ustreas.gov
Department of Veterans Affairs (VA)
www.va.gov
U.S. Agency for International Development (USAID)
www.usaid.gov
Environmental Protection Agency (EPA)
www.epa.gov
Executive Office of the President
Export-Import Bank of the United States (Ex-Im Bank)
www.exim.gov
Farm Credit Administration (FCA)
www.fca.gov
Federal Communications Commission (FCC)
www.fcc.gov
Federal Deposit Insurance Corporation (FDIC)
www.fdic.gov
Federal Emergency Management Agency (FEMA)
www.fema.gov
Federal Trade Commission (FTC)
www.ftc.gov
General Accounting Office (GAO)
www.gao.gov
General Services Administration (GSA)
www.gsa.gov
Government Printing Office (GPO)
www.gpo.gov
Library of Congress (LC)
www.loc.gov
National Aeronautics and Space Administration (NASA)
www.nasa.gov
National Archives and Records Administration (NARA)
www.nara.gov
National Credit Union Administration (NCUA)
www.ncua.gov
National Science Foundation (NSF)
www.nsf.gov
National Transportation Safety Board (NTSB)
www.ntsb.gov
Nuclear Regulatory Commission (NRC)
www.nrc.gov
Office of Management and Budget (OMB)
www.whitehouse.gov/omb
Office of Personnel Management (OPM)
www.opm.gov
Pension Benefit Guaranty Corporation (PBGC)
www.pbgc.gov
Railroad Retirement Board (RRB)
www.rrb.gov
U.S. Securities and Exchange Commission (SEC)
www.sec.gov
Small Business Administration (SBA)
www.sba.gov
Smithsonian Institution
www.si.edu
Social Security Administration (SSA)
www.ssa.gov
Tennessee Valley Authority (TVA)
www.tva.gov
U.S. Postal Service (USPS)
www.usps.gov

Significant Entities Excluded from these Statements:

Army and Air Force Exchange Service
Board of Governors of the Federal Reserve System
(Including the Federal Reserve Banks)
Federal National Mortgage Association (Fannie Mae)
Farm Credit System
Federal Home Loan Banks
Federal Retirement Thrift Investment Board
(Including the Thrift Savings Fund)
Financing Corporation
Federal Home Loan Mortgage Corporation
(Freddie Mac)
Marine Corps Exchange
Navy Exchange Service Command
Resolution Funding Corporation
U.S.A. Education Inc. (Sallie Mae)