2002

Financial Report of the United States Government

Contents

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A MESSAGE FROM THE SECRETARY OF THE TREASURY

I am pleased to present the fiscal year 2002 *Financial Report of the United States Government* issued pursuant to the Government Management Reform Act of 1994. The Report discusses the government's financial operations for the year and includes financial statements that cover the executive branch, as well as parts of the legislative and judicial branches of the U.S. Government. This is the sixth year that the report has been issued.

For fiscal 2002, the U.S. Government is reporting an accrual-based net operating cost of $365 billion down from $515 billion we reported in fiscal 2001. This also compares to a $158 billion budget deficit for fiscal 2002 reported last October. The most significant change between these accrual financial results and the budget deficit is the accrual recognition of veterans benefit costs beyond those covered by budget outlays.

The drive to produce financial reports that better fulfill our responsibilities to the Congress and the public continues. This year, 21 of the 24 Chief Financial Officers' Act departments and agencies received unqualified audit opinions, an increase of three from last year. In addition, the Treasury Department was able to accelerate the issuance of its audited financial statements by over three months thereby complying in fiscal 2002 with the November 15th accelerated reporting dates, which do not go into effect until fiscal 2004. As a result, a total of three major agencies met the future deadline. This is a tremendous achievement that when accomplished by all agencies will significantly improve the timeliness and usefulness of the data.

The significance of these accrual-based reports is that they show the implications of current budgetary decisions over a longer time horizon. The ability to assess such impacts is significantly reduced when analysis is restricted to cash-based budget amounts. This information is therefore an important element of the debate about the real effects of governmental commitments.

I intend to continue the commitment to producing and reporting financial information that meets the highest standards of integrity, and to provide to the American people the accountability and professionalism that they expect from their Government.

John W. Snow

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MANAGEMENT'S DISCUSSION AND ANALYSIS

Introduction

We are pleased to present the consolidated *Financial Report of the United States Government* (*Financial Report*), a comprehensive picture of the Government's finances. Transparent presentation of the Federal Government's financial results and condition has never been more important for understanding the fiscal condition of the United States. Our objective is to provide useful, timely reports of financial information to the American public and the world. We are committed to continue our work to improve financial management, modernize the Government's financial management systems, and strengthen financial reporting.

In this our 6th year of issuing financial statements, we are making progress in our quest to report the financial activities of the U.S. Government timely, reliably, and in a format useful to the readers. Although our auditors have disclaimed an opinion again this year, we have seen significant improvements in the underlying data quality. All 24 of the largest departments and agencies completed their combined performance and accountability reports on time, by February 1, 2003, a month earlier than last year. In addition, 21 received an unqualified or clean opinion, as compared with 18 for the previous year, and only two agencies' auditors were unable to render an opinion. The current focus of our attention is to resolve our material weaknesses in internal controls and improve data quality and timeliness. For example, we are implementing a plan to issue this report for fiscal 2004 operations by December 15, 2004.

The accompanying *Financial Report* 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, Statements of Net Cost, Statements of Operations and Changes in Net Position, Reconciliations of Net Operating Cost and Unified Budget Surplus (or 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

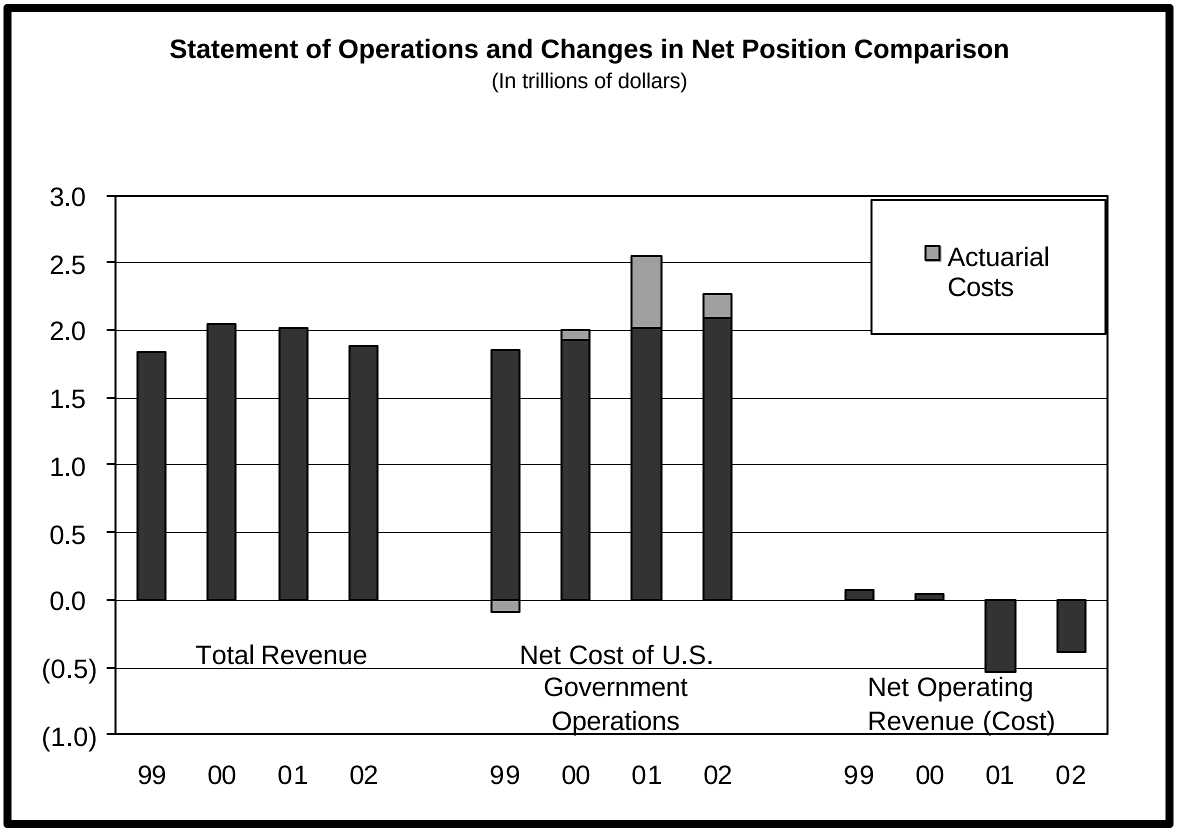
Operating Results Plus Commitments—The Big Picture

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. However, that perspective does not track the many promises made by the Federal Government that translate into future spending. Thus, the first step in examining our financial challenge is to get an accurate snapshot of our current situation by adopting a forward-looking accrual-based accounting system.

In addition to accrual-based results, the larger picture includes many obligations and commitments not captured in accrual-based operating results. An attempt is made here to go beyond the balance sheet to also examine the impact of these other commitments.

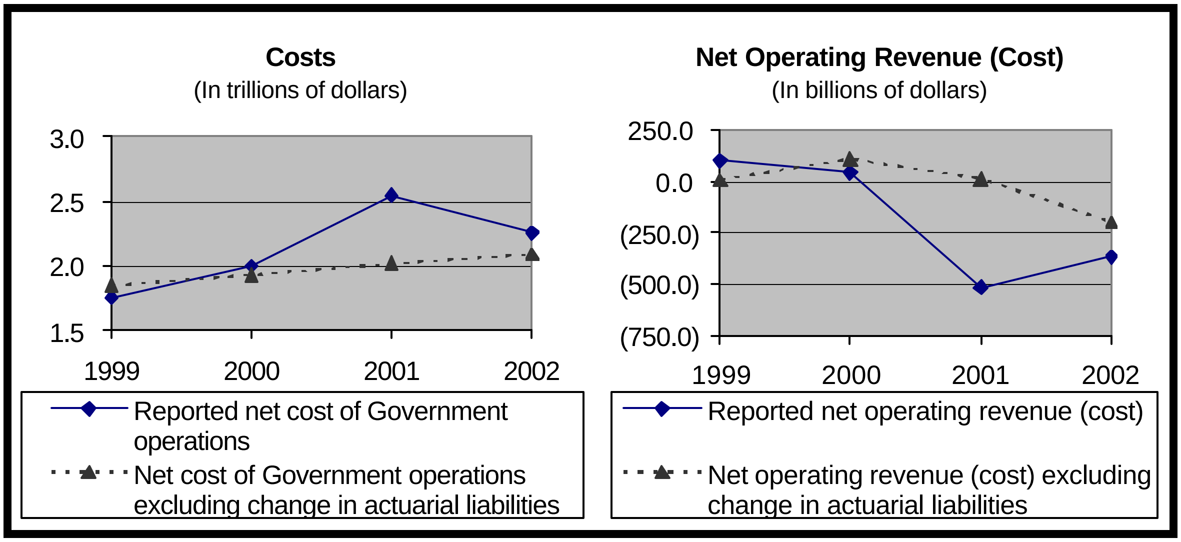
Because the Government traditionally has been viewed from a budget perspective, and because many of the terms used to describe financial events have different meanings when describing budget outcomes, a conscious effort has been made to refer to budget-based amounts by using the term budget in order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

Financial Summary of Operations



The above chart shows the financial results remained in a net operating cost in fiscal 2002. The net operating cost was $364.9 billion in fiscal 2002, as compared to a net operating cost of $514.8 billion for fiscal 2001. The continued net operating cost contributed to the Government's borrowing a net additional $220.5 billion in debt, excluding related accrued interest, from the public. As is also evident in the chart, revenues decreased in fiscal 2002 by $136.0 billion, with individual income tax and tax withholdings comprising almost all of the decrease. Revenues have now declined 2 years in a row. Also, revenues declined in fiscal 2002 by 7 percent, the largest percentage decline since 1946. The net cost of U.S. Government operations decreased in fiscal 2002 by $286.1 billion when compared to fiscal 2001 costs. The largest reason for the decrease is that fiscal 2001 reflected the initial non-recurring effect of a new law that increased the military retirement health benefits liability by $293.0 billion. Under this legislation, TRICARE benefits were extended to military retirees and their beneficiaries who were eligible for Medicare, and a fund was established to pay these benefits. This change resulted in civilian and military retirement and post-retirement health care becoming the largest liability of the Federal Government, and it remained so for fiscal 2002.

The following chart shows that over the past 4 fiscal years, significant costs associated with certain 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, costs are steadily trending upward and the net operating revenue (cost) has fluctuated from break-even in fiscal 1999 to a $109.0 billion net operating revenue in fiscal 2000, and now to a $196.5 billion net operating cost in fiscal 2002. Actuarial liabilities include Federal employee and veteran benefits payable and are discussed in Note 11 of the Notes to the Financial Statements section.



Obligations and Commitments

Liabilities are defined by the Federal Accounting Standards Advisory Board (FASAB) as a probable and quantifiable future outflow or other sacrifice of resources as a result of past transactions or events. Normally, liabilities result from activity related to a contractual obligation. Some of the obligations and commitments assumed by the U.S. Government (primarily related to social welfare) do not rise to the level where they would be included with liabilities due to the nature of the legislation that created them. They represent, however, some of the most significant fiscal commitments and serious future challenges.

Although we report most of the quantifiable off-balance sheet obligations and commitments throughout this *Financial Report*, the following table presents them as a group for a comprehensive view of the magnitude of the Government's current promises. The social insurance figures in the table are closed-group obligations. These obligations are equal to the present value of net payments (benefits less taxes) expected during the projection period on behalf of program participants over age 15 at the start of the projection period. While a true accrual measure would count only benefits already earned (and taxes already paid) by current workers, the closed-group liability includes future benefit accruals and future taxes of current workers. In this sense, the closed-group numbers are more forward-looking than a strict accrual-based calculation. They represent an estimate of the responsibility, under current law, of future taxpayers to pay benefits to current participants.

A different perspective is provided by estimates of open-group obligations. The open group includes future as well as current participants and is appropriate for assessing sustainability. For that purpose, the open group should be extended to the indefinite future. For example, in the case of the Old-Age, Survivors and Disability Insurance (OASDI) program, the infinite-horizon, open-group obligation is $11.9 trillion in present value dollars (per the *2003 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*). Unlike the Trustees' report, however, the focus of the financial statements and disclosures in this report is on Federal Government obligations made to date for which the accrual-based calculation is appropriate.

Category (In billions of dollars)	**2002**	**2001**
Social Insurance Commitment[1]:		
Federal Old-Age, Survivors and Disability Insurance (Social Security)	11,215.0	10,542.0
Federal Hospital Insurance (Medicare Part A)	6,409.0	6,012.0
Federal Supplementary Medical Insurance (Medicare Part B)	6,487.0	6,471.0
Railroad Retirement	38.0	35.0
Total social insurance commitment	24,149.0	23,060.0
Other Commitments and Contingencies:		
Undelivered orders (contractual commitments) (page 120)	538.8	497.9
Multi-lateral development banks (page 120)	69.8	69.4
Long-term leases (page 120)	50.0	48.7
Other commitments (page 120)	48.8	44.5
Contingencies (page 121)	70.0	48.4
Total other commitments and contingencies	777.4	708.9

[1] Calculation based upon present value of 75-year actuarial projections for the closed group (benefit payments in excess of contributions and earmarked taxes). The closed group represents current participants ages 15 and over at the start of the period. (Page 65)

The Big Picture

When obligations and commitments are added to the traditional accounting liabilities, a more complete picture of the Government's promises is revealed. The following table illustrates the extent of these commitments as of September 30, 2002, by combining items already on the Balance Sheet with the above table.

Summary of Total Governmental Commitments and Assets

Category (In billions of dollars)	**Sept. 30, 2002**
Social insurance commitment	24,149.0
Federal post-retirement liabilities	3,589.4
Federal debt held by the public and accrued interest	3,573.2
Other on-balance sheet liabilities	654.1
Other commitments and contingencies	777.4
Total Governmental obligations	32,743.1
Less balance sheet assets	996.5
Less military equipment (1)	616.0
Total Governmental commitments less Governmental assets (2)	31,130.6

[1] Source: Fiscal Year 2004 Analytical Perspectives, page 37, Defense Fixed Reproducible Capital, Nonfinancial Assets.
[2] The power to tax is not reflected as an asset.

In this context, the ratio of assets to liabilities may not provide a meaningful perspective on the financial condition of the Federal Government, partially since the assets do not value the Government's sovereign ability to tax. A more useful reference for the scale of our liabilities may be in terms of the national economy. To help put the numbers in this perspective, they can be expressed as a percent of annual gross domestic product (GDP). GDP in the final quarter of fiscal 2002 was $10.5 trillion. For fiscal 2002, debt held by the public, excluding accrued interest payable, was roughly $3.5 trillion or 33.7 percent of GDP. Total Governmental liabilities less Governmental assets were more than 295 percent of GDP.

In order to further appreciate this situation, some measure of the Government's assets must be added to the analysis. The Government's most significant asset is its power to tax, which is not valued in an accounting sense. However, assumptions can be made relative to the size of the economy to provide a framework for understanding future revenues and their ability to fund our commitments, as well as the projected costs of planned and expected, but discretionary, Federal Government activities.

The Federal Government's function with respect to programs such as Social Security, Medicare and Medicaid is not unlike that of an insurance provider. A private insurer closely monitors its total liabilities and the combination of assets and future premiums it expects to use in meeting those obligations. Similarly, it is prudent on our part to examine the total exposure of the Federal Government rather than focusing on the current annual impact of these programs, which is currently positive. Under current law, current and past participants would receive benefits with a present value that is approximately $24 trillion in excess of the present value of the revenues that we expect to receive. The policy question to be addressed is how do we pay for those promises and rectify this fiscal imbalance? The answer will probably take a combination of actions, including increasing economic growth, greater societal investments and savings, larger Federal debt, controlling health care costs, and legislative changes involving improved incentives, and possibly benefit changes and tax increases. While retirement and health care insurance are the biggest pieces of this problem, we must also confront the true costs of all Government programs.

As these projections indicate, the country faces a significant challenge to better align its promises with its resources for the future.

Mission and Organizational Structure

No other entity in the world compares in size, scope, and complexity to the U.S. Government. It spent more than $2.0 trillion in fiscal 2002. A civilian Federal workforce of 2.7 million individuals plus 1.4 million Department of Defense (DOD) active duty military personnel serves a diverse Nation of almost 281 million Americans.

To fulfill its constitutional mandates, the U.S. Government undertakes a wide variety of programs to:

- Maintain strong, ready, and modern military forces.
- Provide homeland security.
- Provide critical international leadership.
- Contribute to energy security.
- Protect the environment.
- Boost agricultural productivity.
- Facilitate commerce and support housing.
- Support the transportation system.
- Help economically distressed urban and rural communities.
- Assist States and localities in providing essential education and training.
- Promote health care.
- Foster income security.
- Provide benefits and services to veterans.
- Administer justice.

The form of Government that exists in the United States is a constitutional representative democracy. The following organization chart illustrates the constitutionally mandated separation of powers into the three main branches of Government. It also illustrates the breadth and complexity of the executive branch.

THE GOVERNMENT OF THE UNITED STATES

THE CONSTITUTION

LEGISLATIVE BRANCH

THE CONGRESS

SENATE HOUSE

Architect of the Capitol
United States Botanic Garden
General Accounting Office
Government Printing Office
Library of Congress
Congressional Budget Office

EXECUTIVE BRANCH

THE PRESIDENT
THE VICE PRESIDENT
Executive Office of the President

White House Office
Office of the Vice President
Council of Economic Advisers
Council on Environmental Quality
National Security Council
Office of Administration
Office of Homeland Security (*)
Office of Management and Budget
Office of National Drug Control Policy
Office of Policy Development
Office of Science and Technology Policy
Office of the U.S. Trade Representative

(*) Homeland Security Act of 2002, was signed into law 11/25/02 creating the new Department of Homeland Security. See Note 21 for additional information.

JUDICIAL BRANCH

THE SUPREME COURT OF THE UNITED STATES

United States Courts of Appeals
United States District Courts
Territorial Courts
United States Court of International Trade
United States Court of Federal Claims
United States Court of Appeals for the Armed Forces
United States Tax Court
United States Court of Appeals for Veterans Claims
Administrative Office of the United States Courts
Federal Judicial Center
United States Sentencing Commission

DEPARTMENT OF AGRICULTURE
DEPARTMENT OF COMMERCE
DEPARTMENT OF DEFENSE
DEPARTMENT OF EDUCATION
DEPARTMENT OF ENERGY
DEPARTMENT OF HEALTH AND HUMAN SERVICES
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

DEPARTMENT OF THE INTERIOR
DEPARTMENT OF JUSTICE
DEPARTMENT OF LABOR
DEPARTMENT OF STATE
DEPARTMENT OF TRANSPORTATION
DEPARTMENT OF THE TREASURY
DEPARTMENT OF VETERANS AFFAIRS

INDEPENDENT ESTABLISHMENTS AND GOVERNMENT CORPORATIONS

African Development Foundation
Central Intelligence Agency
Commodity Futures Trading Commission
Consumer Product Safety Commission
Corporation for National and Community Service
Defense Nuclear Facilities Safety Board
Environmental Protection Agency
Equal Employment Opportunity Commission
Export-Import Bank of the U.S.
Farm Credit Administration
Federal Communications Commission
Federal Deposit Insurance Corporation
Federal Election Commission
Federal Emergency Management Agency
Federal Housing Finance Board
Federal Labor Relations Authority
Federal Maritime Commission
Federal Mediation and Conciliation Service
Federal Mine Safety and Health Review Commission
Federal Reserve System
Federal Retirement Thrift Investment Board
Federal Trade Commission
General Services Administration
Inter-American Foundation
Merit Systems Protection Board
National Aeronautics and Space Administration
National Archives and Records Administration
National Capital Planning Commission
National Credit Union Administration
National Foundation on the Arts and the Humanities
National Labor Relations Board
National Mediation Board
National Railroad Passenger Corporation (Amtrak)
National Science Foundation
National Transportation Safety Board
Nuclear Regulatory Commission
Occupational Safety and Health Review Commission
Office of Government Ethics
Office of Personnel Management
Office of Special Counsel
Overseas Private Investment Corporation
Peace Corps
Pension Benefit Guaranty Corporation
Postal Rate Commission
Railroad Retirement Board
Securities and Exchange Commission
Selective Service System
Small Business Administration
Social Security Administration
Tennessee Valley Authority
Trade and Development Agency
U.S. Agency for International Development
U.S. Commission on Civil Rights
U.S. International Trade Commission
U.S. Postal Service

Original source: *U.S. Government Manual 2002/2003*

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	Amount for the United States	Information as of	Country Rank	Comments
Land area	9,158,960 square kilometers		4th	Russia, China, and Canada are larger
Population	280.6 million	July 2002 est.	3rd	China and India are greater
Gross domestic product	$10.082 trillion	2001 est.	1st	China was second with $5.6 trillion
Gross domestic product–per capita	$36,300	2001 est.	2nd	Luxembourg was first with $43,400
Infant mortality rate	6.69 deaths per 1,000 live births	2002 est.	41st	Countries with populations > 50 million with lower deaths: France – 4.41 Germany – 4.65 Italy – 5.76 Japan – 3.84 United Kingdom – 5.45
Electricity–production	3.8 trillion kilowatt-hour	2000	1st	China was second with 1.308 trillion
Military expenditures – percent of gross domestic product	3.20 percent	Fiscal 1999 est.	44th	North Korea was first with 31.3 percent
Source: Central Intelligence Agency's *The World Factbook 2002*				

Financial Results

The net operating cost as shown in these financial statements for fiscal 2002 is $364.9 billion, as compared to a budget deficit of $157.7 billion. The primary component of the difference between the budget and accrual numbers is an increase in the liability for veterans compensation and burial benefits of $157.3 billion. For a detailed reconciliation showing the differences, see the Reconciliations of Net Operating Cost and Unified Budget Surplus (or Deficit) in the Financial Statements section.

In fiscal 2001, the financial statements showed a net operating cost of $514.8 billion, as compared to a budget surplus of $127.0 billion. The primary components of the difference were increases in the liability for military health liabilities of $388.6 billion, and an increase in the liability for veterans disability of $115.2 billion.

Revenue and Cost Summary

Revenue

Government revenue comes from two sources: nonexchange transactions and exchange transactions. Nonexchange revenue arises primarily from exercise of the Government's power to demand payments from the public (e.g., taxes, duties, fines, and penalties). Nonexchange revenue is the U.S. Government's primary source of revenue and totaled $1,870.4 billion in fiscal 2002, as compared to $2,001.4 billion in fiscal 2001. More than 98 percent of this total came from tax receipts, with the remainder coming from customs duties and other miscellaneous receipts. This reduction of $131.0 billion, or 6.5 percent, resulted primarily from a drop in individual income tax and tax withholdings and can be attributed to a variety of factors, including a weaker economy, a decline in capital gains realizations, and tax cuts enacted in recent years. Even in the absence of any tax cuts, it is estimated that the receipts would still have declined by 5.7 percent.

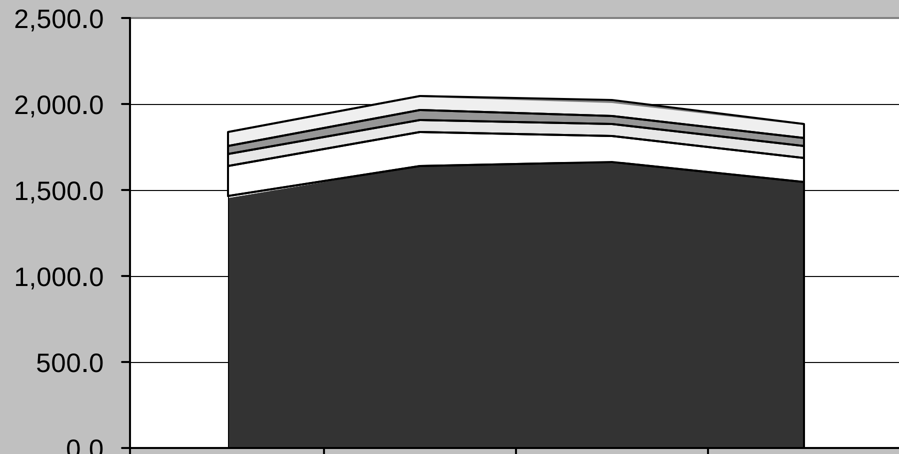
Exchange, or earned, revenue arises when a Government entity provides goods and services to the public for a price. Examples of exchange revenues are the mailing and postage revenue for the U.S. Postal Service and Medicare Part B premiums collected by the Department of Health and Human Services (HHS). During fiscal 2002, the U.S.

Government earned $163.9 billion in exchange revenue, as compared with $172.3 billion in fiscal 2001. Of the fiscal 2002 revenues, $156.6 billion is offset against the gross cost of the related agencies' programs to arrive at the agencies' net cost, as compared with $160.0 billion for fiscal 2001. Also included is $7.3 billion ($12.3 billion in fiscal 2001) that was earned by the U.S. Government but not offset against the cost of any program (e.g., royalties on the Outer Continental Shelf Lands).

The following chart shows the components of revenue by major source.

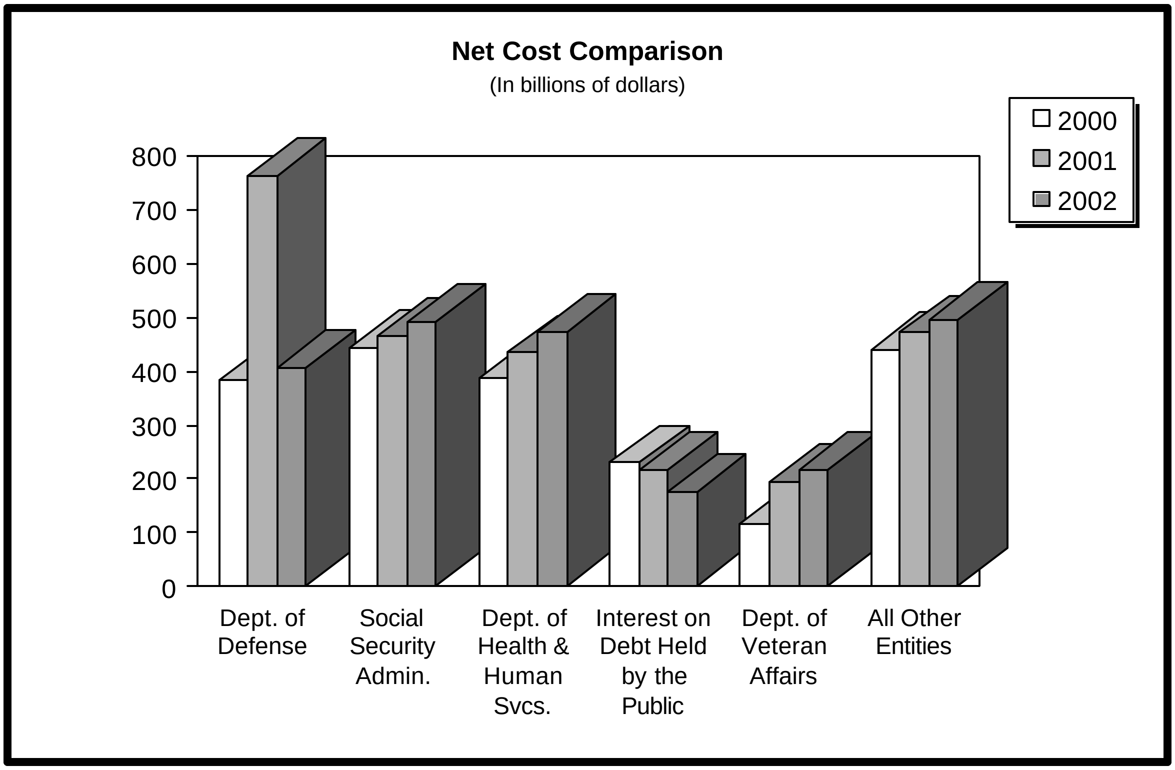
Components of Revenue by Major Source

(In billions of dollars)



	1999	2000	2001	2002
All others	82.2	79.7	86.0	78.2
Other taxes and receipts	42.0	56.3	48.9	49.3
Excise taxes	70.5	69.3	67.3	67.9
Corporation income taxes	182.2	204.3	147.9	143.7
Individual income tax and tax withholdings	1,456.0	1,635.2	1,663.6	1,538.6

Cost



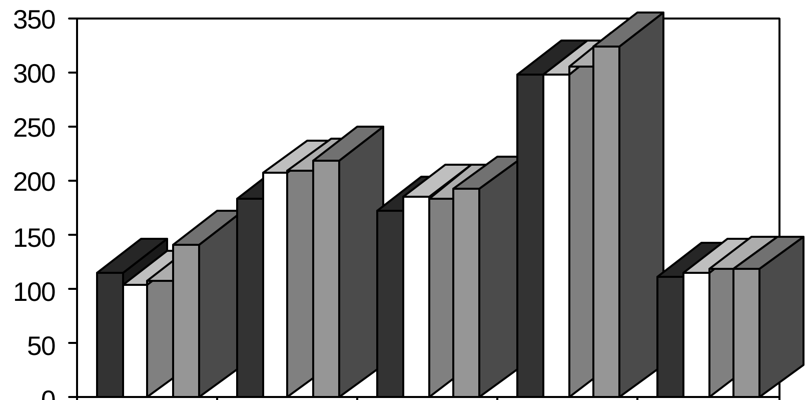
The above chart compares significant elements of net cost by fiscal year. As noted earlier, the significant decrease in DOD cost from fiscal years 2001 to 2002 is because fiscal 2001 reflects the initial non-recurring effect of the extension of medical benefits to retired personnel in the amount of $293.0 billion, plus another $91.3 billion in other actuarial assumption changes. The second largest change was a decrease in the interest on debt held by the public of $42.3 billion. Although the amount of outstanding debt held by the public increased during fiscal 2002, the related fiscal 2002 interest expense on such debt decreased as a result of overall lower interest rates. The net costs of HHS increased by $38.4 billion, primarily due to a $19.7 billion, 15.1 percent, increase in Medicaid and an $11.8 billion, 5.4 percent, increase in Medicare.

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 4-year comparison of the major categories of reported assets as of September 30, for fiscal years 1999 through 2002.

Assets - Key Items Comparison
(In billions of dollars)



	Cash and Other Monetary Assets	Loans Receivable, Net	Inventories and Related Property, Net	Property, Plant and Equipment, Net	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

As can be seen from the above chart, in fiscal 2002, assets increased in all major categories. Cash and other monetary assets increased by $33.6 billion, or 31 percent, and were mostly due to a $14 billion increase in compensating balances and an increased cash balance required to meet early fiscal 2003 payments. Compensating balances are deposited interest free to compensate commercial banks for services provided on behalf of the Federal Government (such as tax collections, handling over-the-counter deposits for Federal program agencies, providing lockbox services for agency collection programs, etc.). Property, plant and equipment also increased by $18.0 billion, or 5.9 percent, mostly due to an $8.5 billion increase in DOD and a $1.7 billion increase in the Department of Transportation. For fiscal 2001, assets remained relatively constant from the previous fiscal year. It is important to note that the assets presented on the Balance Sheets are not a comprehensive list of Federal resources. Natural resources, stewardship land (national parks, forests, and grazing lands), national defense assets, and heritage assets are examples of resources that are not included in the assets reported on the Balance Sheets. Detailed information about these items can be found in the Stewardship Information section. Additionally, the U.S. Government's most important financial resource, its sovereign power to tax, regulate commerce, and set monetary policy cannot be quantified and is not reflected. It should be noted that pending congressional approval, a new Federal accounting standard will require that national defense assets will be capitalized and, with the exception of the cost of land and land improvements that produce permanent benefits, depreciated, and included on the Government's Balance Sheets.

Liabilities

At the end of fiscal 2002, the U.S. Government reported liabilities of $7.8 trillion, as compared to $7.4 trillion for September 30, 2001. The largest component of these liabilities ($3.6 trillion) is represented by pension, disability, and retiree health care costs for Federal civilian and military employees as well as for veterans, as compared to $3.4 trillion for September 30, 2001. During fiscal 2002, the increase of $157.3 billion for veterans compensation and burial benefits was due to a combination of factors, including overall decreases in interest rates used for discounting future benefits and the number of new compensation awards made for diabetes in fiscal 2001. The second largest increase of $21.7 billion was for military pension liability, which represented a 3.1 percent increase in the liability. See Note 11 in the Notes to the Financial Statements section for a more detailed explanation of these changes. During fiscal 2001, there was an increase of $406.8 billion for military employees benefits, which was mostly due to reflecting the initial non-recurring effect of the National Defense Authorization Act and other actuarial assumption changes. In addition, there was an increase of $139.3 billion for liability for veterans compensation and burial benefits caused by changes in interest rate and other actuarial assumptions.

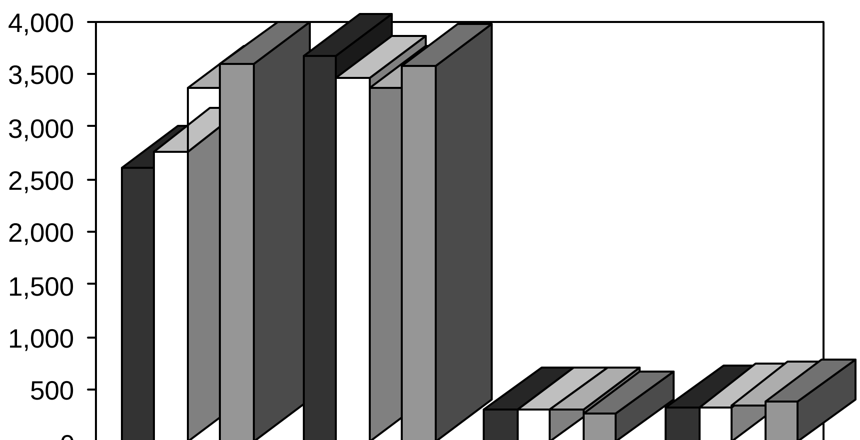
The next largest liability, $3,573.2 billion, relates to Federal debt securities held by the public, as compared to $3,359.3 billion for September 30, 2001; this reflects a $213.9 billion increase in the debt held by the public, including related accrued interest. The fiscal 2002 increase in debt held by the public is primarily due to total Federal spending exceeding total Federal revenues.

Another liability is related to environmental cleanup costs associated with environmental damage/contamination. As of September 30, 2002, the recognized cost of cleaning up environmental damage/contamination across Government programs was estimated to be $273.0 billion, as compared to $306.8 billion for September 30, 2001. A significant component of this reduction relates to the Department of Energy. It reduced its environmental liability by $28.7 billion, mostly due to employing an accelerated cleanup approach resulting from a top-to-bottom review to find efficient and cost-effective ways to achieve greater real cleanup and risk reduction to public health.

The accompanying chart presents a 4-year comparison of the major components of liabilities reported on the Balance Sheets as of September 30, for fiscal years 1999 through 2002.

Liabilities - Key Items Comparison

(In billions of dollars)



	Federal Employee and Veteran Benefits Payable	Federal Debt Securities Held by the Public and Accrued Interest	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

As clearly shown above, Federal employee and veteran benefits payable has been rapidly increasing over the past 2 years. Federal debt securities held by the public, including accrued interest, is now showing an increase, after 3 years of steady reductions. The increase in fiscal 2002 was $213.9 billion, as compared with a $94.9 billion reduction for fiscal 2001.

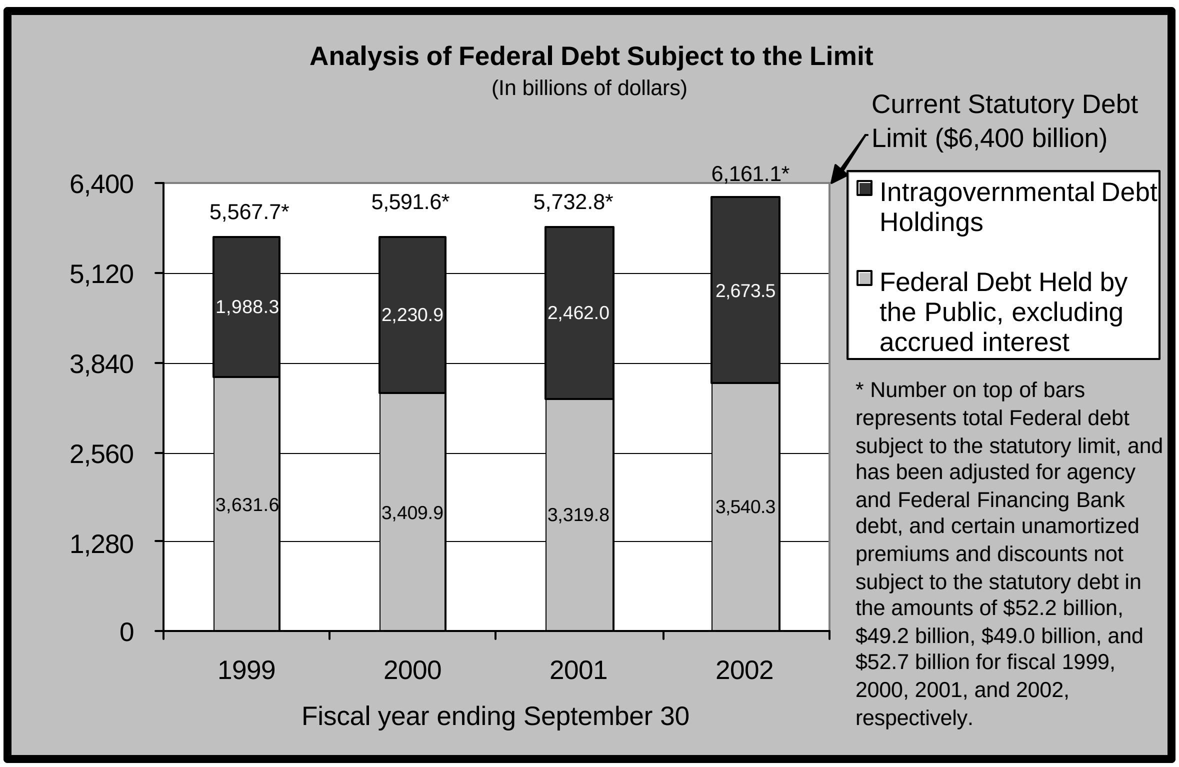
Federal Debt and Budget Surpluses and Deficits

Fiscal 2002 resulted in a budget deficit, following 4 consecutive years of budget surpluses. It is important to understand the composition of budget surpluses and deficits, and the impact that these have on the composition of the Federal debt. There are two components of Federal debt: debt held by the public and intragovemmental debt holdings.

Debt held by the public includes all Federal debt held by individuals, corporations, State or local governments, Federal Reserve Banks, foreign governments, and other entities outside of the U.S. Government. The types of securities held by the public include, but are not limited to, Treasury Bills, Treasury Notes, Treasury Bonds, U.S. Savings Bonds, State and Local Government Series securities, Foreign Series securities, and Domestic Series securities.

Intragovernmental debt holdings generally include nonmarketable securities held by various elements of the Government itself. The laws establishing Government trust funds (such as the Social Security and Medicare Trust Funds) generally require the balances to be invested in these special securities. Although intragovernmental debt holdings are used in the calculation of the Federal debt subject to the statutory debt limit, intragovernmental transactions are eliminated in the consolidation process of preparing this *Financial Report* since they are claims of one part of the Government against another part. However, they are important to an understanding of total debt outstanding because, as the intragovernmental securities are redeemed, other sources of funds will be needed to fund the spending related to the redemptions.

The following chart presents a 4-year comparison of the components of Federal debt subject to the statutory debt limit.

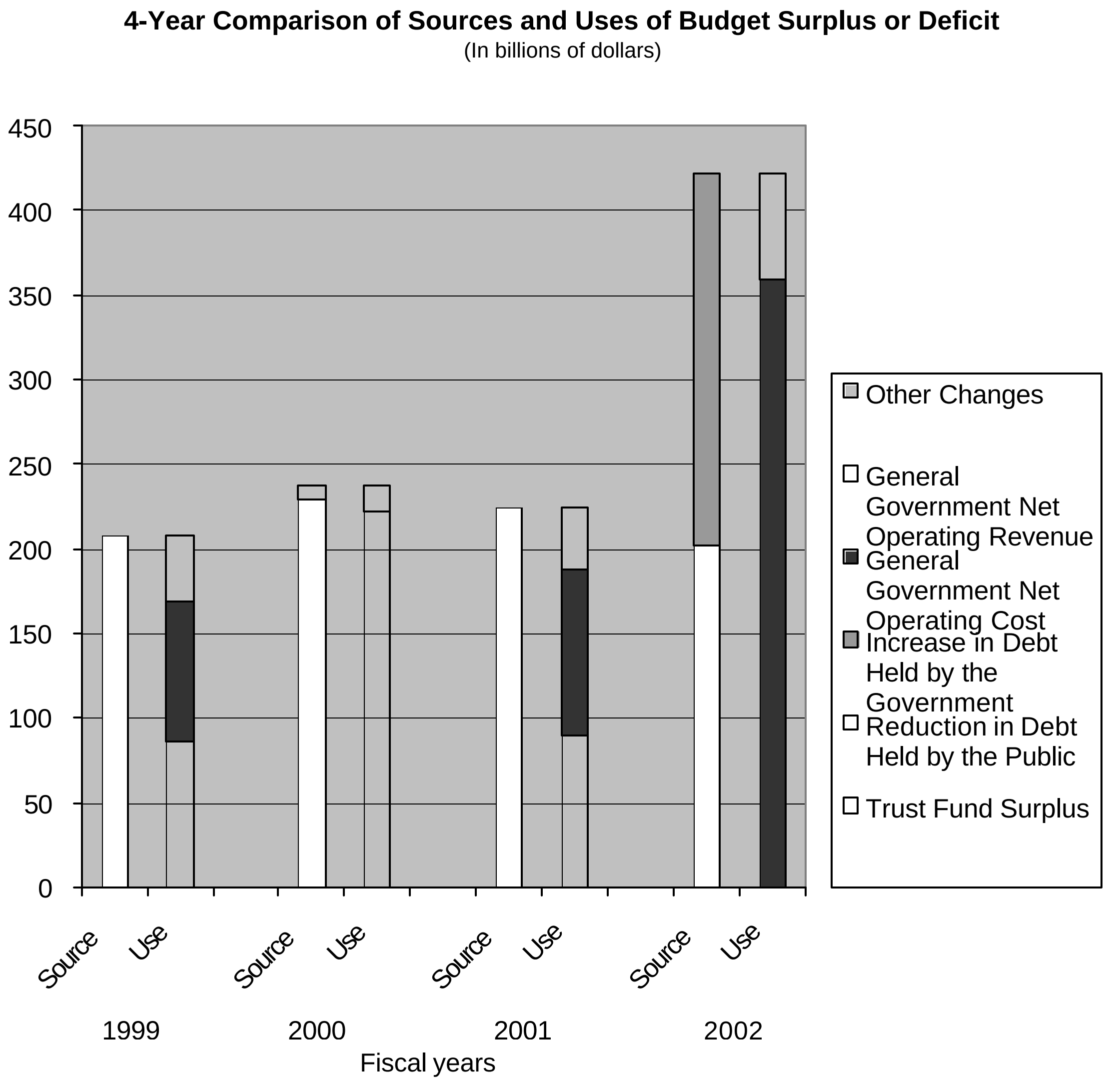


As can be seen from the above chart, total Federal debt subject to the limit increased by $428.3 billion during fiscal 2002, which is primarily comprised of an increase in intragovernmental debt holdings of $211.5 billion and an increase in Federal debt held by the public, excluding related accrued interest, of $220.5 billion. Intragovernmental debt holdings have steadily increased since fiscal 1999 and debt held by the public decreased from fiscal years 1999 through 2001, but increased this fiscal year. The primary reasons for the increases in intragovernmental debt holdings are the annual cash surpluses in the Federal Old-Age and Survivors Insurance, Federal Disability Insurance, Military Retirement, and Civil Service Retirement and Disability trust funds. The fiscal 2002 increase in debt held by the public is primarily due to total Federal spending exceeding total Federal revenues.

The two major components of total Federal debt (or gross Federal debt), debt the Government owes to the public and debt the Government owes to itself, have markedly different interpretations. In a short-run macroeconomic view, only publicly held debt has an impact on the economy. When the Government borrows from the public, it reduces the amount of resources available in the financial markets for private investment. The debt the Government owes to itself, consisting of Federal securities credited to trust funds, has no impact on financial markets. Moreover, while the total debt is often considered a measure of the Government's deferred obligations, the portion held by the trust funds does not reflect what the Government is expected to pay in the future if it is to meet commitments prescribed in programs like OASDI. Essentially, from the perspective of the Federal Government, trust fund holdings represent only reserve spending authority allocated for a particular program. That is, for the Government as a whole, the holdings of trust funds are not assets—they are not resources set aside to support future expenditures. From the perspective of individual programs, however, trust funds are assets of a sort in that the reserve spending authority can be invoked when cash balances are negative. Thus, the total Federal debt is a combination of external and internal debt, representing obligations to the public and to itself through specific programs. But internal debt provides an incomplete picture of future obligations under the programs, and when internal debt needs to be repaid, the expenditure and its financing could have an impact on financial markets.

On December 11, 2001, the Department of the Treasury (Treasury) requested the statutory debt ceiling be raised from $5,950 billion to $6,700 billion. During fiscal 2002, before the debt ceiling was raised, Treasury twice faced debt issuance suspension periods that required it to depart from its normal debt management procedures and to invoke legal authorities provided to avoid breaching the debt limit. Actions taken by Treasury included suspending investment of receipts of the Government Securities Investment Fund (G Fund) of the Federal Employees' Thrift Savings Plan and the Civil Service Retirement and Disability trust fund (Civil Service fund); redeeming Civil Service fund securities early; and suspending the sales of State and Local Government Series securities. In addition, because the debt subject to the limit was so close to the ceiling during these periods, Treasury issued cash management bills to manage short-term financing needs. On June 28, 2002, Public Law 107-199 was enacted, which raised the statutory debt ceiling by $450 billion to $6.4 trillion. Starting in February 2003, Treasury again had to take advantage of available statutory tools to avoid breaching the statutory debt limit. Even with the use of statutory tools, there is a risk that we may hit the statutory debt limit before the collection of April 15 tax receipts.

Federal Government operations are composed of two parts: trust funds, which receive their funding from dedicated collections (including collections from Treasury and other Federal agencies), and 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. Other major trust funds finance highway and transit construction and airport development. The following chart illustrates a 4-year comparison of the budget surpluses or deficits of these two parts of Government and how the budget surpluses were used.



Source: Combined Statement of Receipts, Outlays, and Balances of the United States Government

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 black area). Other changes (the gray area) consist primarily of outlays under various loan programs. In fiscal 2002, it was necessary to increase the debt held by the public since the general Government net operating cost exceeded the trust fund s urplus.

The 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, and 2002, but had a budget surplus for fiscal 2000.

Future Outlook

National Priorities: (1) Winning the War Against Terrorism, (2) Securing the Homeland, and (3) Generating Long-Term Economic Growth

America is in the opening stages of a long struggle against terrorist groups and the nations that support them. The United States and cooperating nations have brought a wide range of capabilities to bear on terrorism. The diverse activities undertaken illustrate the degree to which we are engaged in a new type of war. The United States and cooperating nations have accomplished the following:

- Built and maintained a global coalition of more than 70 countries to fight terrorism.
- Conducted successful military operations resulting in regime change in Afghanistan.
- Provided freedom and humanitarian relief to oppressed people in Afghanistan.
- Frozen terrorists' assets and restricted the flow of money that enables terror.
- Exploited unprecedented intelligence capabilities to locate, track, and apprehend terrorists on the run.

Achieving these kinds of successes in the years ahead requires a sustained commitment of resources. One measure of our commitment is the funding that has already been dedicated to this effort. The Federal Government has spent or committed to spend $100 billion to respond to terrorism. This includes funding to fight the war on terrorism, to improve homeland security, and to finance recovery efforts in the New York metropolitan area and Washington, D.C.

The creation of the Department of Homeland Security (DHS) was an historic step forward in protecting America. The new DHS began operations to secure the Nation's safety in the biggest reorganization of the Federal Government in a half-century. The cabinet-level department unifies the work of 22 programs and agencies, and will move quickly to better protect Americans from threats here at home. By law, the DHS Secretary has 1 year from the time the Department becomes effective to bring all of the 22 agencies into the organization. As stated in the reorganization plan, most of the components moved into the new Department in March 2003.

On November 26, 2002, President Bush signed into law the Terrorism Risk Insurance Act of 2002. Under the Act, Congress established in Treasury a temporary Terrorism Risk Insurance Program and authorized the Secretary of the Treasury to administer the program and pay the Federal share of compensation for insured losses under the program. The purpose of the program is to provide a transitional transparent system of shared public and private compensation for insured losses resulting fromacts of terrorism. The program promotes economic growth by ensuring the continued widespread availability and affordability of property and casualty insurance for terrorism risk. It is structured so as to provide a transitional period for private markets to develop mechanisms for the pricing of terrorism risk insurance, and build capacity and arrangements to diffuse the financial risks of any future losses, with consistent reliance upon State insurance regulation and consumer protections.

Some of the challenges we face will endure for many years and will require great resources. As we look down that path, we will not always get to choose which battles we fight. It is, however, our duty to fight them.

The recession of 2001 likely has been over for a year, but its effects linger. Though the economy has expanded, the rate of growth has not been fast enough and the improvement has been choppy and uneven. Too many Americans remain out of work and are concerned about their economic futures; too many businesses hold back in the face of this economic uncertainty, unwilling to make the investments in new production facilities, new machinery, and new technologies needed to re-ignite the full potential of our economy. To deal with this situation, the Administration proposed a bold jobs and growth program.

The economy has suffered a series of shocks that have cost tens of thousands of jobs. Just as economic recovery was poised to begin, the attacks of September 11, 2001, caused a massive disruption. Flights were cancelled, tourism fell, stock trading was halted, and consumers and businesses retrenched as they sorted through the implications of this new threat to the Nation.

Our economy then faced a new threat from within when Americans discovered serious abuses of trust by some corporate leaders. We learned that a handful of companies across a wide range of industries had engaged in dishonest practices that cost innocent people their jobs and savings. Penalties in the marketplace and the courts were prompt and severe, and new protections and oversight are being put into place, but much damage was done to investor confidence.

To ensure the strongest economy possible, one in which every willing worker can find a job, the Administration is focusing on efforts to clear the way for faster growth and greater prosperity. Its proposed jobs and growth package will operate quickly not only to accelerate recovery, but also to produce a stronger, more resilient economy for years to come. The four key elements of the program are:

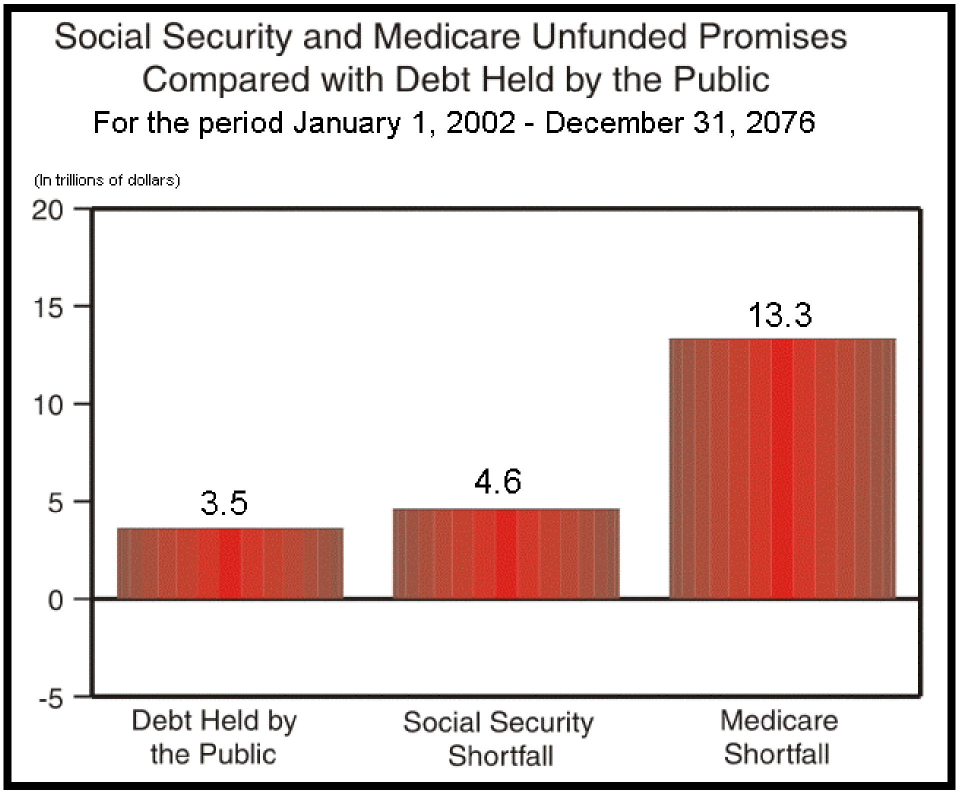
- Accelerating in 2003 certain elements of the Economic Growth and Tax Reform Reconciliation Act of 2001 (EGTRRA), such as the marginal rate reductions and the marriage penalty relief, that would otherwise take effect later.
- Eliminating the unfair double taxation of dividends paid to individuals.
- Increasing immediately the amount that small businesses are allowed to deduct from $25,000 to $75,000.
- Creating new personal reemployment accounts to help unemployed workers search for new jobs and to provide a "reemployment bonus" for those quickly finding work.

Social Security and Medicare: Benefits Will Soon Outstrip Dedicated Revenues

Social Security and Medicare, our largest entitlement programs, combine to provide financial support to 40 million seniors—14 percent of our population—and account for one-third of total Federal spending. As our population ages and health care costs continue to escalate, the costs of these programs will grow enormously, and will rapidly threaten to overwhelm the rest of the budget.

Americans have often heard that Social Security and Medicare are in deep trouble financially, and the simple reason is the benefits provided under current law for these programs will soon far outstrip their dedicated revenues. Over the next 75 years, the actuaries of the Social Security Administration (SSA) project the cost of all benefits paid to current beneficiaries and promised to future beneficiaries will exceed Social Security revenues by almost $5 trillion. The Medicare shortfall over this period is even worse at more than $13 trillion. (In terms defined earlier, these are open group unfunded obligations computed over the traditional 75-year horizon, generally used in the Trustees' Reports.)

Citizens and policymakers rightly monitor and debate the size of the national debt, which stands at $3.5 trillion in public hands, excluding related accrued interest, with another $2.7 trillion credited to various Government trust funds. But in fiscal 2002, the combined shortfall in Social Security and Medicare of nearly $18 trillion was about five times as large as today's publicly held national debt. In other words, it would take an additional $18 trillion in today's dollars to fund the obligations of these systems as they are now constituted. This is roughly the equivalent of the total income Americans will earn over the next year and a half. Expressed yet another way, the combined shortfall in Social Security and Medicare was eight times the amount of total Government spending in fiscal 2002.



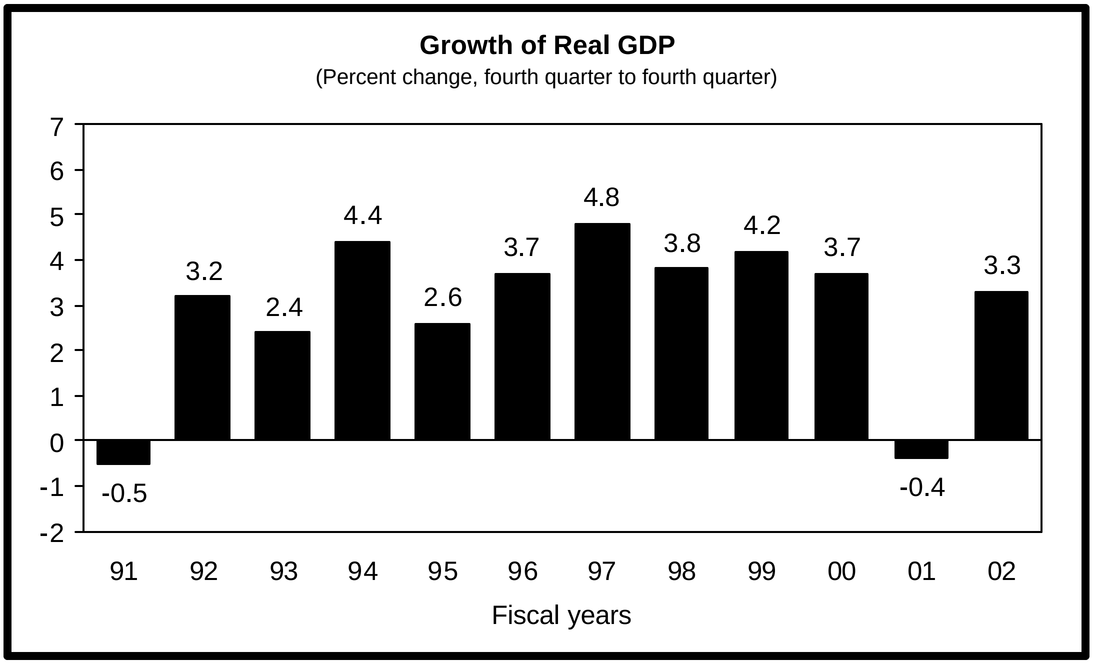
The estimates of Social Security and Medicare's unfunded promises are subject to some variation depending on the underlying assumptions used. However, no conceivable combination of reasonable assumptions can erase the problems in Social Security or Medicare. The Social Security and Medicare shortfalls compel change. The longer the delay in enacting reforms, the greater the danger and the more drastic the remedies will have to be.

Economic and Budgetary Results

The U.S. economy improved significantly in fiscal 2002, spurred by the lagged effects of fiscal and monetary policies put into place earlier. Real GDP increased in each of the four quarters of the fiscal year, after declining in fiscal 2001. Inflation was very low. Productivity growth posted its strongest four-quarter increase in almost 30 years, and real wages rose. Progress in the labor market was less favorable, although employment began to turn around in the second half of the fiscal year. The Federal budget for fiscal 2002 suffered from the impacts of the previous year's recession and the spending requirements following the terrorist attacks, recording a budget deficit of $157.7 billion after 4 years of surpluses.

The Economy in Fiscal 2002

After declining by 0.4 percent in fiscal 2001, real GDP rebounded by a strong 3.3 percent over the four quarters of fiscal 2002. The downturn in fiscal 2001 was relatively mild by historical standards, with the loss in real GDP the smallest among all recessions since the early 1970s. Growth in fiscal 2002 was led chiefly by consumer spending, which rose 3.8 percent over the fiscal year after posting only a 1.8 percent increase the previous year. Low interest rates, engineered in part by the monetary policy actions of the Federal Reserve, and higher disposable personal income, resulting from the EGTRRA and other fiscal policy measures, helped support consumer spending. Those policies offset some of the negative wealth effects on consumer demand that resulted from the decline in the stock market in the last 2 years.



The labor market began to improve in the second half of the fiscal year, but strong job growth has yet to resume. Through the first half of the fiscal year, more than 1 million payroll jobs were cut, mostly in the manufacturing sector. In the second half of the year, employment conditions stabilized and about 130,000 jobs were added. The unemployment rate moved up from 5.0 percent at the start of the year to as high as 5.9 percent in April, then eased to 5.7 percent by the final month. The 5.7 percent average for the fiscal year as a whole compares with 4.4 percent in fiscal 2001.

On the positive side, inflation was well contained in fiscal 2002. Falling prices for petroleum held the increase in the consumer price index to just 1.6 percent over the year. Growth in "core" consumer prices (excluding energy and food) was also moderate at 2.3 percent.

Productivity gains have helped to keep cost pressures down while allowing real output and wages to grow. Productivity in the nonfarm business sector of the economy rose by an extraordinary 5.7 percent over the four quarters of fiscal 2002, the strongest four-quarter performance since 1973.

Budget Results

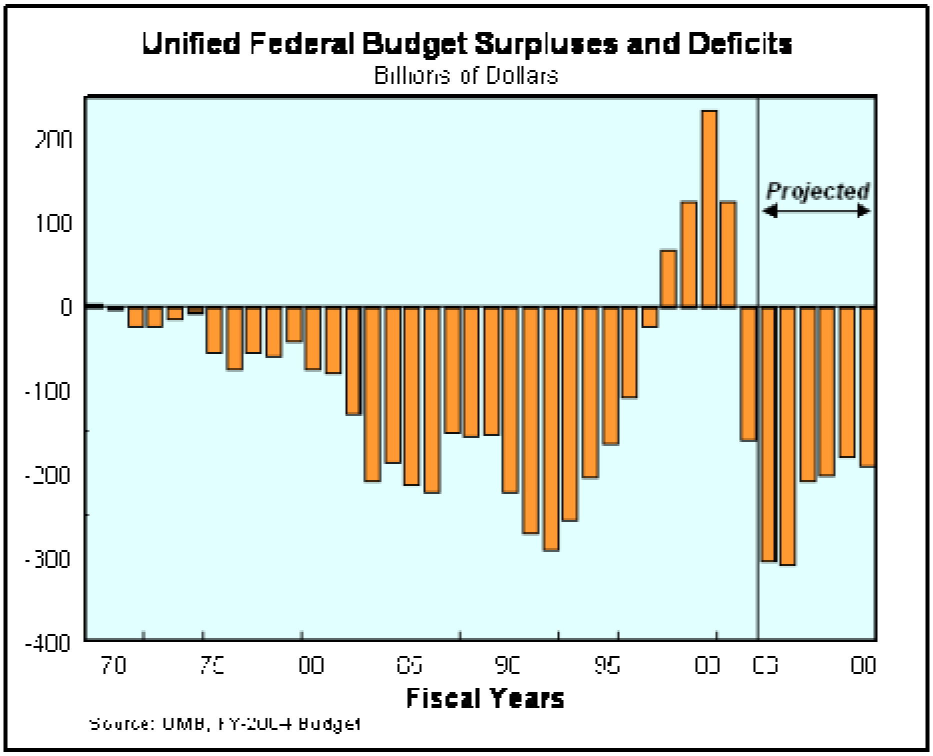
The unified Federal budget was in deficit by $157.7 billion in fiscal 2002. That was the first budget deficit following 4 consecutive years of surpluses, but smaller than the $165.1 billion budget deficit that had been projected in the July *Mid-Session Review*. In relation to GDP, the budget deficit was a modest 1.5 percent, which except for fiscal years 1996 and 1997, was the lowest such share since fiscal 1979. The economic recession and declines in the stock market, estimated to have accounted for nearly two-thirds of the swing from surplus to deficit, were the chief reasons for the deterioration in the unified budget balance. Other factors were the tax cuts and stimulus measures enacted to spur the economy and the increased defense and homeland security spending needed to protect the country from new threats.

Receipts decreased by $138.0 billion, or 6.9 percent, the largest percentage decline since fiscal 1946. Receipts in relation to GDP returned to a more normal 17.9 percent in fiscal 2002, down from 19.9 percent in 2001 and a record high 20.8 percent in 2000. Outlays rose $147.2 billion, or 7.9 percent, and represented a 19.5 percent share of GDP compared with 18.6 percent in the prior fiscal year.

Debt held by the public excluding accrued interest increased by $220.5 billion, or 6.6 percent, in fiscal 2002. That represented a relatively modest 33.7 percent of GDP, however, second only to the 33.1 percent ratio in fiscal 2001, as the lowest since 1984.

Budget Projections

Deficits are projected to increase in fiscal years 2003 and 2004, and then shrink as the economy returns to a stronger growth path. Deficits in relation to GDP are projected to be moderate. The ratio is expected to rise from 1.5 percent in fiscal 2002 to about 2.8 percent in the next 2 years, still well below the 4.0 average in the first half of the 1990s. Thereafter, the ratio of the deficit to GDP declines rapidly, down to 1.4 percent in fiscal years 2007 and 2008.



Significant Performance Accomplishments

Progress on Audited Financial Statements

In fiscal 2002, 21 of 24 major departments and agencies received unqualified opinions on their financial statements. For the first time ever, the Department of Agriculture (USDA) received a clean opinion on its financial statements. The Department of Education (Education), Federal Emergency Management Agency (FEMA) and the National Aeronautics and Space Administration (NASA) received unqualified opinions in fiscal 2002, reclaiming clean opinions that had been lost in recent years. USDA overcame significant financial management challenges in fiscal 2002 to receive its first clean opinion. The U.S. Agency for International Development (USAID) also made substantial progress and received a qualified opinion—an improvement from six consecutive disclaimers.

Audit reports, required for the first time to be combined with agency performance reports, were delivered to the Office of Management and Budget (OMB) by February 1, a month earlier than last year. Treasury and SSA produced audited financial statements in November, implementing 2 years early the Administration's goal to have audited financial statements 45 days after the end of the fiscal year. The Department of Veterans Affairs (VA) submitted its financial statements in December. In addition, Treasury and the Department of Housing and Urban Development submitted their performance reports 2 to 3 months earlier than they ever had before.

The Small Business Administration (SBA), which had previously received unqualified opinions since 1996, received a disclaimer of an opinion for fiscal 2002. The auditors also issued a disclaimer on the fiscal 2001 financial statements and withdrew the opinion on the fiscal 2000 financial statements. SBA's auditors found material errors in the accounting for loan asset sales, and valuation of the Direct Disaster Loan portfolio. SBA is working on an aggressive corrective action plan to remedy its financial management challenges. While DOD received a disclaimer again this year, it has launched a major initiative to clean up its poor financial management by redesigning its financial management systems.

In addition to more reliable and timely financial reporting, a number of agencies made significant progress in improving their internal controls. USDA, along with the Environmental Protection Agency and SSA, resolved long-standing material weaknesses that had plagued their program and financial operations.

A strong internal control environment mitigates risk and helps achieve effectiveness and efficiency, more reliable performance and financial information, and compliance with laws and regulations. Obviously, one of the greatest barriers to adequate financial management is the fact that some Federal agencies are plagued by repeat material control weaknesses—areas so problematic year after year that they detrimentally affect the reliability of financial information. Through the Executive Branch Management Scorecard, the Administration is monitoring and supporting agencies' efforts to resolve these long-standing weaknesses.

Results of Fiscal 2002 Agency Financial Audits

Five agencies improved audit results:

- USDA received its first clean opinion.
- Education, FEMA, and NASA reclaimed their clean opinions.
- USAID improved from a disclaimer (since 1996) to a qualified opinion for the 1st time.

Only one agency, SBA, deteriorated:

- SBA was downgraded from clean opinion (since 1996) to a disclaimer of opinion for 2002, and prior year clean opinions were withdrawn.
- Auditors discovered material errors in SBA's accounting for loan asset sales and the valuation of the Direct Disaster Loan portfolio.

No change in audit opinions for 18 agencies:

- 17 agencies sustained clean opinions.
- DOD continues to receive a disclaimer of opinion. DOD has launched a major initiative to clean up its poor financial management by completely redesigning its financial management systems, which will take years to implement fully.

Expanding the Question from "How Much?" to "How Well?"

In a results-oriented Government, the burden of proof rests on each Federal program and its advocates to prove that the program is getting results. The burden does not rest with the taxpayers or reformers who believe the money could be better spent elsewhere.

This idea is simple, but does not reflect how things have operated in the Federal Government. Instead, the Washington mentality has generally assumed that program funding should increase steadily with the only question being, "by how much?" This type of thinking has wasted untold billions of dollars and prevented the emergence of results-oriented Government.

The fifth element of the President's Management Agenda—budget and performance integration—seeks to shift budget deliberations from an emphasis on inputs to giving greater attention to program objectives, outcomes, and relevant outputs. To this end, the Administration began to rate program effectiveness and reporting on the results for selected programs in the fiscal 2003 President's Budget.

In the President's fiscal 2004 Budget, the process was formalized for 20 percent of Federal programs using a new rating tool, the Program Assessment Rating Tool (PART). The PART included general questions in each of four broad topics to which all programs selected for review are subjected: (1) program purpose and design, (2) strategic planning, (3) program management, and (4) program results (i.e., whether a program is meeting its long-term and annual goals). Additionally, OMB asked more specific questions depending on the approach used for program delivery. The end result was a profile for each program reviewed and an overall rating assigned on a four-point scale of effective, moderately effective, adequate, or ineffective. Those programs judged to have insufficient information available were given a rating of “results not demonstrated.”

For more detailed information regarding PART guidance and PART worksheets, visit the OMB website at **www.omb.gov**.

The President’s Management Agenda: Significant Accomplishments

In August 2001, President Bush launched the President’s Management Agenda, an agenda that identified the five main challenges that represent “the most apparent deficiencies where the opportunity to improve is greatest.” The Administration harbors no illusions that leaps forward will come easily. Constant effort must be made to find ways to save and stretch taxpayer dollars, many through small improvements. Breakthrough gains may come only after years of dedicated, even tedious, effort.

The Human Capital Initiative aims to attract and retain talented and imaginative people into the Federal Government in order to improve the service provided to our citizens. The Competitive Sourcing Initiative exposes parts of the Government to competition so that they may better focus on what customers want while controlling cost. The Improved Financial Performance initiative enhances the quality and timeliness of financial information so that it can be used to manage Federal programs more effectively, while preventing waste, fraud, and abuse. This initiative also improves how the Government manages its money; reducing, for instance, the billions in erroneous payments the Government makes every year. The E-Gov Initiative harnesses the power of the Internet to make Government more productive. The Budget Performance/Integration Initiative starts the process of linking results with resource decisions—the underlying information needed to hold Government accountable.

Since facing such challenges requires sustained effort, the President’s Management Agenda tracks agencies’ status against established standards for success as well as their progress toward meeting the standards. Status and progress are rated using the familiar symbols of red, yellow, and green. Grades are reported on the Executive Branch Scorecard at the end of this section.

Since the scorecard’s unveiling in the fiscal 2003 Budget a year ago, Federal departments and agencies have been working to upgrade their ratings in those areas most in need of improvement. The good news is that signs of progress outnumber distress signals, as 11 departments or agencies show 17 changes for the better. While NASA and SBA slipped in the management of their finances, the results of the fiscal 2002 audits show that NASA regained lost footing by again earning a clean opinion.

Although effort and management attention have been strong at virtually every agency, progress has been uneven. The Administration will follow closely how and whether agencies put their plans into effect. When shortfalls in results become apparent, corrective action will be taken.

	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.

Some real management advances in the Federal Government have been racked up over the past year. For example:

- Both Treasury and SSA met—2 years early—the goal to produce audited financial statements by November 15th, just 45 days after the end of the year, compared with 151 days under previous administrations.
- HHS has reduced its personnel offices from 40 to 7, and will eventually move to just one. This and other consolidations will allow HHS to deploy hundreds of employees to the front lines to deliver services directly to the American people.

- DOD reduced headquarters staff by 11 percent, reducing civilian employees by more than 3,000 in just the last year.
- Rules for conducting public-private competitions have been slashed by almost 12,000 words, cutting the time for conducting competitions from as much as 4 years to a maximum of just 1 year.
- VA is opening up the activities of 52,000 employees to competition over the next 5 years, 25,000 of them in fiscal 2003 alone.
- Government agencies and employees are paying their credit card bills more quickly. The Federal Government began fiscal 2002 with 10 percent of its individually billed travel accounts delinquent. That amount has been reduced to 6 percent, bringing total delinquent dollars for individually billed accounts down by more than $310 million.
- The number of Government-owned vehicles will decline by more than 10,000, from 586,450 in fiscal 2001 to 576,039 in fiscal 2004. (See the Controls section for a further discussion.)
- Citizens are now only three clicks from transactions and services on the redesigned website **www.Firstgov.gov**, which Yahoo!© rated one of the "world's 50 most incredibly useful websites."
- The **www.GovBenefits.gov** website provides, with a minimum of red tape, an online tool for citizens to learn about Federal benefit programs for which they may qualify.
- Free Filing, debuting in fiscal 2003, will enable 60 percent of taxpaying Americans to prepare and file their taxes online and without cost.

While progress to date is encouraging, agencies, by and large, have been moving to address more easily corrected problems. The challenges will undoubtedly increase in fiscal 2003. The coming year will be critical to sustaining the agenda's momentum and achieving the goals envisioned by the President.

The Scorecard

Since July 2002, ratings for each quarter have been posted on the **www.Results.gov** website. The scorecard published here includes ratings for the quarter that ended December 31, 2002, and shows changes in status since the Administration conducted the first evaluation of September 30, 2001. Since then, a single green light has been added to the one that appeared on the original scorecard. The second green score was achieved by the agency that earned the first—the National Science Foundation (NSF). This scorecard includes status scores only for DHS, due to its newness.

Executive Branch Management Scorecard										
	Current Status as of December 31, 2002					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	R	R	Y	R	G	Y	G	G	Y
COMMERCE	R	R	R	Y	Y ↑	G	G	G	Y	G
DEFENSE	Y ↑	R	R	R	R ↑	G	Y	G	G	G
EDUCATION	R	R	R	Y ↑	R	G	G	G	G	G
ENERGY	Y ↑	R	Y ↑	Y ↑	R	G	G	G	G	Y
EPA	R	R	Y ↑	Y	Y	G	G	G	G	G
HHS	R	R	R	R	R	G	G	Y	Y	G
HOMELAND	R	R	R	R	R					
HUD	R	R	R	R	R	Y	Y	G	G	G
INTERIOR	R	R	R	R	R	G	G	G	G	G
JUSTICE	R	R	R	R	R	G	G	G	G	G
LABOR	Y	R	Y ↑	Y	Y ↑	G	Y	G	G	G
STATE	R	R	R	R	R	G	Y	G	Y	G
DOT	R	R	R	R	Y	G	G	G	G	G
TREASURY	R	R	R	R	R	G	G	G	Y	G
VA	R	R	R	Y ↑	Y ↑	G	G	G	G	G
AID	R	R	R	R	R	R	R	Y	Y	G
CORPS	R	R	R	R	R	G	R	G	Y	Y
GSA	R	R	Y	R	R	R	G	G	Y	Y
NASA	Y ↑	R	R ↓	R	Y ↑	G	G	G	G	G
NSF	R	R	G	G ↑	R	G	R	G	G	Y
OMB	R	R	R	R	R	Y	G	Y	G	Y
OPM	Y	R	Y ↑	Y	R	G	G	G	G	G
SBA	R	R	R ↓	Y	Y	G	G	R	G	Y
SMITHSONIAN	R	R	R	Y	R	Y	Y	Y	G	Y
SSA	Y	R	Y	Y	Y ↑	G	Y	G	G	G

Arrows indicate change in status since baseline evaluation on September 30, 2001.
Legend: R = Red Y = Yellow G = Green

Systems, Controls, and Legal Compliance

Systems

The Federal Government faces agency-specific and Governmentwide challenges in modernizing its financial management systems. Many financial management systems need upgrading or replacing before they can provide information to support efforts to achieve the President's goal of a citizen-centered, results-oriented, and market-based Government. In some cases, progress will take several years.

The success of financial systems modernization efforts is dependent, in part, on standardized financial management across the Government. Towards this end, OMB established two sets of standard business rules for certain transactions conducted between Government agencies. Agencies that do not use these business rules will be downgraded on their progress score for financial management on the Executive Branch Management Scorecard.

Controls

Numerous internal controls exist to ensure that financial reporting, compliance, and operation objectives are met. For reporting purposes, instances where these controls are not functioning as planned are described in the individual agency financial reports. Those deficiencies that materially affect the Governmentwide financial statements are described in the accompanying report prepared by the General Accounting Office (GAO). Each agency is responsible for developing and implementing a corrective action plan. In addition, OMB and Treasury will continue to work with Federal agencies to resolve crosscutting issues. In some cases, however, the resolution of these issues requires reengineering of current processes, which is currently being addressed.

Reducing Erroneous Payments

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

For the first time ever, selected agencies were required to report the extent of erroneous payments made in their major benefit programs. Initially, just a few agencies voluntarily reported erroneous payments in their annual financial statements. Now, 11 agencies have estimated their erroneous payment rates. But programs like Medicaid and School Lunch will have to design from scratch a methodology to examine the integrity of program payments. Eleven agencies reported making more than an estimated $30 billion in erroneous payments.

During the past year, the Administration expended considerable effort to prevent a further erosion of controls over payments from Federal programs. USDA’s Food and Nutrition Service, for instance, pursued cash sanctions against States with above-average error rates. During Congress’ recent reauthorization of the Food Stamp Quality Control program, attempts were made to dilute the accountability of States and erode the Federal Government’s ability to maintain fiscal accountability. The Administration opposed and will continue to oppose efforts to weaken financial controls and program integrity.

Congress endorsed the President’s effort to reduce erroneous payments when it passed the Improper Payments Information Act of 2002. This bill requires an estimate of the extent of erroneous payments from all Federal programs. Program-wide erroneous payment estimates can only help stem the loss to the Federal Government in waste, fraud, and abuse—too much of which takes place without an accounting.

Strengthening Asset Management

In another area of deficiency, the Administration will monitor agency asset management practices as part of the Improved Financial Performance initiative. The Federal Government’s asset management practices have been shown to be particularly weak.

According to this year’s financial statements, the Federal Government owns $325 billion in property, plant and equipment, $219 billion in loans receivable, and $192 billion in inventories and related property. But the assets reported on the balance sheet are only a small portion of the assets actually owned by the Federal Government. National defense assets and much of the Government’s immense land holdings do not show up on Government financial statements. For instance, the Federal Government holds title to 28 percent of the United States' entire landmass. It owns sites and structures, monuments, memorials, cemeteries, as well as the items in its museums and libraries, including major works of art and historical documents. These assets are reported in the supplemental stewardship information.

Agency management of vehicle fleets will also be monitored as part of agency asset management practices. The Government owns more than half a million cars and trucks and spends more than $2 billion annually to operate them. In April 2002, the Administration asked agencies to take a closer look at their motor vehicle fleets and to report any planned reductions and cheaper leasing arrangements by the end of the fiscal year. The military agencies and several civilian agencies, notably the Departments of Energy, HHS, and Interior, and the General Services Administration projected reductions ranging from 5 percent to 15 percent. These reductions were offset, however, by equally significant increases in agencies with expanded law enforcement and security-related missions (DHS and Justice).

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. These 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. Generally Accepted Accounting Principles (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.

In fiscal 2002, the Statement of Federal Financial Accounting Standards (SFFAS) No. 24, *Selected Standards for the Consolidated Financial Report of the United States Government*, was implemented at the Governmentwide reporting level. Under the provisions of SFFAS No. 24, two new principal statements are included in the Financial Report: Reconciliations of Net Operating Cost and Unified Budget Surplus (or Deficit) and Statements of Changes in Cash Balance from Unified Budget and Other Activities. These statements reconcile net operating cost with the President's budget surplus (deficit) and explain how the annual budget surplus (deficit) relates to the change in the Government's operating cash.

In addition, SFFAS No. 21, *Reporting Corrections of Errors and Changes in Accounting Principles*, was also implemented at the Governmentwide reporting level for fiscal 2002. SFFAS No. 21 amends SFFAS No. 7 to require that reporting entities restate prior period financial statements for material errors discovered in the current period, if such statements are provided for comparative purposes, and if the effect of the error would be material to the financial statements in either period.

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 giving rise to 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. In addition, GAAP requires the recognition of depreciation expenses on fixed assets, liability for accrued leave, and 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 Surplus (or Deficit), which can be found in the Financial Statements section of this *Financial Report*.

Coverage

These financial statements cover the executive branch, as well as parts of the legislative and judicial branches of the U.S. Government. A list of the significant entities included in these financial statements is in the Appendix. Information from the legislative and judicial branches is limited because those entities are not required by law to submit comprehensive financial statement information to Treasury. Due to its private ownership and independence, the Federal Reserve System is excluded. In addition, Government-sponsored but privately-owned enterprises (such as Federal Home Loan Banks and the Federal National Mortgage Association) also are excluded.

Additional Information

Additional 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.

Comptroller General of the United States

United States General Accounting Office
Washington, DC 20548

March 31, 2003

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 2002 and 2001 is enclosed. As in the 5 previous fiscal years, we were unable to express an opinion on the consolidated financial statements because of certain material weaknesses in internal control and in accounting and reporting. These conditions prevented us from being able to provide the Congress and American citizens an opinion as to whether the consolidated financial statements are fairly stated in conformity with U.S. generally accepted accounting principles.

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 and financial performance of certain programs and effectively manage 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. A number of federal agencies have started to make progress in their efforts to modernize their financial management systems and improve financial management performance as called for in the President's Management Agenda. For example, the Department of the Treasury's Internal Revenue Service (IRS) has made significant progress in addressing its financial management weaknesses, including addressing controls over budgetary activity and its accountability over property and equipment. Resolving many of IRS's most serious financial management weaknesses—identified by GAO as a high-risk area since 1995—will require a sustained, long-term commitment of resources, continued strong involvement of senior management, and sustained progress in systems modernization.

This year marks the earliest that federal agencies' audited financial statements have ever been available. For the first time, CFO Act agencies were required to combine their audited financial statements with performance reports and deliver both to the Office of Management and Budget (OMB) by February 1, a month earlier than last year. Furthermore, the Principals of the Joint Financial Management Improvement Program (JFMIP)[1] have agreed to accelerate the agency financial statement reporting date to November 15 for fiscal year 2004. The Social Security Administration, which has a long-standing record of delivering its audited financial statements well before the mandated deadline, issued its fiscal year 2002 audited financial statements on November 19, 2002. The Department of the Treasury also accelerated its time frame and issued its fiscal year 2002 audited financial statements on November 15, 2002, which was more than 3 months earlier than fiscal year 2001.

For fiscal year 2002, 21 of the 24 Chief Financial Officers (CFO) Act agencies were able to attain unqualified audit opinions on their financial statements, up from 6 agencies for fiscal year 1996. Also, 4 CFO Act agencies showed improvement by receiving unqualified opinions from their auditors this year—the Department of Education, the National Aeronautics and Space Administration, the Federal Emergency Management Agency, and the Department of Agriculture, which received an unqualified audit opinion for the first time. On the other hand, the auditor for the Small Business Administration withdrew its unqualified opinions on the agency's fiscal years 2001 and 2000 financial statements and disclaimed its opinions on the agency's fiscal years 2002 and 2001 financial statements.

In identifying improved financial performance as one of its five governmentwide initiatives, the President's Management Agenda stated that a clean (unqualified) financial audit opinion is a basic prescription for any well-managed organization. It recognized that "most federal agencies that obtain clean audits only do so after making extraordinary, labor-intensive assaults on financial records." Further, the President's Management Agenda stated that without sound internal control and accurate and timely financial information, it is not possible to accomplish the President's agenda to secure the best performance and highest measure of accountability for the American people.

Building on the success that has been achieved in obtaining unqualified audit opinions, federal agency management must continue to work toward fully resolving the pervasive and generally long-standing material weaknesses that have been reported for the past 6

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[1]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.

fiscal years. The underlying causes of these issues are significant financial management systems weaknesses, problems with fundamental recordkeeping and financial reporting, incomplete documentation, and weak internal control. Many federal agencies have continued to expend significant resources to use extensive ad hoc procedures and to make billions of dollars in adjustments to derive financial statements months after the end of a fiscal year. Timely, accurate, and useful financial information is essential for making operating decisions day to day, managing the federal government's operations more efficiently and effectively, meeting the goals of federal financial management reform legislation (such as the CFO Act), supporting results-oriented management approaches, and ensuring accountability on an ongoing basis.

The JFMIP Principals 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 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). Reports of inspectors general and their contract auditors indicated that only 4 of the 24 CFO Act agencies had neither a material internal control weakness, an issue involving compliance with applicable laws and regulations, nor an instance of lack of substantial compliance with FFMIA requirements. While the severity and magnitude of the problems identified varied greatly, auditors for 17 of the 24 CFO Act agencies reported at least one material control weakness. In addition, reports of the inspectors general and their contract auditors indicated that financial management systems of 19 of the 24 CFO Act agencies did not comply substantially with one or more of FFMIA's three federal financial management systems requirements.[2] For the remaining 5 CFO Act agencies, auditors provided negative assurance, meaning that nothing came to their attention indicating that these agencies' financial management systems did not substantially meet FFMIA requirements. The auditors for these 5 agencies did not definitively state whether these agencies' systems substantially complied with FFMIA requirements, as is required under the statute.

Essential to achieving an opinion on the consolidated financial statements is resolution of the serious financial management problems at the Department of Defense (DOD), which we have designated as high risk 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 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

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[2]FFMIA requires auditors, as part of CFO Act agencies' financial statement audits, to report whether agencies' financial management systems substantially comply with federal financial management systems requirements, applicable federal accounting standards (U.S. generally accepted accounting principles), and the federal government's Standard General Ledger at the transaction level.

major DOD components has passed the test of an independent financial audit because of pervasive weaknesses in financial management systems, operations, and controls. In September 2001, Secretary of Defense Rumsfeld announced a broad, top-priority initiative to transform the full range of the department's business processes, including decades-old financial systems that are not well interconnected. The Secretary of Defense recently included improving DOD's financial management as one of his top 10 priorities, and DOD has already taken a number of actions intended to address its serious financial management problems. In addition, DOD has a major effort under way to develop a DOD enterprise architecture that is intended to prescribe a blueprint for operational and technological changes in its financial and related business systems operations. While DOD has a long way to go, its efforts over the past year represent important progress. The level of top leadership that has been brought to bear on this challenge will have to be sustained with a goal of achieving lasting improvement that truly transforms DOD's business systems and operations and enables the department to meet the mandate of the CFO Act and achieve the President's Management Agenda's goal of improved financial performance.

Two other major impediments to an opinion on the consolidated financial statements are the federal government's inability to (1) account for billions of dollars of transactions between federal government entities and (2) properly prepare the consolidated financial statements. As we reported last year, the heart of the intragovernmental transactions issue is that the federal government lacked clearly articulated business rules for these transactions so that they would be handled consistently by agencies. Compounding this problem, a substantial number of the CFO Act agencies did not fully perform reconciliations of intragovernmental activity and balances with their trading partners.[3] To address this issue, OMB has established standard business rules for certain governmentwide transactions between federal government entities and is requiring quarterly reconciliations of intragovernmental activity and balances beginning in fiscal year 2003. For example, in accordance with one of the business rules, beginning in fiscal year 2003 for intragovernmental investments with Treasury's Bureau of the Public Debt (BPD), BPD and trading partner agencies are required to use the same method for recording amortization on market-based notes, bonds, and zero coupon securities. In the past, differences in the amortization methods being used caused out of balance conditions for related intragovernmental activity and balances.

With respect to properly preparing the consolidated financial statements, Treasury is currently developing a new system and procedures to be used beginning with fiscal year 2004. Treasury's initiative is intended to, among other things, directly link information from federal agencies' audited financial statements to amounts reported in the consolidated financial statements. 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.

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

As previously discussed, the President’s Management Agenda includes improved financial performance as one of the top five governmentwide management goals. Other governmentwide initiatives of the President’s Management Agenda include strategic management of human capital, competitive sourcing, expanded electronic government, and budget and performance integration. These initiatives cannot be addressed in an isolated or piecemeal fashion, but rather must be addressed together along with other major management challenges and high-risk areas in an integrated way to ensure that they drive a broader transformation of the cultures of federal agencies. The administration has used the Executive Branch Management Scorecard, which includes broad standards, to highlight federal agencies’ progress in achieving management and performance improvements embodied in the President’s Management Agenda. This is a step in the right direction to improving management and performance. The value of the scorecard is not in the scoring per se, but in the degree to which scores lead to sustained focus and demonstrable improvements. It will be important that there be continuous rigor in the scoring process in order for this approach to be credible and effective in providing the proper incentives that produce lasting results.

During fiscal year 2002, JFMIP Principals continued the series of regular, deliberative meetings that began in August 2001. We focused on key financial management reform issues such as better defining measures for financial management success, requiring accelerated financial statement reporting across government, enhancing the independence of the Federal Accounting Standards Advisory Board, establishing audit advisory committees for the federal government as a whole and for selected major federal agencies, and addressing difficult accounting and reporting issues. Although many actions have been taken, the continued leadership and personal commitment of the Principals is necessary to continue the momentum for improving the federal government’s financial management and performance. At the end of fiscal year 2002, I ended my 2-year term as Chair of the JFMIP Principals, and the Chair rotated to Office of Management and Budget Director Daniels. I look forward to working with the new Chair, Treasury Secretary Snow, and Office of Personnel Management Director James in the upcoming months to continue this important dialogue and build on the strong working relationships that we have established.

As we look ahead, the federal government faces an unprecedented demographic challenge. A nation that has prided itself on its youth will become older. In fact, in 2008—only 5 years from now—the first wave of baby boomers becomes eligible to claim Social Security benefits. As the share of the population over 65 years old climbs to more than 20 percent in 2035, federal spending on the elderly will absorb larger and ultimately unsustainable shares of the federal budget. Federal health and retirement spending are expected to surge as people live longer and spend more time in retirement. In addition, advances in medical technology are likely to keep pushing up the cost of providing health care. Absent substantive reform of these entitlement programs, a rapid escalation of federal spending for Social Security, Medicare, and Medicaid is virtually certain to overwhelm the rest of the federal budget.

On March 17, 2003, the Trustees of the Social Security and Medicare trust funds reported on the current and projected status of these programs over the next 75 years. The Trustees report that the fundamentals of the financial status of both Social Security and Medicare remain highly problematic. However, they stated that Medicare faces financial difficulties that are more severe than those confronting Social Security because costs of the Medicare program are projected to rise faster than costs of the Social Security program. The projections show a 20 percent increase over the prior year in the Present Value of Resources Needed Over the 75-Year Projection Period for Federal Hospital Insurance (Medicare Part A), while the Social Security projection showed an 8 percent increase. Once again, the Trustees state 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.

These long-term demographic and fiscal pressures and the new commitments and actions undertaken as a result of the tragic events of September 11, 2001, serve to increase the need to look at competing claims and new priorities. While reforming health and retirement entitlement programs is essential to preserving fiscal flexibility in the long term, a fundamental review of major programs, policies, and operations can create much-needed fiscal flexibility to address emerging needs. There is a need to consider what the proper role of the federal government will be in the 21st century and how the government should do business in the future.

Timely, accurate, and useful financial and performance information can help form the basis for reconsidering the relevance or "fit" of any federal program or activity in today's world and for the future. Such a review might identify programs that have proven to be outdated or persistently ineffective, or alternatively could prompt us to update and modernize activities through such actions as improving program targeting and efficiency, consolidation, or reengineering of processes and operations. In addition, the review should not be limited to only spending programs but should include the full range of more indirect tools of governance that the federal government uses to address national objectives. These tools include loans and loan guarantees, tax expenditures, and regulations. Ultimately, the federal government should strive to hand to the next generation the legacy of a government that is effective and relevant to a changing society—a government that is as free as possible of outmoded commitments and operations that can inappropriately encumber the future.

The Congress and President Bush face the challenge of sorting out these 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 surplus. Going forward, new rules and goals will be important both to provide fiscal discipline and to prompt a focus on the longer-term implications of decisions. It is still the case that the federal government needs a decision-making framework that permits it to evaluate choices against both today's needs and the longer-term fiscal future that will be handed to future generations. As stewards of the nation's future, the federal government must begin to prepare for tomorrow. In this regard, the federal government must determine how best to address these structural challenges in a reasonably timely manner in order to identify specific actions that need to be taken.

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Once again, we appreciate the cooperation and assistance of Department of the 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, 2002 and 2001,[2] and 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, (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 24 Chief Financial Officers (CFO) Act agencies[4] are responsible for implementing and maintaining financial management systems that comply with the Federal Financial Management Improvement Act of 1996 (FFMIA) requirements. Our objective was to audit the consolidated financial statements for the fiscal years ended September 30, 2002 and 2001. Appendix I discusses the scope and methodology of our work.

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

[2]The consolidated financial statements for the fiscal years ended September 30, 2002 and 2001, consist of the Statements of Operations and Changes in Net Position, the Statements of Net Cost, and Balance Sheets, including the related notes to these financial statements. In accordance with Statement of Federal Financial Accounting Standards No. 24, which was adopted in January 2003, these consolidated financial statements also include comparative Reconciliations of Net Operating Cost and Unified Budget Surplus (or Deficit) and Statements of Changes in Cash Balance from Unified Budget and Other Activities.

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

[4]The Federal Emergency Management Agency (FEMA), one of the 24 CFO Act agencies, transferred to the new Department of Homeland Security (DHS) effective March 1, 2003. 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. DHS, along with most other executive branch agencies, will be 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 (Nov. 7, 2002).

A significant number of material weaknesses[5] related to financial systems, fundamental recordkeeping and financial reporting, and incomplete documentation continued to (1) hamper the federal government's ability to 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 expressing an opinion on the accompanying consolidated financial statements for the fiscal years ended September 30, 2002 and 2001.[6] There may also be additional issues that could affect the consolidated financial statements that have not been identified.

In accordance with the National Defense Authorization Act for fiscal year 2002,[7] the Department of Defense (DOD) reported that for fiscal year 2002 DOD's financial management systems were not able to provide adequate evidence supporting material amounts in its financial statements. DOD asserted that it is unable to comply with applicable financial reporting requirements for (1) property, plant, and equipment, (2) inventory and operating materials and supplies, (3) military retirement health care actuarial liability, (4) environmental liabilities, (5) intragovernmental eliminations and related accounting adjustments, and (6) cost accounting by suborganization/responsibility segment and major program.

Based largely on DOD's assertion, the DOD Inspector General disclaimed an opinion on DOD's financial statements for fiscal year 2002 as it had for the previous 6 fiscal years. 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 these material weaknesses, they will continue to impede our ability to express an opinion on the consolidated financial statements. In addition, as noted later in this report, there are other material weaknesses that need to be corrected.

DISCLAIMER OF OPINION ON THE CONSOLIDATED FINANCIAL STATEMENTS

Because we were unable to determine the reliability of significant portions of the accompanying fiscal years 2002 and 2001 U.S. government's consolidated financial statements, we are unable to, and we do not, express an opinion on such financial statements.

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[5] 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.

[6] We previously reported that material deficiencies prevented us from expressing an opinion on the fiscal years 1997, 1998, 1999, and 2000 consolidated financial statements.

[7] Section 1008, Pub. L. No. 107-107, 115 Stat. 1012 (Dec. 28, 2001).

As a result of the material deficiencies in the federal government's systems, recordkeeping, documentation, and financial reporting, 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 2002 *Financial Report of the United States Government*.

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 such assets were included in the consolidated financial statements, verify that certain reported assets actually exist, or substantiate the amounts at which they were valued. A significant portion of the property, plant, and equipment and the vast majority of inventories and related property are the responsibility of DOD. 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 property, plant, and equipment.

Liabilities and Commitments and Contingencies The federal government could not reasonably estimate or adequately support amounts reported for certain liabilities. For example, the federal government was not able to reliably estimate key components of DOD's environmental and disposal liabilities and could not support its estimate of military postretirement health benefits liabilities included in federal employee and veteran benefits payable. Further, the federal government could not determine whether commitments and contingencies, including those related to treaties and other agreements entered into to further the U.S. government's interest, 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 government operations, most notably related to DOD. As it relates to disbursement reconciliations, some federal agencies did not adequately reconcile disbursements to the Department of the Treasury's (Treasury) records of disbursements, which is intended to be a key control to detect and correct errors and other misstatements in financial records in a timely manner. We have seen progress in this area over the past 6 years. However, for fiscal years 2002 and 2001 there were unsupported adjustments and unreconciled differences between federal agencies' and Treasury's records of disbursements totaling billions of dollars.

Accounting for and Reconciliation of Intragovernmental Activity and Balances OMB and Treasury require CFO Act agencies to reconcile selected intragovernmental activity and balances with their "trading partners"[8] and to report on the extent and results of intragovernmental activity and balances reconciliation efforts. The inspectors general reviewed these reports and communicated the results of their reviews to OMB, Treasury, and GAO. A substantial number of the CFO Act agencies did not fully perform the required reconciliations for fiscal years 2002 and 2001, citing reasons such as (1) trading partners not providing needed data, (2) limitations and incompatibility of agency and trading partner systems, and (3) human resource issues. For both of these years, amounts reported for federal agency trading partners for certain intragovernmental accounts were significantly out of balance. In addition, significant differences in other intragovernmental accounts, primarily related to appropriations, will need to be resolved.

To address certain issues that contributed to the out of balance condition for intragovernmental activity and balances, OMB has established a set of standard business rules for governmentwide transactions among trading partners and is requiring quarterly reconciliations of intragovernmental activity and balances beginning in fiscal year 2003. For example, in accordance with one of the business rules, beginning in fiscal year 2003 for intragovernmental investments with Treasury's Bureau of the Public Debt (BPD), BPD and trading partner agencies are required to use the same method for recording amortization on market-based notes, bonds, and zero coupon securities. In the past, differences in the amortization methods being used have caused out of balance conditions for related intragovernmental activity and balances. Resolving the intragovernmental transactions problem remains a difficult challenge and will require a commitment by the CFO Act agencies and continued strong leadership by OMB.

Preparation of Consolidated Financial Statements The federal government did not have adequate systems, controls, and procedures to properly prepare its consolidated financial statements, as described below. Also, disclosure of certain financial information was not presented in the consolidated financial statements in conformity with U.S. generally accepted accounting principles.

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

Consolidated Financial Statement Compilation Due to the current financial statement compilation process, the federal government could not adequately ensure that the information for each federal agency included in the consolidated financial statements was consistent with the underlying agency financial statements. This process also requires significant human and financial resources and does not adequately leverage the existing work and work products resulting from federal agencies' audited financial statements. The problems are further compounded by the need for broad changes in the structure of the government's Standard General Ledger (SGL) accounts and the process for maintaining the SGL.

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 2002 and 2001 consolidated financial statements balance, Treasury recorded a net $17.1 billion and $17.3 billion decrease to net operating cost, respectively, on the Statement of Operations and Changes in Net Position, which it labeled unreconciled transactions.[9] An additional net $12.5 billion and $3.9 billion of unreconciled transactions were improperly recorded in net cost for fiscal years 2002 and 2001, respectively. Treasury attributes these net unreconciled transaction amounts primarily to the federal government's inability to properly identify and eliminate transactions between governmental entities, federal agency adjustments that affected net position, and other errors. Treasury was unable to adequately identify and explain the gross components of such amounts. Unreconciled transactions also may exist because the federal government does not have effective controls over reconciling net position.

The federal government did not have an adequate process to reconcile the operating results, which for fiscal year 2002 showed a net operating cost of $364.9 billion, to the budget results, which for the same period showed a unified budget deficit of $157.7 billion.

Treasury is currently developing a new system and procedures to prepare the consolidated financial statements beginning with fiscal year 2004. 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 facilitate the reconciliation of net position.

Elimination of Intragovernmental Activity and Balances Consolidated financial statements are intended to present the results of operations and financial position of the components that make up a reporting entity as if the entity were a single enterprise. When preparing the consolidated financial statements, the preparer must eliminate intragovernmental activity and balances between the federal

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[9]Prior to fiscal year 2001, the federal government reported unreconciled transactions as a change in net position. Although the federal government 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.

agencies. Because of federal agencies' problems in handling their intragovernmental transactions, Treasury's ability to eliminate these transactions is impaired. Significant differences reported in intragovernmental accounts, as noted above, have been identified. To help federal agencies better perform their reconciliations, Treasury recently began providing agencies with detailed trading partner information. 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.

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, 2002, 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 U.S. generally accepted accounting principles, 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[10] 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 Prior to fiscal year 2001, we cited accounting for loans receivable and loan guarantee liabilities as a material deficiency contributing to our disclaimer because certain key federal credit agencies could not reliably estimate the costs of their lending programs or determine the net loan amounts expected to be collected. In fiscal year 2001, due to significant improvements at the Department of Agriculture, we removed this area from the list of issues contributing to our disclaimer. Nevertheless, several federal agencies continue to have significant deficiencies in the processes and procedures used to estimate the costs of their lending programs and value their loan receivables. For example, the auditor for the Small Business Administration (SBA) withdrew its unqualified opinions on the agency's fiscal years 2001 and 2000 financial statements because SBA lacks reliable financial data to assess the overall financial impact of its loan asset sales and is unable to support its net

[10]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.

loans receivable balance. This raises significant concerns about SBA's ability to reasonably estimate its loan program costs for budget and financial statement purposes.[11] In addition, we again noted that other federal credit agencies continue to require significant adjustments to the estimates of program costs, net loan amounts to be collected, and related notes. Auditors for these agencies reported related material internal control weaknesses.

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.[12] Many improper payments occur in federal programs that are administered by entities other than the federal government. In general, improper payments often result from a lack of or an inadequate system of internal controls. Most federal agencies have not estimated or reported the magnitude of improper payments in their programs, and while estimates of improper payments disclosed in federal agency financial statements totaled about $20 billion for both fiscal years 2002 and 2001,[13] the federal government did not estimate the full extent of improper payments. The President's Management Agenda includes addressing erroneous payments (a term we consider synonymous with improper payments) as one of the key elements for improving financial performance. Accordingly, OMB, which has shown leadership in this area, now requires annual submissions on improper payments from 15 federal agencies. Specifically, OMB requires actual and projected information on erroneous payment rates and the status of actions taken to reduce improper payments. Further, the Improper Payments Information Act of 2002[14] 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 Congress that include the status of actions to reduce improper payments for programs and activities with estimated improper payments of $10 million or more.

Information Security GAO has reported information security over computerized operations as a governmentwide high-risk area since February 1997.[15] Information

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[11]U.S. General Accounting Office, *Small Business Administration: Accounting Anomalies and Limited Operational Data Make Results of Loan Sales Uncertain*, GAO-03-87 (Washington, D.C.: January 2003).
[12]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.
[13]In trying to establish a baseline of erroneous payments, OMB's fiscal year 2001 estimate of more than $30 billion, reported in Management's Discussion and Analysis, includes amounts from agency sources other than published financial statements. For purposes of this report, we considered only those amounts published in agency fiscal years 2001 and 2002 performance and accountability reports, which include financial statements. We acknowledge that until all agencies systematically identify and report improper payments using the same method of reporting, as required by the Improper Payments Information Act of 2002, there may be variances between the amounts reported annually by OMB and GAO.
[14]Pub. L. No. 107-300, 116 Stat. 2350 (Nov. 26, 2002).
[15]See, for example, U.S. General Accounting Office, *High-Risk Series: Protecting Information Systems Supporting the Federal Government and the Nation's Critical Infrastructures*, GAO-03-121 (Washington, D.C.: January 2003).

security weaknesses are placing enormous amounts of federal government 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. The federal government is not in a position to estimate the full magnitude of actual damage and loss resulting from federal information security weaknesses because it is likely that many such incidents are either not detected or not reported. Although progress has been made, federal agencies have not yet institutionalized comprehensive security management programs, which are critical to resolving information security problems and managing information security risks on an ongoing basis. To provide a comprehensive framework for ensuring the effectiveness of information security controls, the Federal Information Security Management Act of 2002[16] was enacted in December 2002.

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.[17] 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.

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. Instances of noncompliance, some of which the federal agency auditors reported were material to individual agency financial statements, are included in individual agency audit reports. However, 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 information throughout the year and at year-end. As discussed throughout this report, financial management systems weaknesses have contributed to our inability to determine the reliability of the consolidated financial statements. FFMIA requires

[16] Pub. L. No. 107-347, Title III, 116 Stat. 2946 (Dec. 17, 2002).
[17] U.S. General Accounting Office, *Financial Audit: IRS's Fiscal Years 2002 and 2001 Financial Statements,* GAO-03-243 (Washington, D.C.: Nov. 15, 2002).

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 SGL at the transaction level. For fiscal year 2002, auditors for 19 CFO Act agencies reported that the agencies' financial management systems did not comply substantially with one or more of these three FFMIA requirements. 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. GAO plans to report to the Congress by October 1, 2003, on CFO Act agencies' FFMIA implementation for fiscal year 2002, as required by the act.

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We provided a draft of this report to Department of the Treasury and Office of Management and Budget officials, who expressed their continuing commitment to address the problems this report outlines.

David M. Walker
Comptroller General
of the United States

March 20, 2003

APPENDIX I

SCOPE AND METHODOLOGY

The Government Management Reform Act of 1994 expanded the requirements of the CFO Act by making the inspectors general of 24 major federal agencies 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.[18] 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 2001.[19] 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 2002 and 2001 financial statements, which included approximately $2 trillion and $2.1 trillion of tax revenue and $281 billion and $251 billion of tax refunds for fiscal years 2002 and 2001, respectively, and $20 billion of net federal taxes receivable each year.[20] In fiscal year 2002, we continued to report numerous material internal control weaknesses, which resulted in ineffective internal controls. We also reported two instances of noncompliance with applicable laws and regulations and lack of substantial compliance of IRS's financial management systems with FFMIA.

- We audited and expressed an unqualified opinion on the Schedules of Federal Debt managed by Treasury's Bureau of the Public Debt (BPD) for the fiscal years ended September 30, 2002 and 2001.[21] The schedules reported for these 2 fiscal years (1) approximately $3.6 trillion (2002) and $3.3 trillion (2001) of federal debt held by the public comprising individuals, corporations, state and local governments, the Federal Reserve Banks, and foreign governments and central banks, (2) about $2.7 trillion (2002) and $2.5 trillion (2001) 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 $172 billion (2002)

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[18]The 1994 act authorized OMB to designate agency components that also would receive a financial statement audit.

[19]For our report on the U.S. government's consolidated financial statements for fiscal year 2001, see U.S. Department of the Treasury, *Financial Report of the United States Government* (Washington, D.C.: March 2002), pp. 25-42, which can be found on GAO's Internet site at www.gao.gov.

[20]GAO-03-243.

[21]U.S. General Accounting Office, *Financial Audit: Bureau of the Public Debt's Fiscal Years 2002 and 2001 Schedules of Federal Debt,* GAO-03-199 (Washington, D.C.: Nov. 1, 2002).

and $207 billion (2001) of interest on federal debt held by the public.[22] We reported that as of September 30, 2002, BPD had effective internal control over financial reporting and compliance with laws and regulations related to the Schedule of Federal Debt. Further, we reported that there was no reportable noncompliance in fiscal year 2002 with laws we tested.

- We audited and expressed unqualified opinions on the December 31, 2001 and 2000, 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.[23] We reported that as of December 31, 2001, 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, 2002.

We considered the CFO Act agencies' and certain other federal agencies' fiscal years 2002 and 2001 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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[22]On June 28, 2002, legislation was enacted to raise the statutory debt limit by $450 billion to $6.4 trillion. On February 20, 2003, the Secretary of the Treasury began exercising statutory authority available to him to avoid exceeding the current $6.4 trillion debt ceiling. As of March 20, 2003, the debt ceiling had not been raised.

[23]U.S. General Accounting Office, *Financial Audit: Federal Deposit Insurance Corporation's 2001 and 2000 Financial Statements*, GAO-02-633 (Washington, D.C.: May 21, 2002).

APPENDIX II

Primary Effects Caused by the Material Weaknesses Described in This Report

Areas Involving Material Weaknesses	Primary Effects on the Fiscal Years 2002 and 2001 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	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.
Preparation of consolidated financial statements	Weaknesses related to the preparation of the consolidated financial statements impair the federal government's ability to (1) fully ensure that the consolidated financial statements were consistent with federal agency financial statements and were properly balanced and (2) adequately reconcile the operating results reported in the consolidated financial statements with the unified budget results.
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, 2002 and September 30, 2001

In accordance with the Statement of Federal Financial Accounting Standards (SFFAS) No. 24, two new principal financial statements are included in this *Financial Report of the United States Government (Financial Report)*. They are the Reconciliations of Net Operating Cost and Unified Budget Surplus (or Deficit) and the Statements of Changes in Cash Balance from Unified Budget and Other Activities.

Statements of Net Cost

These Statements present the net cost of fiscal years 2002 and 2001 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 in a similar manner as in the budget, even though the budget presents costs by obligations and outlays based on functions. 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 may be traced directly, 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 plan amendments, and the actuarial gains and losses for these agencies. 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.

Please refer to the Management's Discussion and Analysis section for further information concerning 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 individual income taxes, Social Security taxes, Medicare taxes, and railroad retirement taxes, net of related refunds.

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 Statement of Net Cost.

Unreconciled Transactions

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. Please 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—Prior Period Adjustments for detailed information.

Net Position, End of Period

This amount reflects the net position as of the end of the fiscal year.

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

The purpose of the reconciliation is to report how the proprietary net operating cost and the unified budget surplus (or 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 surplus (or deficit) in the President's budget.

Receipts and outlays in the President's budget are measured primarily on a cash basis and, therefore, differ from the accrued cost-basis measures used in the *Financial Report*. These Statements begin with the results of operations (net operating cost), reported on an accrued cost-basis in the Statements of Operations and Changes in

Net Position, and arrive at the unified budget surplus. Reconciling items include accrued 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 Surplus (or 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 Surplus (or 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 because of their long-term nature. 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 surplus (or deficit) relates to the change in the Government's cash balance and debt held by the public. It explains why the unified budget surplus (or deficit) normally would not result in an equivalent change in the Government's cash balance.

These Statements reconcile the unified budget deficit (or surplus) to the change in operating cash during the fiscal year, and explain how the budget deficit (fiscal 2002) was financed and budget surplus (fiscal 2001) was used. A budget deficit is the result of expenditures exceeding receipts (revenue) during a particular fiscal year, and a budget surplus is the result of receipts (revenue) exceeding expenditures during a particular fiscal year.

In depicting how the unified budget deficit (or surplus) affected cash, these Statements show that in fiscal 2002 the greatest amount was net new borrowings from the public, and in fiscal 2001 the greatest amount was net repayments of the debt held by 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. For example, Note 2—Cash and Other Monetary Assets provides information concerning the cash reported in the assets section.

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.

Selected assets are highlighted in the Stewardship Information section of this report to demonstrate the Government's accountability for these assets. Stewardship assets include national defense assets, 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 employee and veteran benefits payable and Federal debt securities held by the public and accrued interest. Liabilities also include social insurance benefits due and payable as of the reporting date.

As with reported assets, the Government's responsibilities and policy commitments 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 19—Dedicated Collections. That note also contains information about trust fund receipts, disbursements, and assets.

A broad perspective on the Government's responsibilities is provided by the Current Services Assessment, which also can be found in the Stewardship Information section. Presented in accordance with the President's 2004 budget, this information estimates Federal expenditures and receipts for fiscal 2002 to 2008, assuming there are no changes to current law.

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—Commitments and Contingencies.

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, 2002 and September 30, 2001

(In billions of dollars)	2002			2001		
	Gross Cost	Earned Revenue	Net Cost	Gross Cost	Earned Revenue	Net Cost
Department of Agriculture	80.5	9.6	70.9	83.5	11.1	72.4
Department of Commerce	7.4	1.2	6.2	7.4	1.2	6.2
Department of Defense	420.4	13.9	406.5	776.8	12.6	764.2
Department of Education	49.9	4.8	45.1	39.9	4.1	35.8
Department of Energy	(3.0)	4.8	(7.8)	27.0	5.2	21.8
Department of Health & Human Services	499.9	27.0	472.9	459.2	24.7	434.5
Department of Housing & Urban Development	36.3	2.2	34.1	34.5	2.4	32.1
Department of Interior	15.0	0.7	14.3	11.7	0.3	11.4
Department of Justice	29.5	2.3	27.2	26.5	2.3	24.2
Department of Labor	64.7	-	64.7	42.3	-	42.3
Department of State	10.9	0.9	10.0	10.0	1.0	9.0
Department of Transportation	65.4	1.6	63.8	63.6	0.3	63.3
Department of the Treasury	66.0	3.6	62.4	60.0	4.4	55.6
Interest on debt held by the public	175.4	-	175.4	217.7	-	217.7
Department of Veterans Affairs	218.4	2.6	215.8	196.0	2.7	193.3
U.S. Agency for International Development	8.0	-	8.0	7.1	0.1	7.0
Environmental Protection Agency	8.2	0.5	7.7	8.4	0.5	7.9
Federal Emergency Management Agency	6.2	1.8	4.4	6.3	1.6	4.7
General Services Administration	(0.1)	0.3	(0.4)	0.1	0.3	(0.2)
National Aeronautics & Space Administration	14.7	0.1	14.6	9.2	0.1	9.1
National Science Foundation	4.2	-	4.2	3.7	-	3.7
U.S. Nuclear Regulatory Commission	0.6	0.4	0.2	0.6	0.4	0.2
Office of Personnel Management	0.2	-	0.2	0.2	-	0.2
Small Business Administration	1.3	0.5	0.8	0.8	0.2	0.6
Social Security Administration	492.9	0.3	492.6	465.3	0.3	465.0
Export-Import Bank of the United States	(1.2)	0.3	(1.5)	0.8	0.3	0.5
Federal Communications Commission	6.8	1.1	5.7	14.9	6.7	8.2
Federal Deposit Insurance Corporation	1.8	0.7	1.1	3.1	0.5	2.6
National Credit Union Administration	0.2	0.5	(0.3)	0.3	0.4	(0.1)
Pension Benefit Guaranty Corporation	12.7	0.9	11.8	2.3	0.8	1.5
Railroad Retirement Board	9.3	-	9.3	9.0	-	9.0
Tennessee Valley Authority	7.9	6.8	1.1	11.8	6.9	4.9
United States Postal Service	83.1	66.4	16.7	86.2	65.6	20.6
All other entities	22.8	0.8	22.0	19.6	3.0	16.6
Total	2,416.3	156.6	2,259.7	2,705.8	160.0	2,545.8

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, 2002 and September 30, 2001

(In billions of dollars)	2002	2001
Revenue:		
Individual income tax and tax withholdings	1,538.6	1,663.6
Corporation income taxes	143.7	147.9
Unemployment taxes	26.2	26.7
Excise taxes	67.9	67.3
Estate and gift taxes	26.4	28.3
Customs duties	18.3	18.7
Other taxes and receipts	49.3	48.9
Miscellaneous earned revenues	7.3	12.3
Total revenue	1,877.7	2,013.7
Less net cost of Government operations	2,259.7	2,545.8
Unreconciled transactions affecting the change in net position (Note 16)	17.1	17.3
Net operating cost	(364.9)	(514.8)
Net position, beginning of period	(6,458.8)	(5,945.4)
Prior period adjustments (Note 17)	3.5	1.4
Net operating cost	(364.9)	(514.8)
Net position, end of period	(6,820.2)	(6,458.8)

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

United States Government
Reconciliations of Net Operating Cost and Unified Budget Surplus (or Deficit) for the Years Ended September 30, 2002 and September 30, 2001

(In billions of dollars)	2002	2001
Net operating cost	(364.9)	(514.8)
Components of net operating cost not part of the budget surplus (or deficit):		
Increase in liability for military employee benefits (Note 11):		
Increase in military pension liabilities	21.7	17.8
Increase in military health liabilities	11.1	388.6
(Decrease)/increase in other military benefits	(0.4)	0.4
Increase in liability for military employee benefits	32.4	406.8
Increase in liability for veterans compensation and burial benefits (Note 11)**:**		
Increase in liability for veterans	147.7	115.2
Increase in liability for survivors	9.0	24.1
Increase in liability for burial benefits	0.6	-
Increase in liability for veterans compensation	157.3	139.3
Increase in liability for civilian employee benefits (Note 11):		
Increase in civilian pension liabilities	16.9	41.0
Increase in civilian health liabilities	16.2	7.2
Increase in other civilian benefits	5.8	1.9
Increase in liability for civilian employee benefits	38.9	50.1
Decrease in environmental liabilities (Note 12):		
(Decrease)/increase in energy's environmental liabilities	(28.7)	4.1
(Decrease)/increase in all others' environmental liabilities	(5.1)	1.6
(Decrease)/increase in environmental liabilities	(33.8)	5.7
Depreciation expense	20.5	21.4
Increase in benefits due and payable (Note 13)	9.3	8.1
(Increase)/decrease in taxes receivable (Note 5)	(0.3)	2.2
Increase in other liabilities (Note 14)	13.8	13.1
Premium on early buyback of public debt	3.8	10.7
Seigniorage and sale of gold	(1.0)	(1.3)
(Decrease)/increase in accounts payable (Note 9)	(0.4)	9.4[1]
Components of the budget surplus (or deficit) not part of net operating cost:		
Capitalized Fixed Assets:		
Department of Defense	(18.1)	(11.1)
Civilian agencies	(22.8)	(23.3)
Total capitalized fixed assets	(40.9)	(34.4)
Decrease in accounts receivable (Note 3)	2.2	(1.9)
(Increase)/decrease in inventory (Note 6)	(8.4)	1.4
Increase in other assets (Note 8)	(2.0)	(3.7)
Principal repayments of precredit reform loans	8.2	19.9
Net amount of all other differences	1.0	(6.4)[1]
Other:		
Prior period adjustments (Note 17)	6.6	1.4[1]
Unified Budget deficit (or surplus)	(157.7)	127.0

[1] Restated.

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, 2002 and September 30, 2001

(In billions of dollars)		2002			2001	
Budget receipts—actual		1,853.3			1,990.9	
Budget outlays—actual		(2,011.0)			(1,863.9)	
Unified budget (deficit) or surplus			(157.7)			127.0
Adjustments for Non-Cash Outlays Included in the Budget:						
Interest accrued by Treasury on debt held by the public		(152.0)			(171.0)	
Subsidy expense (Note 4)		4.9			0.7	
Items Affecting the Cash Balance Not Included in the Budget:						
Net Transactions from Financing Activity:						
Repayment of debt held by the public	3,570.2			2,620.7		
Borrowings from the public	(3,791.0)			(2,530.6)		
Total		(220.8)			90.1	
Net Transactions from Monetary Activity:						
Increase in special drawing rights	.8			1.6		
Increase in other monetary assets	14.3			8.2		
Increase/(decrease) in loans to the IMF	2.5			4.7		
Total		17.6			14.5	
Net Transactions from Other Activities:						
Net direct loan activity	13.7			18.5		
Interest paid by Treasury on debt held by the public	158.6			175.8		
Premium on early buyback of public debt	3.8			10.7		
Net guaranteed loan activity	(2.3)			4.1		
Increase/(decrease) in other assets	(.9)			1.6		
Increase in deposit fund balances	(.4)			(4.1)		
Decrease/(increase) in other liabilities	3.4			(4.1)		
Seigniorage and other equity	(1.0)			(1.3)		
Revisions to the prior budget results	1.0			-		
Total		175.9			201.2	
Disposition of (Deficit) or Surplus			(174.4)			135.5
Increase/(decrease) in operating cash balance			16.7			(8.5)
Operating Cash: (Note 2)						
Operating cash balance beginning of period			44.2			52.7
Operating cash balance end of period			60.9			44.2

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

United States Government
Balance Sheets
as of September 30, 2002 and September 30, 2001

(In billions of dollars)	2002	2001
Assets:		
Cash and other monetary assets (Note 2)	141.6	108.0
Accounts receivable, net (Note 3)	32.0	34.2
Loans receivable, net (Note 4)	219.2	208.9
Taxes receivable, net (Note 5)	21.4	21.1
Inventories and related property, net (Note 6)	192.2	183.8
Property, plant and equipment, net (Note 7)	324.7	306.7
Other assets (Note 8)	65.4	63.4
Total assets	996.5	926.1
Liabilities:		
Accounts payable (Note 9)	55.8	56.2
Federal debt securities held by the public and accrued interest (Note 10)	3,573.2	3,359.3
Federal employee and veteran benefits payable (Note 11)	3,589.4	3,360.8
Environmental and disposal liabilities (Note 12)	273.0	306.8
Benefits due and payable (Note 13)	95.3	86.0
Loan guarantee liabilities (Note 4)	28.1	27.7
Other liabilities (Note 14)	201.9	188.1
Total liabilities	7,816.7	7,384.9
Commitments and contingencies (Note 18)		
Net position	(6,820.2)	(6,458.8)
Total liabilities and net position	996.5	926.1

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

United States Government Stewardship Information for the Years Ended September 30, 2002 and September 30, 2001 (Unaudited)

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.

National Defense Assets

National defense assets consist of property, plant and equipment that the Department of Defense (DOD) requires to perform military missions, such as combat operations, peacekeeping, and support of civilian authorities during civil emergencies, and vessels held in a preservation status by the Maritime Administration's National Defense Reserve Fleet.

In June 2002, the Federal Accounting Standards Advisory Board (FASAB) approved SFFAS No. 23 entitled, *Eliminating the Category National Defense Property, Plant and Equipment*. FASAB has recommended this statement to remove national defense assets from stewardship information and report them on the Balance Sheet as part of general property, plant and equipment. This standard is effective for years ending after September 30, 2002, and is currently pending final approval by Congress. The standard on national defense property, plant and equipment provides for capitalization of property previously defined as national defense property, plant and equipment and the reporting of such property as general property, plant and equipment. DOD cannot fully comply with existing reporting requirements, because many of DOD's accountability and logistics systems do not contain the cost of the national defense property, plant and equipment assets. These systems were designed for the purpose of maintaining accountability and meeting other logistics requirements and capturing the cost of national defense property, plant and equipment.

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 $212.4 million and $373.0 million for the years ended September 30, 2002, and 2001, respectively. The table below depicts the stewardship land owned by the Government and administered by the

Department of the Interior (DOI), DOD, and the Department of Agriculture (USDA). Detailed information concerning stewardship land can be obtained in the financial statements of DOI, DOD, and USDA.

United States Government Stewardship Land as of September 30

Agency	Predominate Use	Millions of Acres 2002	Millions of Acres 2001	Percentage 2002	Percentage 2001
Bureau of Land Management	Public land	261.5	261.8	40.4	40.5
U.S. Forest Service	National forest system	192.3	192.4	29.7	29.8
U.S. Fish and Wildlife Service	National wildlife refuge system	90.1	90.1	13.9	14.0
National Park Service	National park system	79.0	78.9	12.2	12.2
Department of Defense	Defense facilities	18.8	16.8	2.9	2.6
Bureau of Reclamation	Water, power, and recreation	5.8	5.7	0.9	0.9
Total acres		647.5	645.7	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 art and cultural treasures at the Smithsonian Institution and 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 140 million individual objects for public exhibition, education, and research.

Similarly, the Library of Congress holds the world's largest library collection, comprising more than 115 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 more than 2 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 $187.8 million and $13.2 million for the years ended September 30, 2002, and 2001, respectively.

Natural Heritage Assets

Congress has designated several wilderness areas to preserve their natural conditions. DOI manages approximately 69.4 million acres of these wilderness areas comprised of almost 65 percent of the Nation's more than 106 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 53 percent of these 11,303 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 43 national natural landmarks, the Bureau of Land Management manages 45 natural landmarks, and the National Park Service manages 18 national natural landmarks, such as the Garden of the Gods in Colorado.

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 $313.0 million and $51.0 million for the years ended September 30, 2002, and 2001, 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 3,491 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 27 stand-alone memorials, monuments, and markers around the world. This includes the Belleau Wood Marine Monument in France.

Archeological sites contain the remains of human activity. DOI manages numerous archaeological sites. The National Park Service manages 63,000 archeological sites; the Bureau of Land Management, the U.S. Fish and Wildlife Service and the Bureau of Reclamation manage 280,110 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 Responsibilities

Stewardship responsibilities provide information on the social insurance programs: Social Security, Medicare, Railroad Retirement, Black Lung and Unemployment Insurance. The purpose of this information is to assist the American people in evaluating the financial condition and sustainability of these programs.

Social Insurance Update

Congress passed the Social Security Act in 1935. The Act, as subsequently amended, includes programs that provide retirement and disability benefits. Congress established two trust funds for Social Security: the Federal Old-Age and Survivors Insurance (OASI) and the Federal Disability Insurance (DI) Trust Funds (combined as OASDI).

The following table gives financial report users updated information on selected financial aspects of the Social Security and Medicare programs that became available subsequent to the preparation of the related data presented in the detailed social insurance disclosures on pages 63 to 82.

Specifically, the social insurance programs' actuarial analysis and assumptions that are included on pages 73 to 76 were prepared based on estimates as of January 1, 2002. On March 17, 2003, the Boards of Trustees for the Social Security and Medicare Trust Funds released annual reports that present information for these programs as of January 1, 2003. The table below compares selected key data elements from these sources.

Comparison of Trustees' Reports Updated Estimates with the Financial Report Estimates

	Trustees' Report Estimates as of January 1, 2003	Financial Report Estimates as of January 1, 2002
First Year Expenditures Exceed Tax Revenue:		
Social Security (OASI and DI)	2018	2017
Federal Old-Age and Survivors Insurance (OASI)	2018	2018
Federal Disability Insurance (DI)	2008	2009
Federal Hospital Insurance (Medicare Part A)	2013	2016
Year Trust Fund Assets Are Exhausted:*		
Social Security	2042	2041
Federal Old-Age and Survivors Insurance	2044	2043
Federal Disability Insurance	2028	2028
Federal Hospital Insurance	2026	2030
Actuarial Deficit as a Percentage of Taxable Payroll Over the 75-Year Projection Period:		
Social Security	1.92%	1.87%
Federal Old-Age and Survivors Insurance	1.56%	1.54%
Federal Disability Insurance	0.35%	0.34%
Federal Hospital Insurance	2.40%	2.02%
Annual Deficit as a Percentage of Taxable Payroll for the 75th Year of the Projection Period:		
Social Security	6.50%	6.42%
Federal Old-Age and Survivors Insurance	5.73%	5.64%
Federal Disability Insurance	0.77%	0.78%
Federal Hospital Insurance	8.09%	7.37%
Present Value of Resources Needed Over the 75-Year Projection Period:		
Social Security	$4,927 billion[1]	$4,562 billion
Federal Hospital Insurance	$6,166 billion[1]	$5,126 billion

*See page 69 for more information on how trust funds are financed.

[1]Amount derived by the Office of the Actuary at the Social Security Administration and Centers for Medicare & Medicaid Services, respectively, for Trustees' Report projections.

In their 2003 Reports, the Trustees for the OASDI and Federal Hospital Insurance (HI), or Medicare Part A, programs reported that the short-range financial status of these programs is adequate. However, they continued to caution that long-term sustainability issues have deteriorated and still need to be addressed, and that timely action to deal with the continuing long-term financial difficulties is needed. As the Trustees point out, "… the sooner they are addressed the more varied and less disruptive can be their solutions."

For the OASDI program, the long-range actuarial deficit increased by 0.05 percentage of taxable payroll, primarily because the valuation period extends one year later to 2077, a larger deficit year. A higher assumed rate of immigration improved the projected financial status of the trust funds in early years, delaying the start of cash-flow deficits by 1 year and extending the year of trust fund exhaustion by 1 year.

The primary reason for the change in HI program estimates is the increase in the projection base. Actual and projected expenditures are significantly higher than estimated last year mainly due to faster growth in inpatient hospital benefits. In addition, actual and projected payroll tax income is lower than previously estimated because of a downward revision in estimated wage and salary disbursements.

On balance, these changes extend the exhaustion date for the OASDI Trust Fund by 1 year (from 2041 to 2042) and deplete the HI Trust Fund 4 years earlier (from 2030 to 2026). Revenues fall short of expenditures, 1 year later than last year (2018 compared to 2017) for the OASDI Trust Fund and 3 years earlier than last year for the HI Trust Fund (2013 compared to 2016). The 75-year actuarial balances were worse for both trust funds, for the reasons stated above, as well as, the addition of a new deficit year at the end of the 75-year projection period. Both funds remain substantially out of long-term actuarial balance. Compared to last year, the annual deficit (as a percentage of payroll) in the 75th projection year (2077) increased noticeably for the OASDI fund and for the HI fund.

As used in the preceding table, first year expenditures exceed tax revenue is the point at which the trust funds would have to start using interest income to make payments. Interest income is paid in the form of Treasury securities. In order to use the interest, the trust funds would have to redeem the securities. To finance redemption, the Government must raise taxes, increase borrowings from the public, cut spending for other programs, retire less debt, or some combination thereof. The year trust fund assets are exhausted is the point at which all trust fund assets (Treasury securities) have been redeemed. After this date, these respective programs will not have adequate resources to pay promised benefits or obligations in a timely manner. In the year of trust fund exhaustion (based on the intermediate assumptions of the 2003 Trustees' Report), 2042 for OASDI and 2026 for Medicare Part A, tax income is estimated to cover 73 percent of program expenditures. Actuarial deficit as a percentage of taxable payroll over the 75-year projection period can be interpreted as the percentage that, if added to the current scheduled tax rates, would cover projected trust fund shortfalls over the 75-year period and have enough assets on hand at the end of the 75-year period to pay scheduled benefits in the following year. Similarly, annual deficit as a percentage of taxable payroll for the 75th year of the projection period represents the increase in payroll taxes needed in year 2077 and 2076 to cover projected cash shortfalls for each 1-year period. Present value of resources needed over the 75-year projection period represents the discounted net excess of projected cash expenditures (outflow) over cash income (inflow) during the 75-year projection period. The trust fund assets at the beginning of the period are not reflected in the calculation of this amount.

Social Insurance

The social insurance programs were developed to provide income security and health care coverage to citizens under specific circumstances as a responsibility of the Government. Because taxpayers rely on 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 collections. 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, social insurance programs have uniform sets 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. These estimates are based on long-range actuarial projections of the range of persons who are participants or eventually will participate in the programs as contributors or beneficiaries during a projected period of time sufficient to illustrate the financial status and sustainability of the program. The projection includes current workers, retirees, survivors, disabled persons who have not attained retirement age, as well as the participants who have attained retirement age, and those expected to become new participants in the future. Refer to the footnotes at the bottom of these Statements for the projection valuation date.

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

(In billions of dollars)	2002	2001	2000
Federal Old-Age, Survivors and Disability Insurance (Social Security):			
Contributions and earmarked taxes from:			
Participants who are currently receiving benefits	348	309	266
Participants who are not currently receiving benefits	13,048	12,349	11,335
Future participants	11,893	11,035	10,088
All current and future participants	25,289	23,693	21,689
Expenditure payments to or on behalf of:			
Participants who are currently receiving benefits	4,401	4,256	4,020
Participants who are not currently receiving benefits	20,210	18,944	17,217
Future participants	5,240	4,700	4,297
All current and future participants	29,851	27,900	25,534
Present Value of Resources Needed	4,562[1]	4,207[2]	3,845[3]
Federal Hospital Insurance (Medicare Part A):			
Contributions and earmarked taxes from:			
Participants who are currently receiving benefits	125	113	97
Participants who are not currently receiving benefits	4,408	4,136	3,757
Future participants	3,753	3,507	3,179
All current and future participants	8,286	7,756	7,033
Expenditure payments to or on behalf of:			
Participants who are currently receiving benefits	1,747	1,693	1,681
Participants who are not currently receiving benefits	9,195	8,568	6,702
Future participants	2,470	2,225	1,349
All current and future participants	13,412	12,486	9,732
Present Value of Resources Needed	5,126[1]	4,730[2]	2,699[3]
Federal Supplementary Medical Insurance (Medicare Part B):			
Contributions and earmarked taxes from:			
Participants who are currently receiving benefits	252	258	234
Participants who are not currently receiving benefits	1,856	1,845	1,527
Future participants	600	593	404
All current and future participants	2,708	2,696	2,165
Expenditure payments to or on behalf of:			
Participants who are currently receiving benefits	1,132	1,159	1,051
Participants who are not currently receiving benefits	7,463	7,415	6,094
Future participants	2,238	2,206	1,514
All current and future participants	10,833	10,780	8,659
Present Value of Resources Needed	8,125[1]	8,084[2]	6,494[3]
Railroad Retirement *Present Value of Resources Needed*	20[1]	19[4]	8[5]
Black Lung (Part C) *Present Value of Resources Needed*	(5)[6]	(4)[7]	(4)[8]

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

See the Social Insurance update on page 62 for the most recent Trustees' Report projections.
The following notes are an integral part of this statement.

Notes to the Statements of Social Insurance

Actuarial present value of the 75-year projections are computed based on the economic and demographic assumptions believed most likely to occur (the intermediate assumptions) as set forth in the related Trustees' reports.

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; monthly Medicare Part B premiums paid by, or on behalf of, beneficiaries; railroad work-hour tax; and excise tax on coal (Black Lung). Contributions and earmarked taxes for the Medicare Part B program presented in this report are presented from a consolidated perspective. Interest payments and other intragovernmental transfers have been eliminated. The Centers for Medicare & Medicaid Services' (CMS), formerly known as the Health Care Financing Administration, 2002 Financial Report presents income from the trust fund's perspective, not a Governmentwide perspective. Therefore, CMS' Financial Report includes $8,125 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*.

Expenditure payments include benefit payments and administrative expenses.

Black Lung disability benefits for current and future miners are not expected to be material.

Future participants, in the three insurance groups, include births during the period and individuals below age 15 as of January 1 of the valuation year.

The present value of resources needed is the current amount of funds needed to cover projected shortfalls, excluding the starting trust fund balances, over the projection period. The trust fund balances at the beginning of the valuation period that were eliminated for this consolidation were: $1,213 billion—Social Security, $209 billion—Medicare Part A, $41 billion—Medicare Part B, $24 billion—Railroad Retirement, and Black Lung Trust Fund, which had a negative balance of $7.7 billion.

The projection period for new entrants 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. As a practical matter, the present values of future payments and contributions for/from current participants beyond 75 years are not material.

The actuarial present value of the excess of future scheduled expenditure payments to current participants (that is, to the closed group of participants) over future scheduled contributions and tax income from them or paid on their behalf is calculated by subtracting the actuarial present value of future scheduled contributions and tax income by and on behalf of current participants from the actuarial present value of the future scheduled benefit payments to them or on their behalf. For Social Security and Medicare, further information can be obtained from the Social Security Administration (SSA) (*The 2002 Annual Report of the Board of the 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 2002 Annual Report of the Boards of the Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds)*.

Program Sustainability

Social Security (OASDI)

Under the intermediate assumptions (best estimates) of the Board of Trustees of the Federal OASDI Trust Funds, OASDI income from contributions on taxable earnings and from income taxes on benefits is expected to exceed total expenditures for 2002 and each of the next 14 calendar years. From 2010 through 2030, however, OASDI costs, relative to taxable earnings, are expected to increase rapidly as the "baby-boom" generation reaches retirement age. In contrast, the program's income from contributions due on taxable earnings and income taxes on benefits will remain a relatively constant percentage of taxable payroll.

In view of the size of the financial shortfall in the OASDI program over the next 75 years, the Board of Trustees of the Federal OASDI Trust Funds urges that the long-range deficits of both the OASI and DI Trust Funds be addressed in a timely way.

Medicare

Medicare has generally been viewed as a program in greater financial difficulty than Social Security because it will combine the rising costs of health care over time with the increase in beneficiaries as baby boomers become eligible. The approach of the last two decades, that of seeking improvements in the efficiency and effectiveness of health care delivery, will continue to be an important contributor to Medicare's future. The challenge facing the future financing of this program is how we, as a society, will share the costs of health care for a much larger aging population.

The Medicare Part A program is substantially out of financial balance in the long range. Under the intermediate assumptions of the Board of Trustees trust funds, income excluding interest (2022 including) income is projected to continue to exceed expenditures moderately for the next 14 years, but to fall short by steadily increasing amounts in 2016 and later. The long-range outlook, however, remains extremely unfavorable, in large part as a result of the impending retirement of the baby-boom generation. Over the full 75-year projection period, substantially greater changes in income and/or outlays are needed to bring the program into actuarial balance.

These projections indicate that without additional legislation, the fund would be exhausted in the future—initially producing payment delays, but very quickly leading to a curtailment of health care services to beneficiaries. In its 2002 annual report to Congress, the Board of Trustees urged the Nation's policymakers to address the remaining financial imbalance facing the trust fund by taking "further effective and decisive action, building on the strong steps taken in recent reforms." They also stated, "Consideration of further reforms should occur in the relatively near future."

The recent improvements in projected expenditures for Medicare Part B, while welcome, are not sufficiently large to diminish serious concerns with expenditure growth. The Board of Trustees note that program costs have generally grown faster than the gross domestic product (GDP) and that this trend is expected to continue under present law. The projected increases are attributable, in part, initially to assumed continuing growth in the volume and intensity of services provided per beneficiary. Starting in 2011, the attainment of eligibility of the post-World War II baby-boom generation will also have a major influence on the growth in program costs.

Prior to the Balanced Budget Act of 1997, Medicare Part A Trust Fund assets were projected to be exhausted in the very near future. The urgency of this situation prompted considerable attention and led directly to the provisions in the Act to slow expenditure growth. In contrast, the financing provisions for Medicare Part B prevent such crises. While Medicare Part B is in fact running a shortfall since premiums only cover about 25 percent of program costs, the trust fund remains solvent because of a growing infusion of general revenue funds. As a result, there has been substantially less attention directed toward the financial status of the Medicare Part B program than to the Medicare Part A program, even though Part B expenditures have increased faster than Part A expenditures in most years and are expected to continue to do so in the future.

Given the past and projected cost of the Medicare Part B program, the Board of Trustees urges the Nation's policymakers to consider effective means of controlling costs in the near term. For the longer term, legislative proposals need to be developed to address the large increases in Part B costs associated with the baby boom's retirement in partnership with Part A cost increases.

Railroad Retirement

The Railroad Retirement program is projected to have a $20.0 billion negative cashflow, based on a projection through 2077, on a consolidated basis. This negative cashflow will be financed through the redemption of securities that resulted from past program surpluses. The long-term stability of the program, however, is still questionable. Under the current financing structure, actual levels of railroad employment over the coming years will largely determine whether corrective action is necessary.

The Railroad Retirement and Survivors' Improvement Act of 2001 (RRSIA), enacted on December 21, 2001, provided several changes in benefit and financing provisions, including the transfer of the investment responsibility from the Railroad Retirement System Trust funds managed by the Railroad Retirement Board (RRB).

The provisions of RRSIA 2001:

- Restored full annuities for employees and their spouses who retire at age 60, instead of 62, with 30 years of railroad service.
- Eliminated a cap on monthly retirement and disability benefits.
- Increased some widow(er)s' benefits by providing a guaranteed minimum amount of benefits.
- Lowered the minimum service requirements from 10 to 5 years, if performed after 1995.
- Reduced the tier II tax rates on rail employers and employee representatives in calendar years 2002 and 2003, and beginning with 2004, provides automatic adjustments in the tier II tax for employers, employee representatives, and employees. It also repealed the supplemental annuity work-hour tax paid by employers beginning with calendar year 2002.
- Created a new National Railroad Retirement Investment Trust (NRRIT) as a private entity authorized to invest Railroad Retirement assets in diversified investment portfolios in the same manner as those of private sector

retirement plans. Prior to RRSIA, investment of the Railroad Retirement assets was limited to U.S. Government securities.

- Allows for railroad retirement benefit payments in the future to be issued by a qualified nongovernmental financial institution with payments continuing to be processed through Treasury in the meantime.

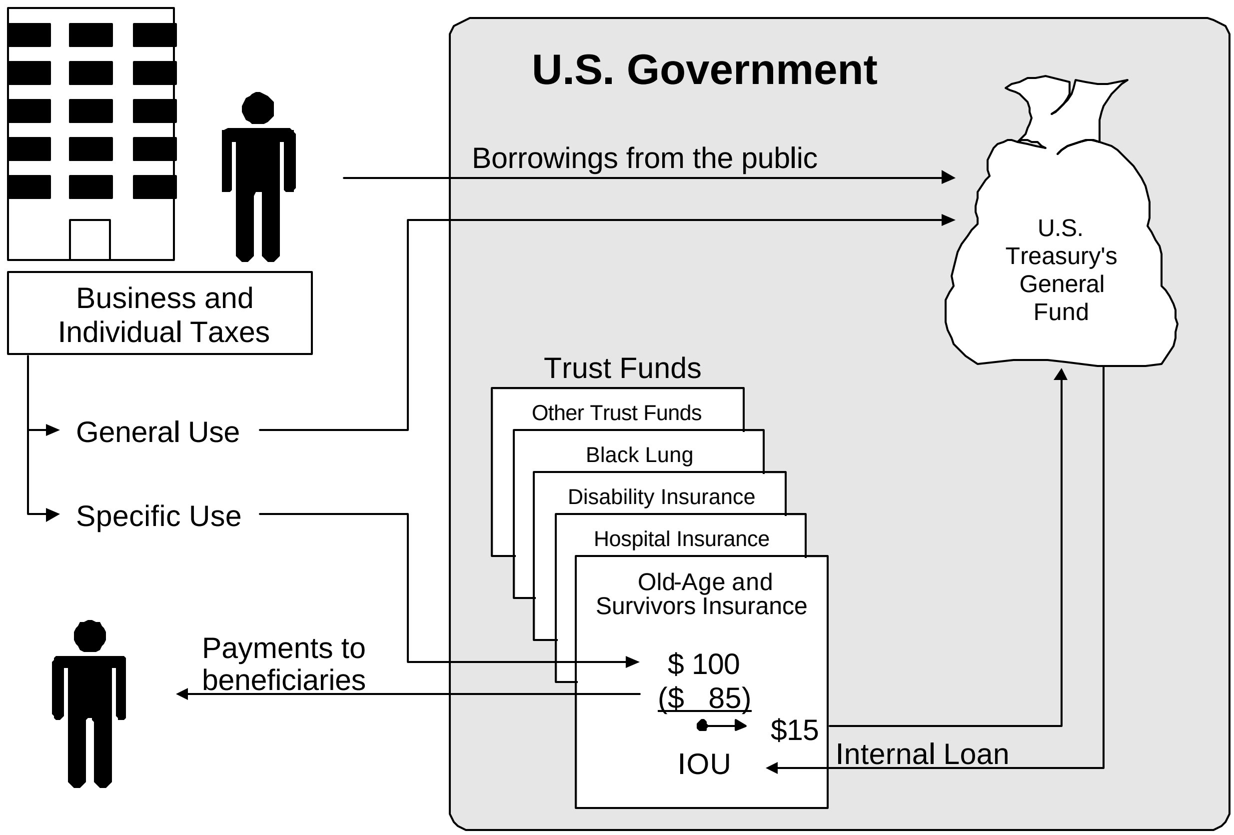
During fiscal 2002, the RRB transferred $1.5 billion from the Railroad Retirement Account to NRRIT, which was invested in equity index funds. An additional $17.8 billion was transferred to the NRRIT from October 1, 2002 through March 20, 2003.

In fiscal 2002, FASAB was asked for guidance on the proper presentation and disclosures of NRRIT transactions in RRB's financial statements (where it was not consolidated) and the *Financial Report* (where it was consolidated). FASAB was unable to provide guidance in fiscal 2002, but may do so in broader perspective of social insurance disclosures in the next year or two.

Black Lung

The Black Lung Part C disability program's net present value of future benefit payments for the 38-year period ending September 30, 2040, is $3.1 billion. The net present value of future excise taxes for the 38-year period is $7.8 billion, which results in a $4.7 billion excess of excise taxes over benefit payments. However, the net present value of total cash outflows, including interest payments and administrative costs, is $20.9 billion, resulting in an excess of cash outflows over excise taxes of $13.1 billion.

Trust Fund Financing



The Government collects taxes from business and individuals. Each type of tax collected is classified for "general use" or for "specific use." The taxes collected for general use are included in the general fund and are used to fund the Government's general operations.

The taxes collected for specific use are credited to the corresponding trust fund that will use these funds to meet a particular Government purpose. The beneficiaries from these earmarked trust funds are paid from the balance of each of the corresponding trust funds. If the collections from taxes and other sources exceed outlays to the beneficiaries, the excess collections are invested, normally in Treasury securities, which means that the excess collections are "loaned" to the Treasury's general fund. The reason for this is the trust funds generally are not permitted to hold the excess cash collected. Usually, all excess collections as well as interest earnings must be invested by the trust funds in Treasury securities or Government-guaranteed securities. Therefore, the trust fund balances do not represent cash. These balances are the sum of all specific use collections plus interest and other receipts, less payments to beneficiaries over the life of the fund.

When payments to beneficiaries exceed receipts, the trust funds redeem a commensurate amount of their Treasury securities holdings.

In addition to earmarked taxes, trust funds receive income from the interest earned on investments in Treasury securities and, in some cases, from other sources as well.

Social Security

OASI pays retirement and survivors' benefits and DI pays benefits to disabled workers and their dependents. At the end of calendar year 2002, OASDI benefits were paid to approximately 46 million beneficiaries. Revenue to the combined OASDI funds consists primarily of taxes on earnings paid by employees, their employers, and the self-employed. OASDI also receives revenue from the income taxes on some Social Security benefits and interest on its investments in Treasury securities. Social Security revenues not needed to pay current benefits or administrative expenses are invested in special-issue Treasury securities. Eligibility and benefit amounts are determined under the laws applicable for the period. Current law bases the amount of the monthly benefit payments for workers, or their eligible dependents or survivors, on the workers' lifetime taxable earnings histories.

The Board of Trustees of the OASI and DI Trust Funds provides in its annual report to the President and 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 Board of Trustees uses three alternative sets of economic and demographic assumptions to show a range of possibilities. Assumptions are made about many economic and demographic factors, including GDP, earnings, the consumer price index (CPI), the unemployment rate, the fertility rate, immigration, mortality, and disability incidence and terminations. The assumptions used in the accompanying tables, generally referred to as the "intermediate assumption," reflect the best estimate of expected future experience, under current law.

Cashflow Projections

The present values of actuarial estimates as shown in the following sections were computed as of January 1, 2002, the beginning of the valuation period. The actuarial estimated income equals the sum of the present value of all estimated scheduled non-interest income during the period. The actuarial estimated expenditures equal the sum of the present value of all estimated scheduled payments during the valuation period.

The primary receipts of OASDI are funds appropriated under permanent authority based on contributions payable by workers, their employers, and individuals with self-employment income. Revenue derived from subjecting a portion of OASDI benefits to Federal personal income taxation is dedicated to the OASDI and HI programs. All contributions, or taxes, are collected by the Internal Revenue Service (IRS) and deposited to the trust fund. Another source of income is interest received on the investments held by the trust funds, which is implicit in the present values presented in this report. The primary expenditures are for scheduled OASDI benefit payments and for expenses related to administration of the OASDI programs.

Under current legislation and using intermediate assumptions, the OASI and DI Trust Funds are projected to be exhausted in 2043 and 2028, respectively. Combined OASDI expenditures will exceed annual tax income beginning in 2017 and will exceed total annual income (including interest income) for calendar years 2027 and later. Thus, tax income plus a portion of interest income will be needed to meet expenditures for the years 2017 through 2026. Thereafter, in addition to tax income and interest income, a portion of the principal (combined OASDI assets) will be needed each year until the trust fund assets are totally exhausted in 2041. At that point, annual program tax income will be sufficient to pay only approximately 73 percent of the benefits due.

Chart 1 shows actuarial estimates of combined OASDI annual income (excluding interest) and expenditures for 1960-2076 in nominal dollars. The estimates are for the open-group population, all persons projected to participate in the OASDI program as covered workers or beneficiaries, or both, during that period. Thus, the estimates include payments 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 expenditures made to, and on behalf of, such workers during that period.

Currently, Social Security tax revenues exceed benefit payments, and the system is building large trust fund reserves to help finance the retirement of the baby-boom generation. Under current estimates, benefit payments will begin to exceed program tax income in 2017, and Social Security will start using annual trust fund interest to help pay benefits. Starting around 2027, Social Security will need to use the trust fund reserves themselves to help pay benefits; by about 2041, the trust fund reserves will be exhausted. The trust fund interest and reserves are in the form of Treasury securities that must be redeemed. The Government will need to raise taxes (other than OASDI payroll taxes), increase borrowing from the public, and/or cut spending for other programs to redeem the securities. However, if the Government changes the law to increase OASDI taxes and/or reduce OASDI benefits, then this redemption could be reduced or delayed.

Chart 1—Estimated OASDI Income (Excluding Interest) and Expenditures 1960-2076

(In billions of dollars)

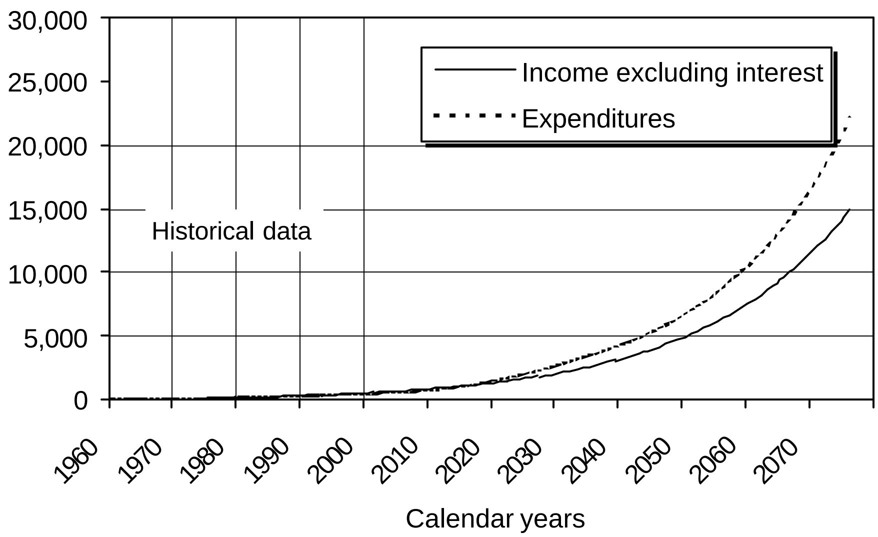


Chart 2 shows estimated annual income excluding interest and expenditures expressed as percentages of taxable payroll. As presently constructed, the program receives most of its income from the 6.2 percent payroll tax that employees and employers each pay on taxable wages and salaries (for a combined payroll tax rate of 12.4 percent of taxable payroll), and the 12.4 percent that is paid on taxable self-employment income. Because estimated annual income excluding interest consists primarily of payroll taxes, when expressed as a percentage of taxable payroll, it is close in magnitude to the OASDI payroll tax rate. The amount by which the income exceeds the tax rate reflects revenue transferred to the trust funds based on Federal income-taxation of OASDI benefits. When estimated expenditures are compared to income as percentages of taxable payroll, they necessarily reflect a similar pattern as when compared in nominal dollars. Whether expressed as percentages of taxable payroll or in nominal dollars, prior to 2017, estimated annual expenditures are less than estimated annual income, excluding interest, whereas in 2017 and thereafter expenditures are more.

The Statement of Social Insurance on page 65 shows that the present value of the excess of income (excluding interest) over expenditures for the 75-year period is -$4,562 billion. If augmented by the trust fund assets at the start of the period (January 1, 2002), it is -$3,350 billion. This excess does not equate to the actuarial balance in the Trustees' Report. To reconcile these values, it should be considered that the excess (including the starting trust fund assets) would need to take into account the cost of attaining a target trust fund balance by the end of the period. The present value of this cost is $270 billion, which reduces the excess to -$3,619 billion. This reduced (more negative) excess, when expressed as a percentage of taxable payroll, is defined by the Trustees in their annual reports to be the actuarial balance. Thus, the excess of -$3,619 billion equates to the actuarial balance of -1.87 percent of taxable payroll reported in the 2002 Trustees' Report.

One interpretation of this negative actuarial balance (-1.87 percent of the taxable payroll) is that it represents the magnitude of the increase in the combined payroll tax rate for the 75-year period that would result in an actuarial balance of zero. The combined payroll tax rate is 12.4 percent today and is currently scheduled to remain at that level. An increase of 1.87 percentage points in this rate in each year of the 75-year projection period—about 0.94 percentage points for employees and employers each, resulting in a total rate for each of 7.14 percent—is estimated to produce enough income to pay all benefits due under current law for that period. Equivalent benefit reductions, or combinations of both tax increases and benefit reductions, could be made to achieve the same effect. Any accumulation and subsequent redemption of substantial trust fund assets may have economic and public policy implications that go beyond the operation of the OASDI program itself. Discussion of these broader issues is not within the scope of this report.

Chart 2—Estimated OASDI Income (Excluding Interest) and Expenditures as a Percentage of Taxable Payroll 1960-2076

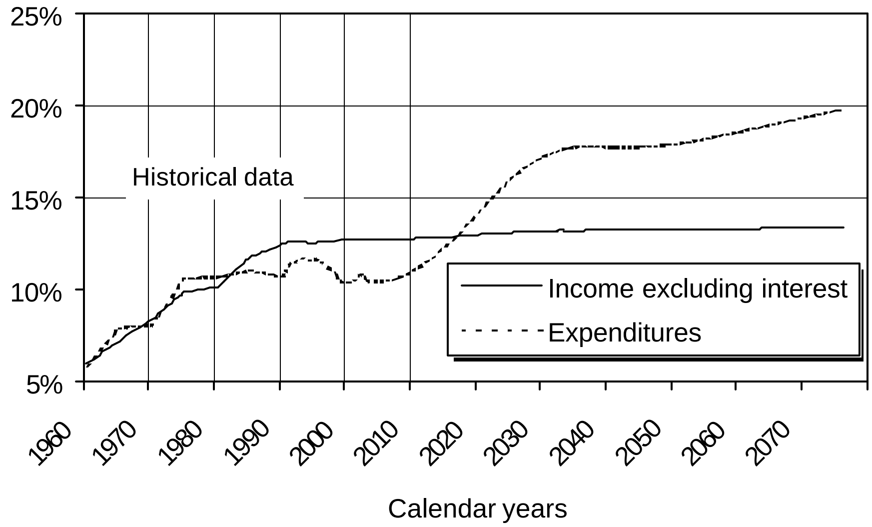
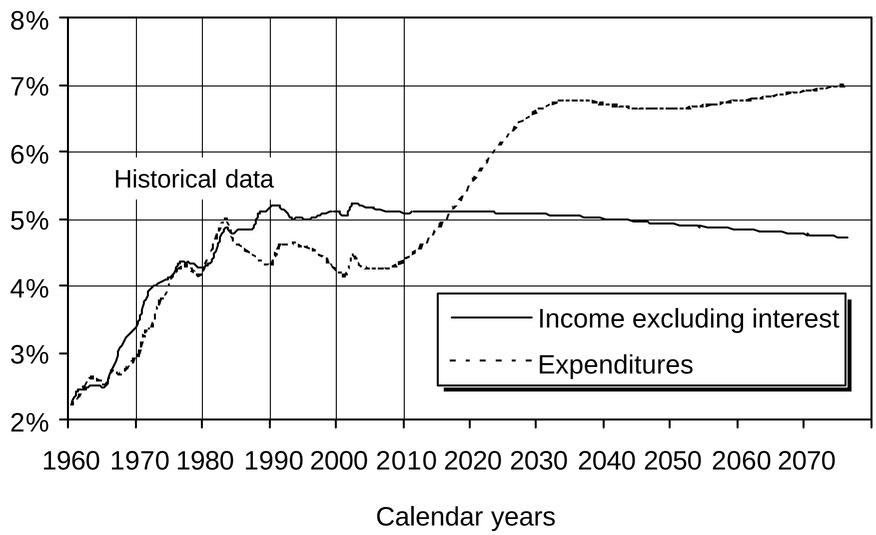


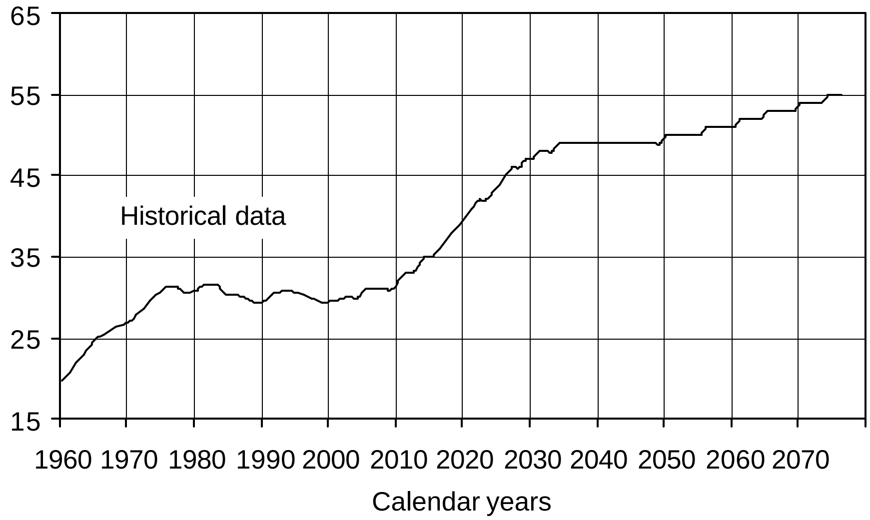
Chart 3 shows estimated annual income, excluding interest, and expenditures, expressed as percentages of GDP. Analyzing these cashflows in terms of percentage of the GDP, which represents the total value of goods and services produced in the United States, provides a measure of the size of the OASDI program in relation to the capacity of the national economy to sustain it.

Chart 3—Estimated OASDI Income (Excluding Interest) and Expenditures as a Percentage of GDP 1960-2076



As shown in Chart 4, there were about 29 OASDI beneficiaries for every 100 covered workers in 2001. As indicated, this ratio is expected to increase substantially in the future. The most rapid increase will occur as the relatively large number of persons born during the baby boom (from the end of World War II through the mid-1960s) reaches retirement age and begins to receive benefits. At the same time, the relatively small number of persons born during the subsequent period of low fertility rates will comprise the labor force. Between 2030 and 2050, the number of workers per beneficiary is estimated to remain relatively stable as the baby-boom generation diminishes in size. After 2050, this ratio is expected to continue to increase at a slower pace, reflecting the increasing numbers of beneficiaries due to projected increases in life expectancy. Under the intermediate assumption, by the end of 2076, the number of OASDI beneficiaries per 100 covered workers is projected to increase to 55.

Chart 4—Estimated Number of OASDI Beneficiaries per 100 Covered Workers 1960-2076



Actuarial Assumptions and Sensitivity Analysis

Actual future income from OASDI payroll taxes and other sources, and actual future expenditures for 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.

While it is reasonable to assume that actual trust fund experience will fall within the range defined by the three alternative sets of assumptions used in the Trustees' report, no definite assurance can be given that this will occur because of the uncertainty inherent in projections of this type and length. In general, a greater degree of confidence can be placed in the assumptions and estimates for the earlier years than for the later years. Nonetheless, even for the earlier years, the estimates are only an indication of the expected trend and potential range of future program experience.

The assumptions fluctuate in the earlier years of the projection period before reaching their ultimate values for the remainder of the 75-year projection period. The following table summarizes the ultimate values assumed for the key economic and demographic factors underlying the actuarial estimates shown in this report.

The estimates used in this presentation are based on the assumption that the programs will continue as presently constructed. They are also based on various economic and demographic assumptions, including those in the following table.

Social Security Intermediate Assumptions

Year	Total Fertility Rate[1]	Age-Sex-Adjusted Death Rate[2] (per 100,000)	Period Life Expectancy at Birth[3] Male	Period Life Expectancy at Birth[3] Female	Net Annual Immigration (Persons per Year)	Real-Wage Differential[4] (Percentage Points)	Average Annual Percentage Change In: Average Annual Wage in Covered Employment	Average Annual Percentage Change In: CPI[5]	Average Annual Percentage Change In: Real GDP[6]	Average Annual Interest Rate[7]
2002	2.12	804.3	73.9	79.5	900,000	1.8	3.1	1.3	0.7	4.9%
2005	2.10	789.6	74.3	79.7	900,000	1.2	4.1	2.9	3.2	6.4%
2010	2.07	759.8	74.9	80.1	900,000	1.0	4.1	3.0	2.2	6.0%
2020	1.99	698.1	76.0	81.0	900,000	1.1	4.1	3.0	1.8	6.0%
2030	1.95	642.2	77.1	81.9	900,000	1.1	4.1	3.0	1.8	6.0%
2040	1.95	593.2	78.0	82.8	900,000	1.1	4.1	3.0	1.8	6.0%
2050	1.95	550.0	79.0	83.5	900,000	1.1	4.1	3.0	1.7	6.0%
2060	1.95	511.9	79.8	84.3	900,000	1.1	4.1	3.0	1.7	6.0%
2070	1.95	478.1	80.7	85.0	900,000	1.1	4.1	3.0	1.7	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 2026.

[2] The age-sex-adjusted death rate is the crude rate that would occur in the enumerated total population as of April 1, 1990, if that population were to experience the death rates by age and sex observed in, or assumed for, the selected year. It is a summary measure and not a basic assumption; it summarizes the basic assumptions from which it is derived.

[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.

[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 real GDP is the value of total output of goods and services, expressed in 1996 dollars. It is a summary measure and not a basic assumption; it summarizes the effects of the basic assumptions from which it is derived.

[7] 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.

Present value amounts attempt to demonstrate what future cashflow amounts would be if shown in interest discounted dollars. This is done by discounting, or removing, the increase in these cashflows that is caused by interest. Even small changes in the estimated amount of future interest over the next 75 years have dramatic impact on present value calculations. Given the cashflow estimates between the high and low interest-rate assumptions, the present value of OASDI expenditures over income ranges from $6,681 billion to $3,264 billion using ultimate annual real interest rates of 2.2 percent to 3.7 percent, respectively, compared to $4,562 billion using the intermediate ultimate annual real interest rate of 3.0 percent. These interest rate assumptions do not influence the future cashflow in the OASDI program.

Charts of cashflows with varying assumptions that have not been adjusted for interest, as well as other assumptions that are not expected to have a material impact on OASDI, can be found in Social Security's Performance and Accountability Report and on the web at **www.ssa.gov/finance**.

These assumptions and the other values on which these displays are based reflect the intermediate assumptions of the 2002 Trustees' Report. Estimates made in certain prior years have changed substantially because of revisions to the assumptions based on changed conditions or experience, and to changes in actuarial methodology. It is reasonable to expect more changes for similar reasons in future reports.

Death Rates

The assumptions regarding future death rates have a substantial impact on estimated future cashflows in the OASDI program. The following table shows the present values of the estimated OASDI expenditures in excess of income for the 75-year period, using various assumptions about future reductions in death rates. The analysis was developed by varying the percentage decrease assumed to occur during 2001-2076 in death rates by age, sex, and cause of death. The decreases assumed for this period, summarized as average annual reductions in the age-sex-adjusted death rate, are 0.32, 0.75, and 1.33 percent per year, where 0.75 percent is the intermediate assumption in the 2002 Trustees' Report. (The resulting cumulative decreases in the age-sex-adjusted death rate during the same period are 21, 43 and 63 percent, respectively.) These assumptions do not apply uniformly to all ages. Some variation by age was assumed in recognition of historical patterns and to ensure that, in terms of the financial status of the OASDI program, estimates based on the summarized 0.32 percent and 1.33 percent reduction assumptions would be more optimistic and more pessimistic, respectively, than those based on the intermediate assumption.

As the following table demonstrates, if the reduction in death rate is changed from 0.75 percent, the Trustees' intermediate assumption, to 0.32 percent, meaning that people die younger, the shortfall for the period of estimated OASDI income relative to expenditures would decrease to $3,300 billion, from $4,562 billion; if the annual reduction were changed to 1.33 percent, meaning that people live longer, the shortfall would increase to $6,092 billion.

Present Value of Estimated OASDI Expenditures in Excess of Income with Various Death Rate Assumptions
Valuation Period: 2002-2076

Average Annual Reduction in Death Rates	0.32%	0.75%	1.33%
Expenditures in excess of income (In billions of present-value dollars)	$3,300	$4,562	$6,092

Real-Wage Differential

The following table shows the present values of the estimated OASDI expenditures in excess of income for the 75-year period, using various assumptions about the ultimate real-wage differential. These assumptions are that the ultimate real-wage differential will be 0.6, 1.1, and 1.6 percentage points, where 1.1 percentage point is the intermediate assumption in the 2002 Trustees' Report. In each case, the ultimate annual increase in the CPI is assumed to be 3.0 percent (as used in the intermediate assumptions), yielding ultimate percentages increases in the average annual wage in covered employment of 3.6, 4.1, and 4.6 percent, respectively.

As the following table demonstrates, if the ultimate real-wage differential is changed from 1.1 percentage point, the Trustees' intermediate assumption, to 0.6 percentage point, the shortfall for the period of estimated OASDI income relative to expenditures would increase to $5,028 billion from $4,562 billion; if the ultimate real-wage differential were changed from 1.1 to 1.6 percentage points, the shortfall would decrease to $3,873 billion.

Present Value of Estimated OASDI Expenditures in Excess of Income with Various Ultimate Real-Wage Assumptions
Valuation Period: 2002-2076

Ultimate percentage change in wages, CPI	3.6% - 3.0%	4.1% - 3.0%	4.6% - 3.0%
Expenditures in excess of income (In billions of present-value dollars)	$5,028	$4,562	$3,873

Differences among the estimates of annual net cashflow based on the three assumptions about the ultimate real-wage differential become apparent early in the projection period. Higher real-wage differentials increase both wages and initial benefit levels. Because the effects on wages and, therefore, on payroll taxes are immediate, while the effects on benefits occur with a substantial lag, annual net cashflow is higher (less negative in later years) for higher assumed real-wage differentials. In the early years, when the effects on benefits are quite small and while the effects on wages are compounding, the patterns of the estimates of annual net cashflow based on the three assumptions diverge fairly rapidly.

Total Fertility Rate

The following table shows the present value of the estimated excess of OASDI expenditures over income for the 75-year period, using various assumptions about the ultimate total fertility rate. These assumptions are 1.7, 1.95, and 2.2 children per woman, where 1.95 is the intermediate assumption in the 2002 Trustees' Report. The total fertility rate is assumed to change from its current level and to reach the selected ultimate value in 2026.

As the following table demonstrates, if the ultimate total fertility rate is changed from 1.95 children per woman, the Trustees' intermediate assumption, to 1.7, the shortfall for the period of estimated OASDI income relative to expenditures would increase to $5,041 billion, from $4,562 billion; if the ultimate rate were changed to 2.2, the shortfall would decrease to $4,102 billion.

Present Value of Estimated OASDI Expenditures in Excess of Income with Various Ultimate Total Fertility Rate Assumptions Valuation Period: 2002-2076

Ultimate total fertility rate (children per woman)	1.7	1.95	2.2
Expenditures in excess of income (In billions of present-value dollars)	$5,041	$4,562	$4,102

Consumer Price Index

The following table shows the present value of the estimated OASDI expenditures in excess of income for the 75-year period, using various assumptions about the ultimate rate of change in the CPI.

These assumptions are that the ultimate annual increase in the CPI will be 2.0, 3.0, and 4.0 percent, where 3.0 percent is the intermediate assumption in the 2002 Trustees' Report. In each case, the ultimate real-wage differential is assumed to be 1.1 percentage point (as used in the intermediate assumptions), yielding ultimate percentage increases in average annual wages in covered employment of 3.1, 4.1, and 5.1 percent, respectively.

As the following table demonstrates, if the ultimate annual increase in the CPI is changed from 3.0 percent, the Trustees' intermediate assumption, to 2.0 percent, the shortfall for the period of estimated OASDI income relative to expenditures would increase to $4,907 billion, from $4,562 billion; if the ultimate annual increase in the CPI were changed to 4.0 percent, the shortfall would decrease to $4,191 billion. This seemingly counter-intuitive result—that higher CPI-increases result in decreased shortfalls, and vice versa—occurs because varying CPI-increases while retaining the same annual real-wage differentials affects earnings (and, therefore, taxes) sooner than benefits (and, therefore, expenditures).

Present Value of Estimated OASDI Expenditures in Excess of Income with Various Ultimate CPI-Increase Assumptions Valuation Period: 2002-2076

Ultimate percentage change in wages, CPI	3.1% - 2.0%	4.1% - 3.0%	5.1% - 4.0%
Expenditures in excess of income (In billions of present-value dollars)	$4,907	$4,562	$4,191

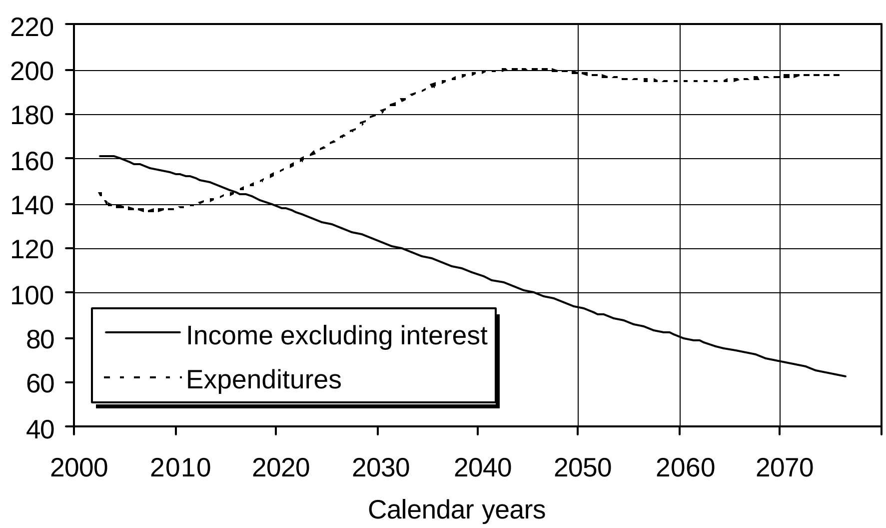
Federal Hospital Insurance Medicare Part A

Federal Hospital Insurance (Medicare Part A) Trust Fund revenue consists primarily of taxes on earnings paid by employees, their employers, and the self-employed. The fund also receives revenue from part of the taxation of Social Security benefits and from interest on its investments in Treasury securities. Revenues not needed to pay current benefits of the Medicare Part A program or administrative expenses are invested in special issue Treasury securities.

The present values of actuarial estimates were computed as of the beginning of the valuation period, January 1, 2002. The contributions consist of the sum of the present value of various program income items expected to be received through fiscal 2076. The expenditure consists of the sum of the present value of estimated payments through fiscal 2076, claims incurred through September 30, 2002, which were unpaid as of that date, and administrative expenses related to those claims. Under intermediate assumptions from the 2002 Trustees' Report, and based on current legislation in place, the fund is projected to be exhausted in calendar year 2030.

Chart 5—Present Value of Estimated Medicare Part A Income (Excluding Interest) and Expenditures 2002-2076

(In billions of dollars)

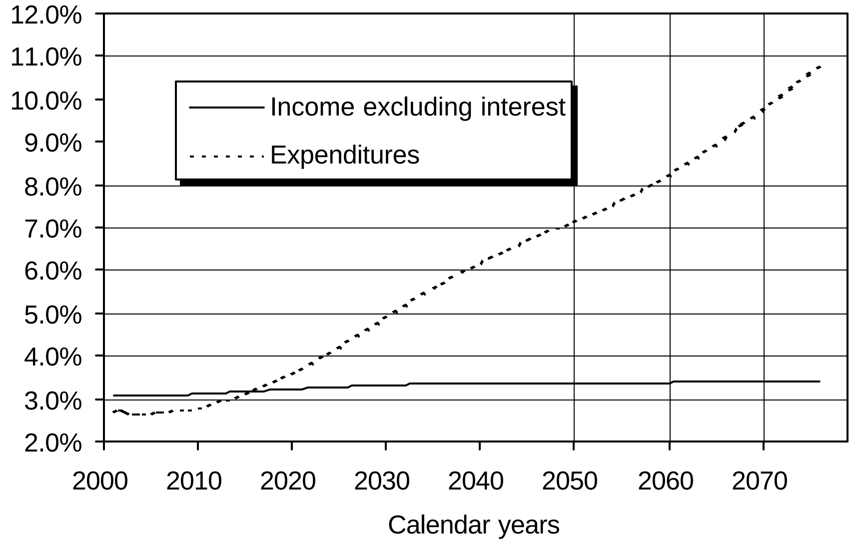


Medicare Part A Cashflow as a Percentage of Taxable Payroll

Each year, estimates of the financial and actuarial status of the Medicare Part A program are prepared for the next 75 years. Because of the difficulty in comparing dollar values for different periods without some type of relative scale, income and expenditure amounts are shown relative to the earnings in covered employment that are taxable under the Medicare Part A program (referred to as "taxable payroll").

Chart 6 illustrates income excluding interest and expenditures as a percentage of taxable payroll over the next 75 years. Although the long-range financial outlook for the Medicare Part A program has improved substantially in recent years because of the Balanced Budget Act of 1997, favorable economic conditions, and efforts to curb fraud and abuse, the program remains seriously underfunded through 2076. This is due in part to health care cost increases that exceed wage growth; a more significant cause, however, is the impending retirement of those born during the 1946-1965 baby boom.

Chart 6—Estimated Medicare Part A Income (Excluding Interest) and Expenditures as a Percentage of Taxable Payroll 2002-2076

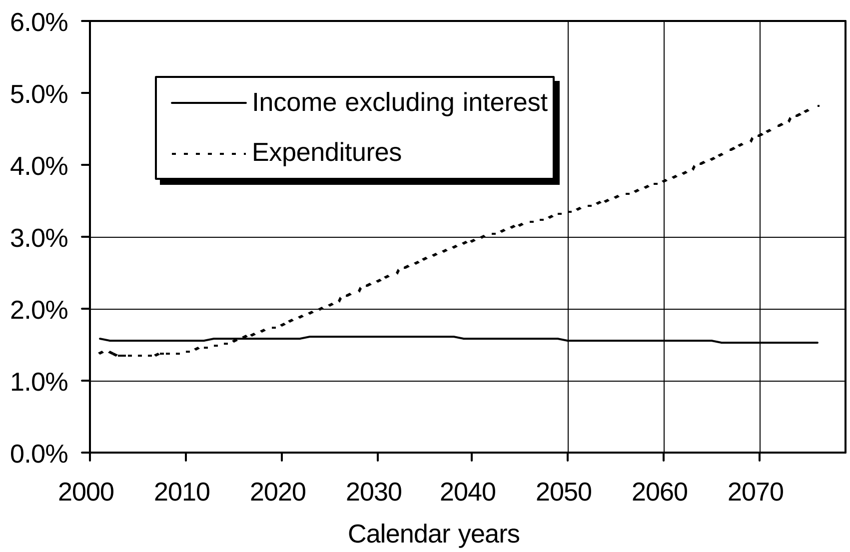


Medicare Part A Cashflow as a Percentage of Gross Domestic Product

Expressing Medicare-incurred disbursements as a percentage of GDP gives a relative measure of the size of the program compared to the general economy. GDP represents the total value of goods and services produced in the United States. This measure provides an idea of the relative financial resources that will be necessary to pay for Medicare services.

Chart 7 shows income excluding interest and expenditures for the Medicare Part A program over the next 75 years expressed as a percentage of GDP. In 2001, the expenditures were $143.4 billion, which was 1.4 percentage of GDP. Following slight reductions in 2003 and 2004, this percentage increases steadily throughout the entire 75-year period.

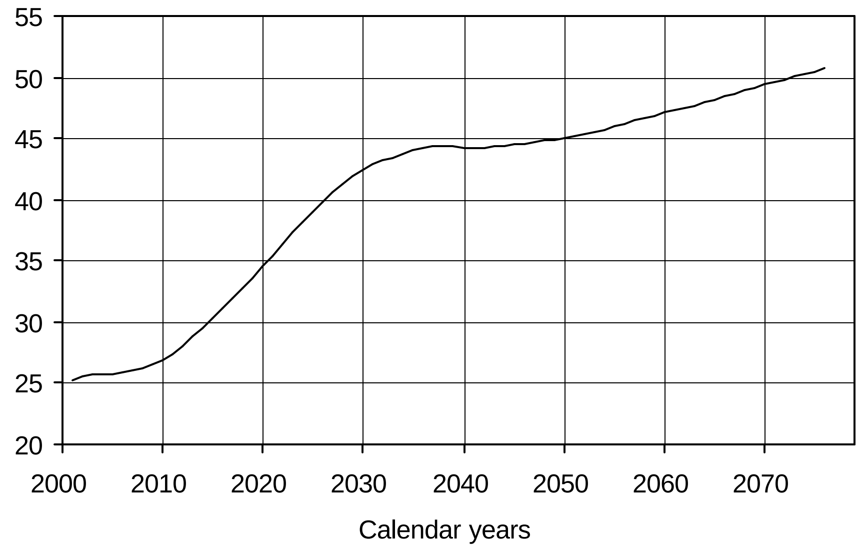
Chart 7—Estimated Medicare Part A Income (Excluding Interest) and Expenditures as a Percentage of GDP 2002-2076



Worker-to-Beneficiary Ratio

Another way to evaluate the long-range outlook of the Medicare Part A program is to examine the projected number of Medicare Part A beneficiaries per 100 covered workers. Chart 8 illustrates this ratio over the next 75 years. For the most part, current workers pay for current benefits. The relatively smaller number of persons born after the baby boom will therefore finance the retirement of the baby-boom generation. In 2001, a group of 100 workers provided benefits for 25 beneficiaries. In 2030, however, after the last baby boomer turns 65, a group of 100 workers will provide benefits to 42 beneficiaries. The projected ratio continues to increase until there will be 51 beneficiaries per 100 workers in 2076.

Chart 8—Estimated Number of Medicare Part A Beneficiaries per 100 Covered Workers 2002-2076



Actuarial Assumptions and Sensitivity Analysis

In order to make projections regarding the future financial status of the Medicare Part A and Medicare Part B programs, various assumptions have to be made. First, the estimates presented here are based on the assumption that the programs will continue under present law. In addition, the estimates depend on many economic and demographic assumptions, including changes in wages and the CPI, fertility rates, immigration rates, and interest rates. In most cases, these assumptions vary from year to year during the first 5 to 30 years before reaching their ultimate values for the remainder of the 75-year projection period.

The following chart and amounts are presented for analysis of the major assumptions influencing estimates in Medicare's future cashflows. Present value amounts attempt to demonstrate what future cashflow amounts would be if shown in today's dollars. Discounting or removing the increase in these cashflows that is caused by interest, sometimes referred to as inflation, does this. Even small changes in the estimated amount of future interest over the next 75 years have dramatic impact on present value calculations. Given the cashflow assumptions between the highest and lowest expected interest assumptions, the present value of Medicare Part A expenditures over income ranges from $7,892 billion to $3,812 billion using interest rates of 2.2 percent to 3.7 percent, respectively.

Charts of cashflows with varying assumptions that have not been adjusted for interest, as well as other assumptions that are not expected to have a material impact on Medicare, can be found in the CMS Financial Report and on the web at **www.cms.gov**.

The following table shows some of the underlying assumptions used in the projections of Medicare spending displayed in this report. Further details on these assumptions are available in the OASDI and Medicare Trustees' Reports for 2002.

Medicare Intermediate Assumptions

Year	Fertility Rate[1]	Net Immigration	Real Wage Differential[2]	Annual Percentage Change in: Wages	CPI	Real GDP	Real Interest Rate[3]
2002	2.13	900,000	1.8	3.1	1.3	0.7	3.6
2005	2.10	900,000	1.2	4.1	2.9	3.2	3.5
2010	2.07	900,000	1.0	4.1	3.0	2.2	3.0
2020	1.99	900,000	1.1	4.1	3.0	1.8	3.0
2030	1.95	900,000	1.1	4.1	3.0	1.8	3.0
2040	1.95	900,000	1.1	4.1	3.0	1.8	3.0
2050	1.95	900,000	1.1	4.1	3.0	1.7	3.0
2060	1.95	900,000	1.1	4.1	3.0	1.7	3.0
2070	1.95	900,000	1.1	4.1	3.0	1.7	3.0
2076	1.95	900,000	1.1	4.1	3.0	1.6	3.0

[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 2026.
[2] 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.
[3] Average rate of interest earned on new trust fund securities, beyond rate of inflation.

Estimates made in prior years have changed substantially sometimes because of revisions to the assumptions, which are due either to changed conditions or to more recent experience. Furthermore, it is important to recognize that actual conditions are very likely to differ from the projections presented here, since the future cannot be anticipated with certainty. In order to illustrate the magnitude of the sensitivity of the long-range projections, three of the key assumptions were varied individually to determine the impact on the Medicare Part A actuarial present values and net cashflow. The assumptions varied were health care cost factors, the fertility rate, and the real-wage differential.

The sensitivity of the projected Medicare Part A 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 Medicare Part A mortality sensitivity. CMS is sponsoring a current research effort that is expected to provide the information necessary to produce such estimates.

For this analysis, the intermediate economic and demographic assumptions in the *2002 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Trust Funds* are used as the reference point. Each selected assumption is varied individually to produce three scenarios. All present values are calculated as of January 1, 2002, and are based on estimates of income and expenditures during the 75-year projection period.

Health Care Costs

The following table shows the net present value of cashflow during the 75-year projection period under three alternative assumptions of the annual growth rate in the aggregate cost of providing covered health care services to beneficiaries. These assumptions are that the ultimate annual growth rate in such costs, relative to taxable payroll, will be 1 percent slower than the intermediate assumptions, the same as the intermediate assumptions, and 1 percent faster than the intermediate assumptions. In each case, the taxable payroll will be the same as that which was assumed for the intermediate assumptions.

Present Value of Estimated Medicare Part A Expenditures in Excess of Income under Various Health Care Cost Assumptions			
Annual cost/payroll relative growth rate	-1 percentage point	Intermediate assumptions	+1 percentage point
Expenditures in excess of income (In billions of present-value dollars)	$906	$5,126	$12,047

The above table demonstrates that if the ultimate growth rate assumption is 1 percentage point lower than the intermediate assumptions, the deficit of expenditures in excess of income decreases from $5,126 to $906. On the other hand, if the ultimate growth rate assumption is 1 percentage point higher than the intermediate assumptions, the deficit increases substantially to $12,047 billion.

Fertility Rate

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 table below shows the net present value of cashflow during the 75-year projection period under three alternative ultimate fertility rate assumptions: 1.7, 1.95, and 2.2 children per woman.

Present Value of Estimated Medicare Part A Expenditures in Excess of Income under Various Fertility Rate Assumptions			
Ultimate fertility rate	1.7	1.95	2.2
Expenditures in excess of income (In billions of present-value dollars)	$5,266	$5,126	$4,989

The table above demonstrates that if the assumed ultimate fertility rate is decreased from 1.95 to 1.7, the projected deficit of expenditures in excess of income increases from $5,126 billion to $5,266 billion. On the other hand, if the ultimate fertility rate is increased from 1.95 to 2.2 children per woman, the deficit decreases to $4,989 billion.

Real-Wage Differential

The following table shows the net present value of cashflow during the 75-year projection period under three alternative ultimate real-wage differential assumptions: 0.6, 1.1, and 1.6 percentage points. In each case, the CPI is assumed to be 3.0 percent, yielding ultimate percentage increases in average annual wages in covered employment of 3.6, 4.1, and 4.6 percent, respectively.

Present Value of Estimated Medicare Part A Expenditures in Excess of Income under Various Real-Wage Assumptions			
Ultimate percentage increase in wages—CPI	3.6% - 3.0%	4.1% - 3.0%	4.6% - 3.0%
Ultimate percentage increase in real-wage differential	0.6%	1.1%	1.6%
Expenditures in excess of income (In billions of present-value dollars)	$5,361	$5,126	$4,812

The above table demonstrates that if the ultimate real-wage differential assumption is decreased from 1.1 percentage points to 0.6 percentage points, the deficit of expenditures in excess of income increases from $5,126 billion to $5,361 billion. On the other hand, if the ultimate real-wage differential assumption is increased from 1.1 percentage points to 1.6 percentage points, the deficit decreases to $4,812 billion.

Federal Supplementary Medical Insurance Medicare Part B

The Medicare Part B program differs fundamentally from the Medicare Part A program by the way it is financed. In particular, Medicare Part B financing is not based on payroll taxes; instead, it is based on monthly premiums and income from the general fund of the U.S. Treasury. General fund transfers account for approximately 75 percent of the Medicare Part B Trust Fund's income.

Since the income to the Medicare Part B Trust Fund from beneficiary premiums and the general fund is adjusted annually to match expected costs, the trust fund is always in actuarial balance. By law, income and expenditures will continue to be virtually the same. However, as shown in the trust fund illustration on page 69, transfers from the general fund of the U.S. Treasury draw from the same resources as any other social insurance program that is experiencing a negative cashflow. Moreover, the general fund transfers occur from one account of the Government to another and do not represent an external, earmarked source of tax or other revenue. Therefore, for the purposes of this report, with the objective of presenting the financial operations of these programs from a Governmentwide consolidated perspective, transfers from the general fund of the Treasury are excluded. This is the same reason that interest earned on Federal debt securities is eliminated for this and all other social insurance programs—again, because such payments represent intragovernmental transfers.

The elimination of this major revenue source to the Medicare Part B Trust Fund produces information that appears to be significantly different from that presented in CMS' Financial Report, as well as the annual Trustees' Report on the Medicare Part B Trust Fund. From the perspective of the financial status of the Medicare Part B Trust Fund (as shown in CMS' Financial Report and the Trustees' Report), it is appropriate to consider all sources of income to the fund. Thus, the accounting treatment of Medicare Part B general revenues (and trust fund interest earnings) vary appropriately depending on whether an overall consolidated or trust fund perspective is shown.

Chart 9 shows the actuarial estimates of Medicare Part B premiums and expenditures for each of the next 75 years, in nominal dollars. Income includes monthly premiums paid by, or on behalf of, beneficiaries. Expenditures include benefit payments as well as administrative expenses.

Estimated Medicare Part B Premiums and Expenditures

Chart 9—Estimated Medicare Part B Premium Income and Expenditures 2002-2076

(In billions of dollars)

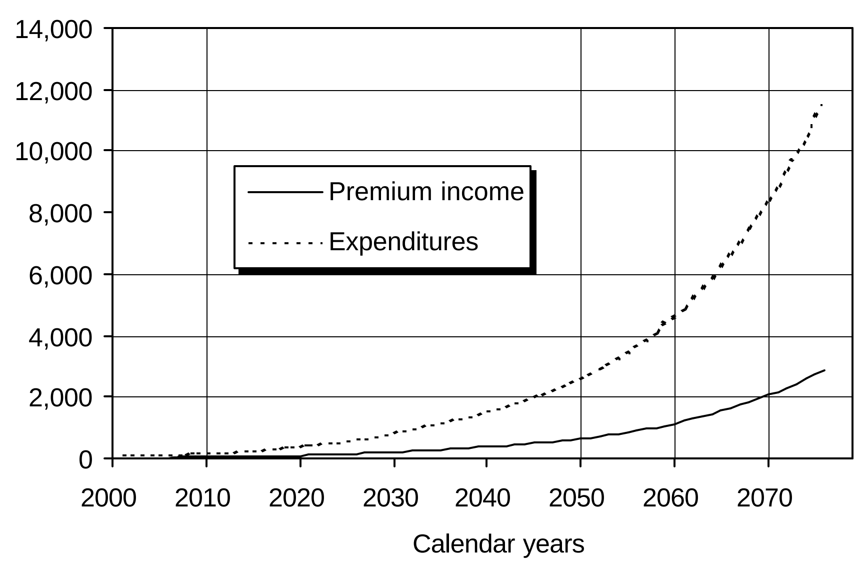
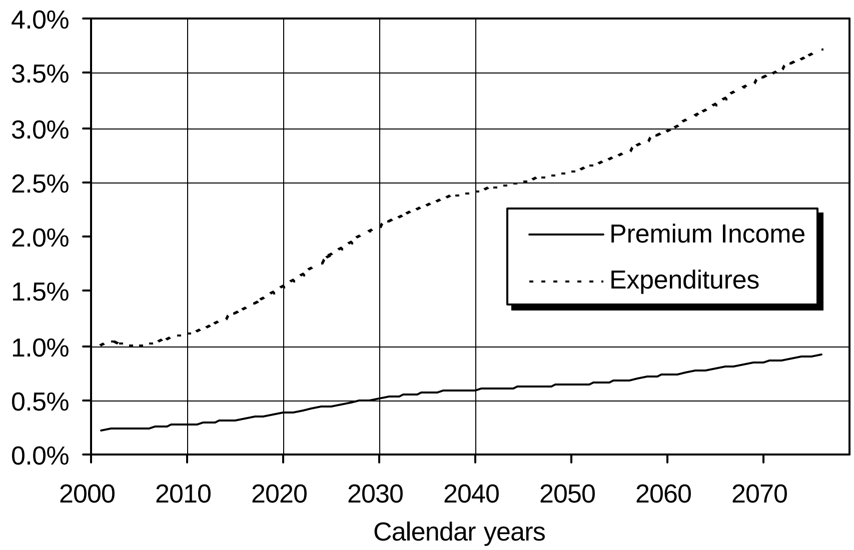


Chart 10 shows expenditures for the Medicare Part B program over the next 75 years expressed as a percentage of GDP. In 2001, Medicare Part B expenditures were $101.4 billion, which was 1.0 percent of GDP. After 2005, this percentage is projected to increase steadily, reflecting growth in the volume 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—Estimated Medicare Part B Premium Income and Expenditures as a Percentage of GDP 2002-2076



Estimated Medicare Part B Premiums and Expenditures

The Medicare Part B program's actuarial assumptions are the same as those used in Medicare Part A, presented on pages 77-82. Since the unique funding mechanism of Medicare Part B allows its trust fund to remain in actuarial balance, the data on various sensitivity analyses are not routinely compiled. It is planned that future editions of the *Financial Report* will regularly contain this information.

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 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.

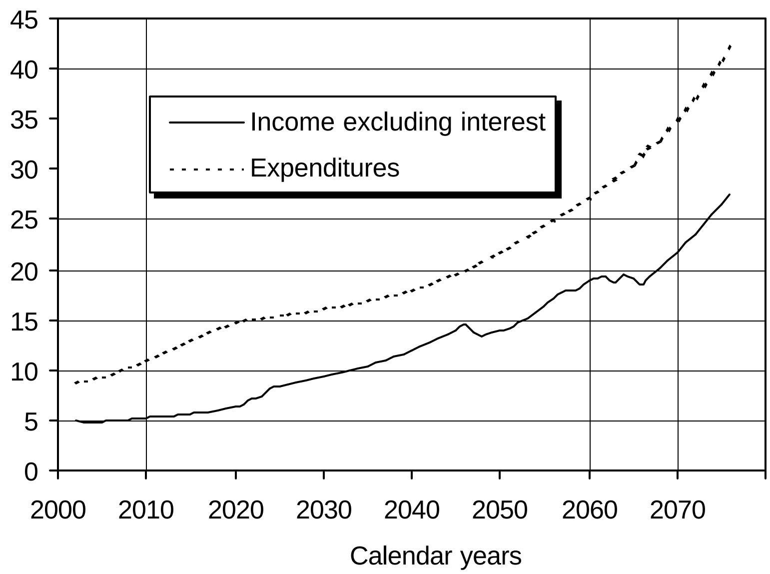
Payroll taxes paid by railroad employers and their employees provide the primary source of income for the Railroad Retirement Survivor Benefit program. By law, railroad retirement taxes are coordinated with Social Security taxes. Employees and employers pay tier I taxes at the same rate as Social Security 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 trust funds; interest 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).

RRSIA, enacted on December 21, 2001, provided several changes in benefit and financing provisions into law, including the transfer of the investment responsibility from the Railroad Retirement System Trust funds managed by the RRB to the newly created NRRIT (see page 67).

Chart 11—Estimated Railroad Retirement Income (Excluding Interest) and Expenditures 2002-2076

(In billions of dollars)



Railroad Retirement Program Actuarial Surplus (or Deficiency) [1,2]
Under Employment Assumption 2
75-Year Projection as of January 1, 2002

(In billions of present-value dollars)

Estimated future income (excluding interest) [3] **received from or on behalf of:**	
Former employees and dependents	51.1
Current employees and dependents	60.5
Future employees and dependents	30.8
All participants	142.4
Estimated future expenditures: [4]	
Former employees and dependents	73.8
Current employees and dependents	75.8
Future employees and dependents	12.8
All participants	162.4
Estimated future excess of income over expenditures	(20.0)

[1] Represents combined values for the Railroad Retirement Account, Social Security Equivalent Benefit Account, and National Railroad Retirement Investment Trust.

[2] The data used reflect the provisions of RRSIA of 2001. Comparable data for prior to fiscal 2001 by participant groupings are not available. Following is the actuarial surplus (in millions) under the prior law as of the dates stated below:

September 30, 1998	$4,083
September 30, 1999	7,292
September 30, 2000	10,238

[3] Future income (excluding interest) includes tier I taxes, tier 2 taxes, income taxes on benefits, financial interchange income, advances from general revenues, and repayments of advances from general revenues. The calculations assume that all future transfers required by current law under the financial interchange will be made.

[4] Future expenditures include benefit and administrative costs.

Note: Detail may not add to totals due to rounding. Employee and beneficiary status are determined as of 1/1/2001, whereas present values are as of 1/1/2002.

The average railroad employment is assumed to be 237,000 in 2001. The employment assumption that is based on a model developed by the Association of American Railroads, assumes that (1) passenger employment will remain at the level of 45,000, 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.

Black Lung (Part C)

The Black Lung Disability program compensates eligible coal miners who are disabled because of employment-related pneumoconiosis (black lung disease). The program provides both medical and survivor benefits. Under Part C, the Black Lung Disability Trust Fund (BLDTF) provides benefit payments to eligible disabled miners when no responsible mine operator can be assigned the liability. The Department of Labor (DOL) administers Part C of the Black Lung Disability Benefits program.

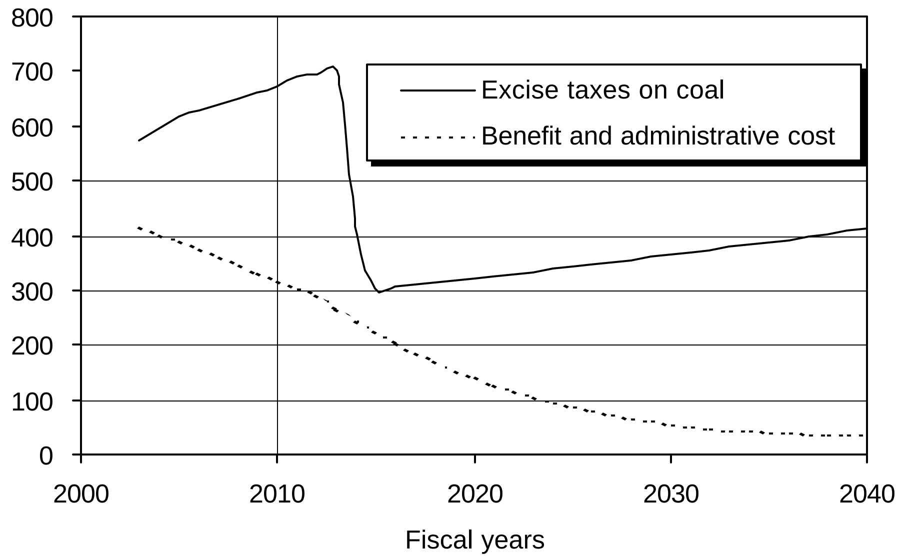
Excise taxes on coal mine operators, based on the sale of coal, partially fund the black lung disability payments and the related administrative and interest costs. Intragovernmental advances to the BLDTF, which must be repaid with interest, fund the shortfall.

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 57 percent decrease in excise tax collections. By the year 2040, the rate reduction is expected to decrease cash inflows by more than $12.7 billion.

Chart 12 shows the estimated Black Lung expenditures (excluding interest payments) and excise tax collections for the period 2003-2040. Under the intermediate assumptions for the next 38 years, the Black Lung Trust Fund will collect $16.7 billion in excise taxes on coal and pay $6.4 billion for benefits and administrative costs. However, this favorable cashflow will not be sufficient to repay the intragovernmental debt that resulted from previous deficits. Currently this debt is $7.7 billion. Cumulative net cash outflows including interest payments on the debt are projected to reach $58.3 billion by the year 2040, increasing the debt to $49.3 billion on September 30, 2040.

Chart 12—Estimated Black Lung Expenditures and Excise Tax Collections 2003-2040

(In millions of dollars)



Unemployment Insurance

The Unemployment Insurance program was created in 1935 to provide temporary partial wage replacement to unemployed workers who lost their jobs. The program is administered through a unique system of Federal and State partnerships, established in Federal law, but executed through conforming State laws by State officials. DOL 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 States may borrow funds to pay benefits.

Estimated Unemployment Trust Fund Contributions and Expenditures
September 30, 2003–September 30, 2012
(Expected Economic Conditions)

Contributions to September 30, 2012	472.1
Expenditures to September 30, 2012	489.3
Expenditures in excess of contributions (In billions of current dollars)	17.2

Charts 13 through 15 demonstrate the effect on accumulated Unemployment Trust Fund assets of projected total cash inflows and cash outflows over a 10-year period ending September 30, 2012, 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 programs.

For expected economic conditions, the estimates are based on an expected unemployment rate of 5.68 percent during fiscal 2003, decreasing to 4.90 percent in fiscal 2008 and thereafter. Under the mild recessionary scenario, the expected unemployment rate will peak at 7.43 percent in fiscal 2004, and for the deep recession scenario, the expected unemployment rate will rise to 10.15 percent in fiscal 2005.

Chart 13—Estimated Unemployment Fund Cashflow
Using Expected Economic Conditions
2003-2012

(In billions of dollars)

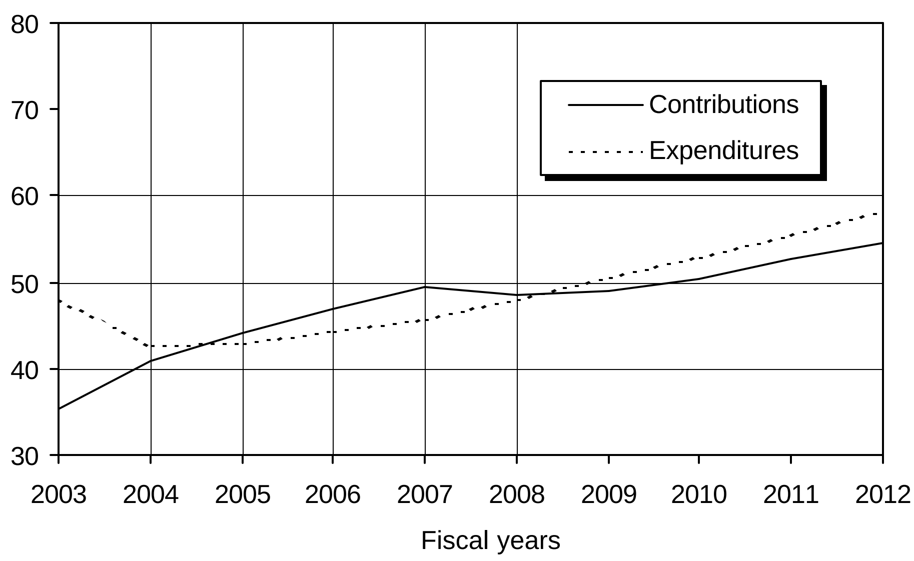


Chart 14—Estimated Unemployment Fund Cashflow Using a Mild Recessionary Unemployment Rate 2003-2012

(In billions of dollars)

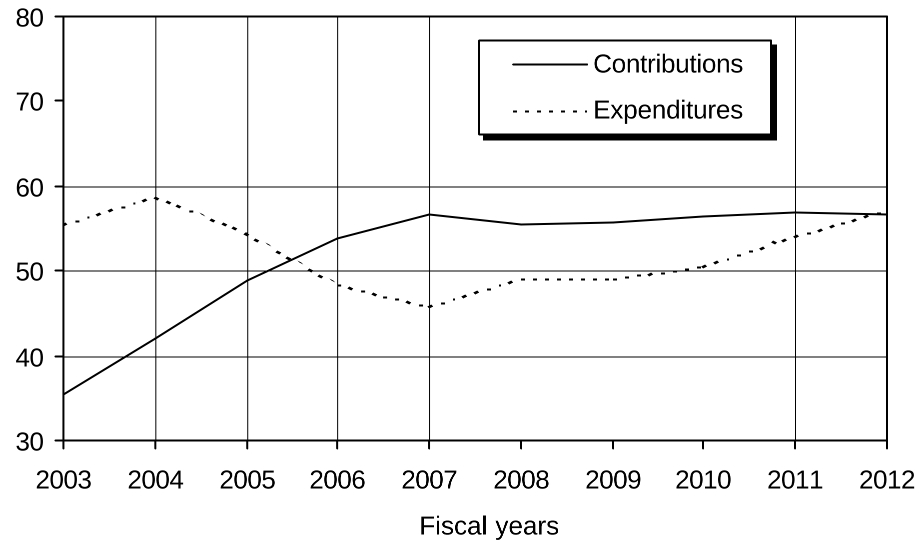
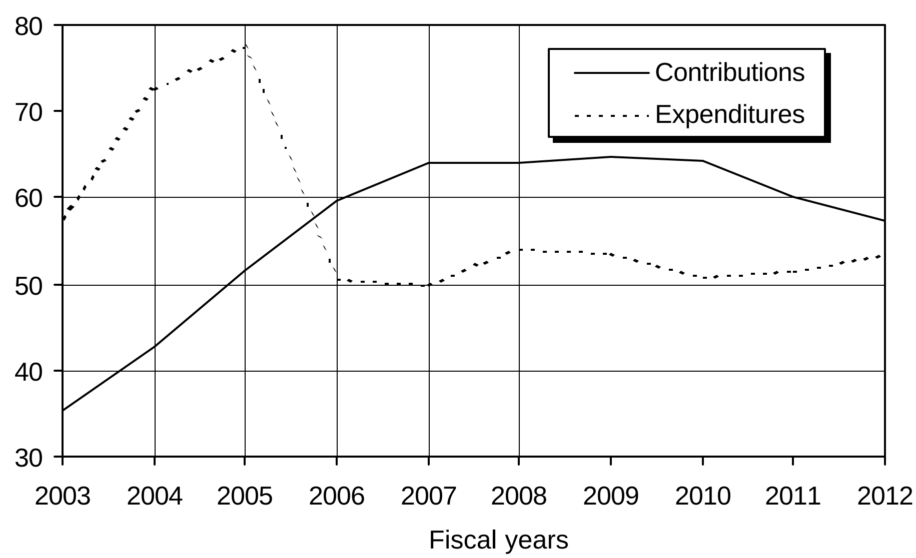


Chart 15—Estimated Unemployment Fund Cashflow Using a Deep Recessionary Unemployment Rate 2003-2012

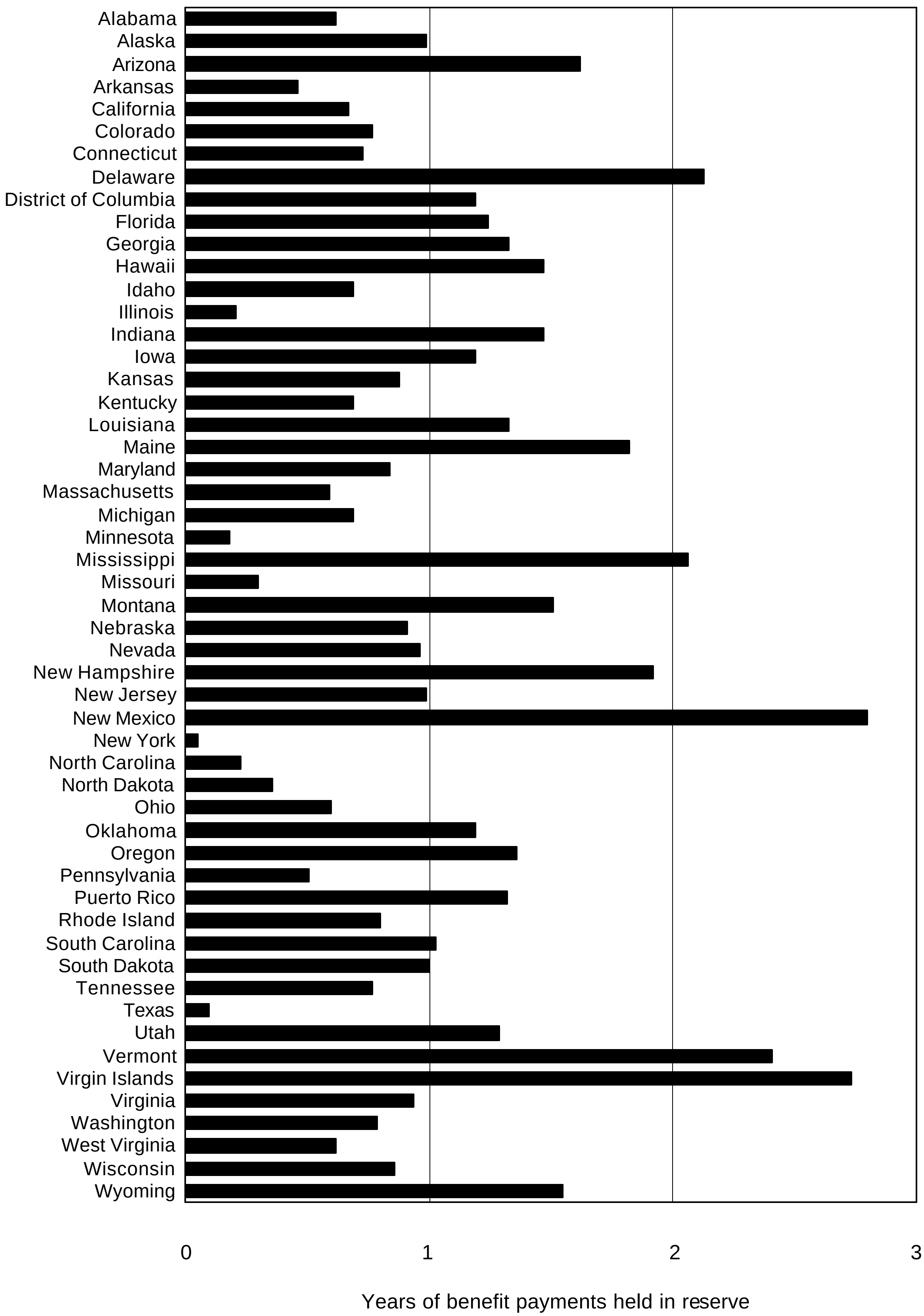
(In billions of dollars)



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.

Chart 16—Unemployment Trust Fund Solvency as of September 30, 2002



Stewardship Investments

Stewardship investments focus on Government programs aimed at providing long-term benefits by improving the Nation's productivity and enhancing economic growth. These investments can be provided through direct Federal spending or grants to State and local governments for certain education and training programs, research and development, and federally financed but not federally-owned property, such as bridges and roads. When incurred, these investments are included as expenses in determining the net cost of operations.

Stewardship Investments
for the Years Ended September 30

(In billions of dollars)	Fiscal 2002	Restated Fiscal 2001	Restated Fiscal 2000	Restated Fiscal 1999
Investments in non-Federal physical property	44.7	39.6	36.5	32.1
Investments in human capital	62.3	51.0	42.3	45.5
Research and development:				
Investments in basic research	22.9	19.2	18.6	17.4
Investments in applied research	21.7	17.9	16.6	16.3
Investments in development	44.5	39.5	38.8	40.9
Total investments	196.1	167.2	152.8	152.2

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 the table above. They are measured on the same accrual basis of accounting used in the *Financial Report* statements.

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.

Current Services Assessment

The Current Services Assessment table shows the Office of Management and Budget's (OMB's) estimate of budget receipts, outlays, and surplus or deficit if no changes were made to laws that have already been enacted. Receipts and mandatory outlays, such as Social Security benefits and net interest, involve ongoing activities that generally operate under permanent legal authority; the underlying statutes generally specify the tax rates or benefit rates, and the conditions for who must pay taxes or who is eligible to receive benefits. The current services estimates of receipts and mandatory spending assume that they continue in the future as specified by current laws. Discretionary spending is spending that generally is funded by annual appropriations acts. The current services estimates for discretionary spending assume that discretionary funding for fiscal 2003 is based on enacted appropriations for DOD and extension of the continuing resolution to cover the entire year for other appropriations. It also assumes that discretionary funding for subsequent years holds constant in real terms.

Because laws already enacted provide the basis for current services estimates, they do not constitute a proposed budget. For the same reason, they do not predict the most likely budget outcomes.

The current services estimates may be used to help assess the sustainability of programs under current law. That is, they may be used to project whether future resources can sustain public services and meet obligations as they come due. In this way, they can warn of future problems inherent in current law. They also can provide a benchmark against which tax and spending proposals can be compared to assess the magnitude of proposed changes. Moreover, they can provide an analytical perspective on Government by showing the short- and medium-term direction of programs under current law.

The following schedule presents the actual budget results for fiscal 2002 and the current services estimates for all Federal taxes and spending programs for the subsequent 6 years. It shows receipts by source and outlays by function. The estimates for these years are the same as the current services estimates published in the President's budget for fiscal 2004.

Current Services Assessment Receipt and Outlay Estimates as Presented in the President's Budget

(In billions of dollars)	Base Year 2002	Fiscal Year 2003	2004	2005	2006	2007	2008
Receipts by Source:							
Individual income taxes	858	877	954	1,029	1,095	1,163	1,236
Corporation income taxes	148	146	174	233	240	245	252
Social insurance and retirement receipts	701	727	765	812	848	888	925
Excise taxes	67	68	71	73	75	77	79
Other receipts	79	74	83	88	95	97	101
Adjustment for revenue uncertainty	-	(25)	(15)	-	-	-	-
Total receipts	1,853	1,867	2,031	2,235	2,352	2,469	2,593
Outlays by Function:							
National defense	349	376	384	394	401	411	421
Social Security	456	478	497	515	537	563	592
Medicare	231	245	253	266	272	290	307
Income security	313	330	323	336	345	352	365
Health	197	222	239	257	276	296	317
Veteran benefits and services	51	56	59	64	64	63	69
Education, training, employment, and social services	71	84	83	81	82	83	84
Transportation	62	65	63	63	64	65	67
Other programmatic functions	160	169	173	174	174	177	180
Net interest	171	161	173	193	205	211	214
Undistributed offsetting receipts	(48)	(54)	(56)	(68)	(71)	(70)	(73)
Total outlays	2,011	2,131	2,189	2,276	2,348	2,440	2,541
Surplus or (deficit)	(158)	(264)	(158)	(40)	5	29	51

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

United States Government Notes to the Financial Statements for the Years Ended September 30, 2002 and September 30, 2001

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. This includes corporations that are part of the Government. The Appendix contains a list of significant Government entities included in these financial statements, as well as a partial list of entities excluded. The financial reporting period ends September 30 and is the same used for the annual budget.

Material intragovernmental transactions were eliminated in consolidation, except as described in Note 16 Unreconciled Transactions Affecting the Change in Net Position.

B. Basis of Accounting and Revenue Recognition

This *Financial Report* is based on Generally Accepted Accounting Principles (GAAP). These principles typically recognize:

- Expenses when incurred.
- Non-exchange (unearned) revenues on a modified cash basis of accounting. Non-exchange revenues arise primarily from the exercise of the Government's power to tax and levy duties, fines and penalties. Remittances of non-exchange revenue are recognized when received. Related receivables are recognized when measurable and legally collectible. Refunds and other offsets are recognized when measurable and legally payable and are netted against non-exchange revenue.
- Exchange (earned) revenues when earned. Exchange (earned) revenues arise when a Government entity provides goods and services to the public for a price. Earned revenue represents revenue earned from user charges, such as admission fees to Federal parks and insurance premiums that are recognized when the Government provides the goods or services.

This basis of accounting differs from that used for budgetary reporting, which is primarily on a cash basis according to accepted budget concepts and policies. (See Reconciliations of Net Operating Cost and Unified Budget Surplus (or Deficit) on page 56.

This *Financial Report* presents comparative fiscal 2001 data. Some balances previously reported for fiscal 2001 are reclassified. Interest accrued by Treasury on debt held by the public, which was included in prior years in Note 9—Accounts Payable, is now reported in Note 10—Federal Debt Securities Held by the Public and Accrued Interest.

New for fiscal 2002 is the implementation of SFFAS No. 24. Under the provisions of SFFAS No. 24, two new principal statements are included in the *Financial Report*: Reconciliations of Net Operating Cost and Unified Budget Surplus (or Deficit) and Statements of Changes in Cash Balance from Unified Budget and Other Activities. These Statements reconcile net operating cost with the President's budget surplus (or deficit) and explain how the annual budget surplus (or deficit), which is derived from the Treasury Central Accounting and Reporting System, relates to the change in the Government's operating cash.

In addition, SFFAS No. 21, *Reporting Corrections of Errors and Changes in Accounting Principles*, was also implemented at the Governmentwide reporting level for fiscal 2002. SFFAS No. 21 amends SFFAS No. 7 to require that reporting entities restate prior period financial statements for material errors discovered in the current period, if such statements are provided for comparative purposes, and if the effect of error would be material to the financial statements in either period.

C. Direct Loans and Loan Guarantees

Direct loans obligated and loan guarantees committed after fiscal 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 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 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.

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. Refer to the Stewardship Information section for assets excluded in this 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 and past service cost, if any) are recognized immediately in the year they occur, without amortization. Due to the effect of Public Law No. 106-398 (National Defense Authorization Act) enacted October 30, 2000, TRICARE benefits are extended to military retirees and their beneficiaries eligible for Medicare.

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 information is disclosed in the Supplemental Information to the Financial Statements.

Deferred maintenance expenses are not accrued in the Statements of Net Cost or recognized as liabilities on the Balance Sheets.

J. Commitments and Contingencies

In the normal course of business, the Government has a number of unfulfilled commitments that will require the use of its financial resources. Note 18—Commitments and Contingencies 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.

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.

K. 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 19—Dedicated Collections.

L. 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 $603 billion and $558 billion of Treasury securities held by the public as of September 30, 2002, and 2001, respectively. FRB earnings that exceed statutory amounts of surplus established for FRBs are paid to the Government and are recognized as non-exchange revenue. Those earnings totaled $23.7 billion and $26.1 billion for the years ended September 30, 2002, and 2001, 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)	2002	2001
Operating cash	60.9	44.2
Other cash	28.3	14.2
Total cash	89.2	58.4
International monetary assets	41.0	38.1
Gold	10.9	10.9
Domestic monetary assets	0.5	0.6
Total cash and other monetary assets	141.6	108.0

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 $27.4 billion and $13.4 billion as of September 30, 2002, and 2001, respectively. These balances compensate financial institutions for services provided to the Government, such as maintaining zero-balance accounts for the collection of public monies. 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), 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 required payment to the IMF is made in the form of reserve assets; the remainder is payable in the form of a letter of credit from the United States to the IMF.

The balance available under the letter of credit totaled $28.2 billion and $29.3 billion for the years ended September 30, 2002, and 2001, respectively. The U.S. reserve position in the IMF has a U.S. dollar equivalent of $20.9 billion and $18.4 billion for the years ended September 30, 2002, and 2001, 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 $11.7 billion and $10.9 billion equivalent for the years ended September 30, 2002, and 2001, 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, 2002, and 2001, respectively, and are included in Note 14—Other Liabilities.

As of September 30, 2002, and 2001, other liabilities included $6.5 billion and $6.3 billion, respectively, of interest-bearing liability to the IMF on the ESF balance sheet 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, 2002, and 2001. The market value of gold on the London Fixing as of the reporting date was $323.70 and $293.10 per fine troy ounce for the years ended September 30, 2002, and 2001, respectively. Gold totaling $10.9 billion for each year ended September 30, 2002, and 2001, 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, 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 $15.3 billion and $17.2 billion for the years ended Septemb er 30, 2002, and 2001, respectively.

Accounts Receivable as of September 30

(In billions of dollars)	2002	2001
Department of Defense	6.4	4.6
Social Security Administration	5.7	4.4
Department of Energy	4.4	4.6
Department of Health and Human Services	4.1	4.2
Department of Agriculture	1.9	2.3
Department of Interior	1.3	1.6
Department of Veterans Affairs	1.2	1.3
Department of the Treasury	0.8	0.5
Department of Housing and Urban Development	0.8	0.8
Tennessee Valley Authority	0.6	0.7
Department of Labor	0.6	0.6
Federal Communications Commission	0.5	0.8
Environmental Protection Agency	0.5	0.5
Department of Education	0.2	2.6
All other departments	3.0	4.7
Total accounts receivable, net	32.0	34.2

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 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 year-end. 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	
	2002	2001	2002	2001	2002	2001	2002	2001	2002	2001
Direct Loan Programs:										
Federal Direct Student Loans ...	80.0	70.5	(4.8)	(4.3)	84.8	74.8			0.9	1.8
Rural Utilities Service	39.5	38.8	3.1	3.7	36.4	35.1			0.2	0.5
Rural Housing Service.............	28.2	28.8	7.2	5.3	21.0	23.5			(0.3)	1.1
Federal Family Education Loans.	17.8	19.5	11.5	13.9	6.3	5.6			-	-
Food for Progress credits	10.2	10.5	5.5	5.9	4.7	4.6			(0.3)	-
U.S. Agency for International Development	9.0	9.6	3.3	4.3	5.7	5.3			-	-
Housing and Urban Development	8.5	8.6	0.5	0.4	8.0	8.2			-	-
Agricultural Credit Insurance Fund	4.4	4.3	1.4	1.5	3.0	2.8			0.1	2.2
Direct Loans for Spectrum auction sales	5.3	5.6	-	(0.4)	5.3	6.0			-	(5.5)
Export Credit Guarantees	6.9	7.1	3.2	3.7	3.7	3.4			-	-
Export-Import Bank Loans	7.5	7.6	(0.2)	(0.1)	7.7	7.7			0.1	0.1
Disaster Loan programs	3.2	3.6	(0.6)	(0.1)	3.8	3.7			0.1	1.8
All other programs...................	28.4	29.5	(0.4)	1.3	28.8	28.2			0.3	(1.4)
Total	248.9	244.0	29.7	35.1	219.2	208.9			1.1	0.6
Guaranteed Loan Programs:										
Federal Family Education Loans.	182.0	160.0	11.7	8.4			179.0	157.0	4.5	(0.3)
Subsidized Federal Housing Administration Loans	106.8	107.9	5.5	6.9			95.8	95.9	(0.6)	-
Export-Import Bank guarantees ..	30.3	29.6	1.7	3.2			30.3	29.6	1.8	1.3
Veterans Housing Benefit program................................	216.1	218.5	5.6	5.3			69.5	71.4	(0.1)	-
Small Business Loans	50.1	46.6	1.5	1.1			40.4	37.5	0.7	(0.1)
Israeli Loan Guarantee program..	9.2	9.2	0.7	0.6			9.2	9.2	-	-
Urban and Environmental program	2.1	2.2	0.4	0.5			2.1	2.2	-	-
Overseas Private Investment Corporation Credit program	3.0	3.4	0.5	0.6			3.0	3.4	-	-
Rural Housing Service.............	13.9	13.0	0.3	0.4			12.5	11.6	(0.1)	-
Health Education Assistance Loans...................................	2.7	3.2	0.3	0.4			2.7	3.2	-	-
Export Credit Guarantee programs	4.9	4.4	0.4	0.3			4.7	4.3	-	-
Unsubsidized Federal Housing Administration Loans	501.3	493.7	(1.7)	(0.9)			467.7	459.5	(2.6)	-
All other programs...................	22.0	21.3	1.2	0.9			19.3	18.9	0.2	(0.8)
Total	1,144.4	1,113.0	28.1	27.7			936.2	903.7	3.8	0.1

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 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 1965, has both direct and 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 is 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 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 farm ownership, emergency, and disaster loans.

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 $0.1 billion and $0.1 billion for the years ended September 30, 2002, and 2001, respectively.

Taxes Receivable as of September 30

(In billions of dollars)	2002	2001
Gross taxes receivable	89.4	82.2
Allowance for doubtful accounts	(68.0)	(61.1)
Taxes receivable, net	21.4	21.1

Note 6. Inventories and Related Property, Net

Inventories and Related Property as of September 30

(In billions of dollars)	Defense 2002	All Others 2002	Total 2002	Defense 2001	All Others 2001	Total 2001
Inventory purchased for resale	59.4	0.5	59.9	54.5	0.5	55.0
Inventory held in reserve for future sale	2.8	-	2.8	3.9	-	3.9
Inventory held for repair	42.0	0.8	42.8	25.1	0.9	26.0
Inventory—Excess, obsolete and unserviceable	4.5	-	4.5	11.8	-	11.8
Operating materials and supplies held for use	74.9	4.6	79.5	49.1	2.8	51.9
Operating materials and supplies held in reserve for future use	5.1	0.1	5.2	34.5	4.9	39.4
Operating materials and supplies—Excess, obsolete and unserviceable	1.9	0.1	2.0	1.7	-	1.7
Stockpile materials	2.1	38.3	40.4	2.4	37.7	40.1
Other related property	2.3	3.7	6.0	2.3	2.7	5.0
Total allowance for inventories and related property	(48.9)	(2.0)	(50.9)	(49.3)	(1.7)	(51.0)
Total inventories and related property, net	146.1	46.1	192.2	136.0	47.8	183.8

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

Inventory purchased for resale is the cost or value of tangible personal property purchased by an agency for resale. DOD, 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 held for repair is damaged inventory, and operating materials and supplies that require repair to make it suitable for sale (inventory), or is more economical to repair than to dispose of (operating materials and supplies).

Inventory—Excess, Obsolete, and Unserviceable inventory:

- 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, uses LAC and Standard Price under the purchase and consumption methods of accounting to value operating materials and supplies and does not adjust for holding gains and losses, which does not approximate historical cost.

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 that are 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. Certain types of tangible assets, collectively referred to as national defense assets, are currently a category of Stewardship Information that is not required to be reported in these Statements.

FASAB has recommended SFFAS No. 23, *Eliminating the Category National Defense Property, Plant and Equipment*, which removes national defense assets from Stewardship Information and includes them on the Balance Sheet as part of property, plant and equipment. SFFAS No. 23 is currently pending final approval by Congress.

Property, Plant and Equipment as of September 30

(In billions of dollars)	Cost	Accumulated Depreciation/ Amortization	Net	Cost	Accumulated Depreciation/ Amortization	Net
	2002			2001		
Buildings, structures, and facilities	301.0	146.7	154.3	292.8	141.6	151.2
Furniture, fixtures, and equipment	177.4	99.0	78.4	160.3	89.0	71.3
Construction in progress	61.5	N/A	61.5	54.4	N/A	54.4
Land and land improvements	31.3	7.9	23.4	32.0	8.8	23.2
Automated data processing software	6.9	3.2	3.7	5.7	2.9	2.8
Assets under capital lease	1.9	0.7	1.2	1.7	0.6	1.1
Leasehold improvements	3.3	1.6	1.7	3.1	1.4	1.7
Other property, plant and equipment	0.5	-	0.5	1.0	-	1.0
Total property, plant and equipment, net	583.8	259.1	324.7	551.0	244.3	306.7

Note 8. Other Assets

Other Assets as of September 30

(In billions of dollars)	2002	2001
Securities and investments	36.1	35.6
Advances and prepayments	22.9	21.5
Other	6.4	6.3
Total other assets	65.4	63.4

Securities and investments are presented at cost, net of unamortized premiums and discounts.

Note 9. Accounts Payable

Accounts Payable as of September 30

(In billions of dollars)	2002	2001
Department of Defense	24.9	23.2
Department of Energy	3.3	3.7
Department of Agriculture	3.1	3.3
Department of Veterans Affairs	2.6	2.4
Department of Transportation	2.5	3.5
National Aeronautics and Space Administration	2.4	2.8
Department of Justice	2.4	2.0
United States Postal Service	2.3	2.0
General Services Administration	2.0	1.9
Department of Housing and Urban Development	1.4	1.5
Tennessee Valley Authority	1.3	1.4
Department of Treasury - excluding interest on debt	1.2	0.7
Agency for International Development	1.1	1.2
Department of Health and Human Services	0.7	0.6
Executive Office of the President	0.1	0.9
All other departments	4.5	5.1
Total accounts payable	55.8	56.2[1]

[1] See Note 1B- Basis of Accounting and Revenue Recognition.

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

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, 2001	Net Change During Fiscal 2002	Balance September 30, 2002	Average Interest Rate 2002	Average Interest Rate 2001
Treasury Securities (Public):					
Marketable securities					
Treasury bills	734.8	133.4	868.2	1.7%	3.5%
Treasury notes	1,528.1	87.2	1,615.3	4.7%	5.8%
Treasury bonds	652.3	(14.5)	637.8	8.0%	8.0%
Total marketable Treasury securities	2,915.2	206.1	3,121.3		
Non-marketable securities	424.1	7.7	431.8	6.0%	6.3%
Net unamortized premium/ (discounts)	(46.0)	6.7	(39.3)		
Total Treasury securities, net (public)	3,293.3	220.5	3,513.8		
Agency Securities:					
Tennessee Valley Authority	24.9	-	24.9		
All other agencies	1.6	-	1.6		
Total agency securities, net of unamortized premiums and discounts	26.5	-	26.5		
Accrued interest payable[1]	39.5	(6.6)	32.9		
Total Federal debt securities held by the public and accrued interest	3,359.3	213.9	3,573.2		

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.

[1] See Note 1B- Basis of Accounting and Revenue Recognition.

This table details Government borrowing to finance operations and shows marketable and non-marketable securities at face value including accrued interest and excluding unamortized discounts.

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, 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 2002 and 2001, the Secretary of the Treasury authorized the redemption of $12.5 and $33.8 billion of outstanding unmatured marketable Treasury securities at a premium of $3.8 and $10.6 billion, respectively. These early redemption transactions are known as Treasury “buybacks.” The net change of the Federal debt securities held by the public and accrued interest includes $12.5 billion and $33.6 billion during fiscal 2002 and 2001, respectively, related to these buybacks.

As of September 30, 2002, and 2001, respectively, $6,161.4 billion and $5,732.8 billion of debt was subject to a statutory limit (31 U.S.C. § 3101). That limit was $6,400 billion and $5,950 billion as of September 30, 2002, and 2001, 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 19- 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 2001	Net Change During Fiscal 2002	Balance 2002
Social Security Administration, Federal Old-Age and Survivors Insurance	1,034.1	139.6	1,173.7
Office of Personnel Management, civil service retirement and disability	542.6	31.1	573.7
Department of Health and Human Services, Hospital Insurance	197.1	31.8	228.9
Department of Defense, military retirement	157.0	5.4	162.4
Social Security Administration, Federal Disability Insurance	135.8	19.5	155.3
Department of Labor, unemployment	88.6	(20.3)	68.3
Department of Health and Human Services, Federal Supplementary Medical Insurance	42.0	(3.2)	38.8
Federal Deposit Insurance Corporation funds	44.0	0.5	44.5
Department of Transportation, Highway Trust Fund	24.1	(5.3)	18.8
Railroad Retirement Board	26.9	(1.6)	25.3
Office of Personnel Management, Employees' Life Insurance	23.7	1.6	25.3
Housing and Urban Development, Federal Housing	17.3	4.0	21.3
Department of Veterans Affairs	14.0	(0.1)	13.9
Department of Transportation, Airport and Airway Trust Fund	13.7	(2.7)	11.0
Department of Energy, nuclear waste disposal	21.1	2.3	23.4
All other programs and funds	86.2	4.2	90.4
Subtotal	2,468.2	206.8	2,675.0
Less: Unamortized net discounts	6.2	(4.7)	1.5
Total intragovernmental debt holdings, net	2,462.0	211.5	2,673.5

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. The Government offers both defined benefit and defined contribution pension plans. The largest are defined benefit plans. The changes in actuarial accrued post-retirement pension and health benefits liability and components of related expense for the years ended September 30, 2002, and 2001, respectively, are presented below.

Federal Employee and Veteran Benefits Payable as of September 30

(In billions of dollars)	Civilian[1] 2002	Civilian[1] 2001	Military 2002	Military 2001	Total[1] 2002	Total[1] 2001
Pension	1,129.8	1,112.9	730.0	708.3	1,859.8	1,821.2
Post-retirement health benefits	221.4	205.2	592.0	580.9	813.4	786.1
Veterans compensation and burial benefits	N/A	N/A	849.2	691.9	849.2	691.9
Liability for other benefits	46.9	41.1	20.1	20.5	67.0	61.6
Total Federal employee and veteran benefits payable	1,398.1	1,359.2	2,191.3	2,001.6	3,589.4	3,360.8

[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, 2001	1,112.9	708.3	1,821.2
Pension Expense:			
Normal costs	23.2	18.5	41.7
Interest on liability	73.9	43.0	116.9
Actuarial (gains)/losses	(31.2)	(4.9)	(36.1)
Total pension expense	65.9	56.6	122.5
Less benefits paid	49.0	34.9	83.9
Actuarial accrued pension liability as of September 30, 2002	1,129.8	730.0	1,859.8

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

Significant Assumptions Used in Determining Pension Liability and the Related Expense

(In percentages)	Civilian 2002	Civilian 2001	Military 2002	Military 2001
Rate of interest	6.75%	6.75%	6.25%	6.25%
Rate of inflation	3.75%	3.75%	3.0%	3.50%
Projected salary increases	4.25%	4.25%	3.5%	3.50%

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, 2001	205.2	580.9	786.1
Post-Retirement Health Benefits Expense:			
Normal costs	8.7	13.1	21.8
Interest on liability	13.9	34.7	48.6
Actuarial (gains)/losses	1.8	(26.2)	(24.4)
Total post-retirement health benefits expense	24.4	21.6	46.0
Less claims paid	8.2	10.5	18.7
Actuarial accrued post-retirement health benefits liability, as of September 30, 2002	221.4	592.0	813.4

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

	Civilian		Military	
(In percentages)	2002	2001	2002	2001
Rate of interest	6.75%	6.75%	6.25%	6.25%
Rate of health care cost inflation	7.0%	7.0%	2.1-16.73%	4.8-13%

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 securities. See Note 19—Dedicated Collections.

The Federal Retirement Thrift Investment Board, an independent Government agency, administers the Thrift Savings Plan (TSP) Fund. Federal employees and retirees covered by CSRS and FERS own the fund's assets. These financial statements exclude this fund because the employees own its assets.

Treasury securities held by the 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 7 percent of base pay with no Government match.

The TSP Fund held $44.9 billion and $36.8 billion in nonmarketable Treasury securities for the years ended September 30, 2002, and 2001, 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

Civilian retirees pay the same insurance premium as active employees under the Federal Employees Health Benefits Program. These premiums cover only a portion of the costs.

Other Benefits

Employee and annuitant contributions and interest on investments fund a portion of the Federal Employees' Group Life Insurance program. OPM administers this program, although claims are paid through private insurance companies.

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.

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 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.

The large net increase ($293 billion) in Military Retirement Health Benefits (MRHB) actuarial liability as of September 30, 2001, included the effect of Public Law No. 106-398 (the National Defense Authorization Act) that was signed into law on October 30, 2000. Under this legislation, TRICARE benefits were extended to military retirees and their beneficiaries eligible for Medicare, and a fund was established to pay these benefits. In fiscal 2002, the actuarial liability was reduced by $36.5 billion. This decrease, when combined with the actuarial gains and losses and related costs, resulted in a much smaller net increase to the MRHB. The Act also included a number of other enhanced medical benefits in addition to the specific Medicare eligible benefits.

Some of the Act's provisions include:

- On April 1, 2001, Medicare eligible military retirees and their beneficiaries became eligible for a worldwide pharmacy benefit, including Military Treatment Facilities, National Mail Order Pharmacy, and retail pharmacy benefit.
- On October 1, 2001, TRICARE became the secondary payer to Medicare for Medicare eligible military retirees and their beneficiaries.
- The catastrophic cap was reduced from $7,500 to $3,000 for retiree families and other active duty family benefits.

One of the specific initiatives included in the President's Management Agenda for fiscal 2002 is the coordination of DOD and VA medical programs and systems.

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 veterans compensation and burial benefits payable increased by $157.3 billion and $139.3 billion in fiscal 2002 and 2001, 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)	2002	2001
Veterans	721.7	574.0
Survivors	124.1	115.1
Burial benefits	3.4	2.8
Total compensation and burial benefits payable	849.2	691.9

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.

Note 12. Environmental and Disposal Liabilities

Environmental and Disposal Liabilities as of September 30

(In billions of dollars)	2002	2001
Department of Energy:		
Environmental management baseline estimates	161.8	184.2
Active and surplus facilities—other programs	26.6	31.4
High-level waste and spent nuclear fuel disposition	14.8	14.6
Other	6.5	8.1
Total Department of Energy	209.7	238.3
Department of Defense:		
Active installations	13.9	13.1
Training ranges and non-range unexploded ordnance	12.9	16.4
Chemicals weapons disposal	12.8	14.2
Nuclear powered aircraft carriers and submarines	9.8	10.0
Other	9.9	9.6
Total Department of Defense	59.3	63.3
All other agencies	4.0	5.2
Total environmental and disposal liabilities	273.0	306.8

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 components of the liability are: (1) environmental management baseline estimates, (2) anticipated remediation costs of active and surplus facilities that ultimately will require stabilization, deactivation and decommissioning, (3) high-level waste and spent nuclear fuel disposition, and (4) other environmental liabilities. 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 and regulatory agencies. Active and surplus facilities represent anticipated remediation costs for those facilities that are conducting ongoing operations but ultimately will require stabilization, deactivation, and decommissioning.

Projects with no current feasible remediation approach are excluded from the baseline estimate. 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).

The active and surplus facility component of the liability is largely based on a cost-estimating model which extrapolates stabilization, deactivation and decommissioning costs from facilities included in the baseline estimates to those active and surplus facilities with the same characteristics. Cost estimates are updated each year to reflect current year constant dollars, the transfer of clean up and management responsibilities for these facilities by other programs to the baseline estimate, changes in facility size or contamination assessments, and estimated clean-up for newly contaminated facilities.

The high-level waste and spent nuclear fuel disposition liability reflect DOE's share of the estimated future cost to provide for permanent disposal of the Nation's high-level radioactive waste and spent nuclear fuel, plus the unfunded portion of actual costs incurred to date and accrued interest on the unfunded costs. The Nuclear Waste Policy Act of 1982 established DOE's responsibility to provide for permanent disposal of the Nation's spent nuclear fuel and high-level radioactive waste. DOE performed comprehensive scientific tests to determine the suitability of the Yucca Mountain site for this purpose. The characterization of the Yucca Mountain site is complete, and in July 2002, the President signed into law the Congressional Joint Resolution designating Yucca Mountain as the site for the Nation's first repository. It is scheduled to open in 2010, and at that time, it will accept spent nuclear fuel from commercial utilities and DOE's high-level waste and spent nuclear fuel.

DOD is required to clean up contamination resulting fromwaste disposal practices, leaks, spills and other activities that have created a public health or environmental risk. DOD must restore active installations, installations affected by base realignment or 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 (SARA) 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 clean-up contamination in coordination with regulatory agencies, other responsible parties, and current property owners.

DOD currently uses two independently validated models to estimate and report its environmental liabilities: the Remedial Action Cost Engineering Requirements model and Navy's cost to complete system. These two methods of valuation are used in this note's table.

DOD was unable to fully implement elements of Federal GAAP and OMB Bulletin No. 01-09 due to limitations of its financial management processes and systems, including nonfinancial feeder systems and processes.

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)	2002	2001
Federal Old-Age and Survivors Insurance	34.1	32.4
Grants to States for Medicaid	16.3	13.4
Federal Hospital Insurance (Medicare Part A)	14.1	13.6
Federal Supplementary Medical Insurance (Medicare Part B)	14.1	13.5
Federal Disability Insurance	12.2	9.5
Unemployment insurance	2.1	1.4
Supplemental security income	1.4	1.3
Railroad retirement	0.8	0.7
Other benefits	0.2	0.2
Total benefits due and payable	95.3	86.0

Note 14. Other Liabilities

Other Liabilities as of September 30

(In billions of dollars)	2002	2001
Insurance programs	48.8	33.2
Accrued wages and benefits	28.2	27.3
Deferred revenue	26.0	28.3
Gold certificates	10.9	10.9
Other debt	9.3	9.7
Exchange stabilization fund	8.7	8.5
Deposit funds and undeposited collections	6.6	6.8
Advances from foreign governments	5.4	4.9
Contractual services	3.9	4.2
Advances from others	3.7	2.2
Energy Employees Occupational Illness Compensation Act	2.8	3.2
Other miscellaneous liabilities	47.6	48.9
Total other liabilities	201.9	188.1

Insurance programs include bank 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.

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.

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.

Gold certificates include monetized portions of gold and certificates deposited in FRBs.

Other debt includes Government obligations, whether secured or unsecured, not included in public debt.

Exchange stabilization fund includes SDR certificates issued to the FRBs and allocations from the IMF.

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.

Contractual services consist of contractual obligations of DOD.

Advances from others are amounts received in advance for future delivery of goods or services.

The Energy Employees Occupational Illness Compensation Act authorized compensation for certain illnesses suffered by the employees of the Department and contractors who performed work for the nuclear weapons program.

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, 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
Customs duties	19.8	19.8	-	-	-
Fees and licenses	1.0	1.0	-	-	-
Unemployment taxes	26.3	24.5	1.7	-	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	2.0	1.3	0.7	-	-
Subtotal	2,098.0	1,335.9	723.7	17.8	20.6
Less: Amounts collected for Non-Federal entities	0.4				
Total	2,097.6				

Collections of Federal Revenue for the Year Ended September 30, 2001

(In billions of dollars)	Federal Revenue Collections	Tax Year to Which Collections Relate			
		2001	2000	1999	Prior Years
Individual income tax and tax withholdings	1,843.8	1,155.4	665.8	14.0	8.6
Corporation income taxes	186.4	99.2	79.8	0.7	6.7
Estate and gift taxes	29.2	0.6	25.1	1.2	2.3
Excise taxes	68.2	49.2	18.6	0.1	0.3
Custom duties	19.7	19.7	-	-	-
Fees and licenses	0.9	0.9	-	-	-
Unemployment taxes	27.0	25.0	1.9	-	0.1
Railroad retirement taxes	4.7	3.6	1.1	-	-
Federal Reserve earnings	26.1	21.6	4.5	-	-
Fines, penalties, interest, and other taxes	2.7	2.0	0.7	-	-
Total	2,208.7	1,377.2	797.5	16.0	18.0

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

Collections of individual income tax and tax withholdings include estimated income tax payments by individuals, Social Security and Medicare taxes, and individual income tax withholdings, but do not include Federal tax refunds.

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 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. (In fiscal 2001, $26.1 billion of EITC refunds were issued, $72 million were applied to advance EITC, and an additional $5.1 billion of EITC refunds 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 2002 include corporate taxes of $5 billion for tax year 2003. (Similarly, amounts reported for corporate income taxes collected in fiscal 2001 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 are reported on a gross cash basis.

The Statement of Operations and Changes in Net Position reports total revenue of $1,877.7 billion and $2,013.7 billion for fiscal 2002 and 2001, 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.

The Current Services Assessment table in the Stewardship section of this document also includes the Government's receipts and outlays. The total amounts included in the table for the years 2002 and 2001 are the same as those described in Note 15 but classified differently. The classifications differ because the budget classifies some collections and refunds differently. For example, Note 15 nets part of the EITCs (amounts in excess of offsets to individual taxes owed) in receipts, while the budget reports them as outlays. Meanwhile, the Statements of Net Cost reports refunds and EITCs as expenses.

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

Federal Tax Refunds Disbursed for the Year Ended September 30, 2001

(In billions of dollars)	Refunds Disbursed	Tax Year to Which Refunds Relate 2001	2000	1999	Prior Years
Individual income tax and tax withholdings	210.3	1.4	195.7	9.4	3.8
Corporation income taxes	38.6	1.3	14.8	8.2	14.3
Unemployment taxes	0.1	-	0.1	-	-
Excise taxes	0.9	0.3	0.4	-	0.2
Estate and gift taxes	1.0	-	0.3	0.4	0.3
Custom duties	0.9	0.4	0.2	0.1	0.2
Total	251.8	3.4	211.5	18.1	18.8

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 $17.1 billion and $17.3 billion for the years ended September 30, 2002, and 2001, 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. Prior Period Adjustments

Prior Period Adjustments to Fiscal Years 2002 and 2001

(In billions of dollars)	Increases to Net Position 2002	Increases to Net Position 2001	Reconciliations of Net Operating Cost 2002	Reconciliations of Net Operating Cost 2001
Department of Treasury	(3.1)	-	-	-
National Aeronautics and Space Administration	2.9	0.6	2.9	0.6
Department of Defense	2.0	(5.3)	2.0	(5.3)
Department of Agriculture	(1.3)	-	(1.3)	-
Department of Transportation	1.3	2.1	1.3	2.1
Department of Labor	1.2	-	1.2	-
All other adjustments to prior periods	0.5	4.0	0.5	4.0
Total prior period adjustments	3.5	1.4	6.6	1.4

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

Significant components of this net adjustment include:

- A $3.1 billion adjustment by Treasury to operating cash to correct the balance in outstanding checks.
- 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.
- A $0.5 billion net adjustments resulting from corrections of errors composed of smaller debits and credits from different agencies.

Prior period adjustments for fiscal 2001 consist of $1.4 billion in net adjustments to correct errors in prior periods.

Significant components of this net adjustment include:

- A $5.3 billion adjustment by DOD for correction of errors in determining the environmental cleanup liability.
- A $2.1 billion adjustment by DOT to correct accruals, property and inventory.
- A $0.6 billion correction by NASA to property, plant and equipment. For comparative presentation reasons, last year this amount was included in other, bringing the net amount reported to ($0.5) billion.
- Other $4.0 billion includes: A $5.1 billion adjustment by SSA for correction of errors in determining eligibility for disability benefits. For comparative presentation reasons, last year it was reported as a single item. A ($1.1) billion net adjustment to prior period resulting from a correction composed of smaller debits and credits from different agencies.

Note 18. Commitments and Contingencies

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

Contingent liabilities related to the loan guarantee programs are described in Note 4—Loans Receivable and Loan Guarantee Liabilities, Net.

A contingency is an existing condition or situation involving uncertainty as to a possible loss. A loss is considered reasonably possible if the future confirming event(s) is more than remote, but less than probable. These contingencies do not include existing conditions or situations where the future occurring event is only considered remote, nor do they include contingencies that would result in a gain.

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

Numerous cases are pending involving, among many other matters, supervisory goodwill at savings and loan institutions, harbor maintenance fees, 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.

The Government has unused statutory lines of credit to Government-sponsored enterprises totaling $10 billion, as well.

Commitments as of September 30

(In billions of dollars)	2002 Capital Leases	2002 Operating Leases	2001 Capital Leases	2001 Operating Leases
Long-term Leases:				
General Services Administration	0.3	17.4	0.3	17.2
Department of Justice	0.1	10.9	0.1	7.9
U.S. Postal Service	0.8	9.6	0.8	9.4
Department of Health and Human Services	0.1	1.7	-	1.2
Department of Agriculture	-	0.5	0.1	2.4
Department of Interior	-	1.6	-	1.7
Department of Veterans Administration	-	1.4	-	1.4
Department of Commerce	-	1.3	-	2.2
Other long-term leases	1.1	3.2	1.3	2.7
Total long-term leases	2.4	47.6	2.6	46.1

	2002	2001
Undelivered Orders:		
Department of Housing and Urban Development	83.7	89.5
Department of Transportation	63.8	74.2[1]
Department of Health and Human Services	51.2	60.6
Department of the Navy	48.6	42.7
Department of Treasury	47.7	20.0[1]
Department of Education	35.3	22.5[1]
Department of the Air Force	34.0	26.4
Other Defense agencies	33.1	29.2
Department of the Army	25.2	24.2
Department of Agriculture	23.7	21.1
Department of Justice	12.4	12.8
Environmental Protection Agency	10.9	9.6
Department of Energy	9.1	8.0
U.S. Agency for International Development	8.8	8.3
Department of Labor	7.8	8.5
General Service Administration	6.7	4.8
National Science Foundation	5.6	4.9
Federal Emergency Management Agency	5.4	5.6
Other undelivered orders	25.8	25.0[1]
Total undelivered orders	538.8	497.9[1]
Other Commitments:		
Callable capital subscriptions for multi-lateral development banks	69.8	69.4
Department of Agriculture	23.3	15.9[1]
Tennessee Valley Authority	9.1	9.5
National Oceanic and Atmospheric Administration satellites and weather systems	7.4	8.4
Department of Transportation	4.3	4.0
Real property activities	3.2	3.4
All other programs	1.5	3.3[1]
Total other commitments	118.6	113.9

[1] Restated.

Contingencies as of September 30

(In billions of dollars)	2002	2001
Insurance:		
Pension Benefit Guaranty Corporation	35.5	11.0
Federal Deposit Insurance Corporation	7.3	7.0
Other insurance programs	0.5	0.1
Total insurance programs	43.3	18.1
Unadjudicated Claims:		
Department of Commerce	4.5	7.0[1]
Department of Agriculture	1.7	-
Department of Interior	1.4	0.5
Other unadjudicated claims	1.8	1.4
Total unadjudicated claims	9.4	8.9[1]
Other Contingencies:		
Department of Army	10.2	8.8
Administrative order against Tennessee Valley Authority	3.0	3.0
Other contingencies	4.1	9.6[1]
Total other contingencies	17.3	21.4[1]

[1] Restated.

Financial Treatment of Loss Contingencies

Probability of Loss	Probable	Reasonably possible, more than remote but less than probable	Remote, chance of occurrence slight
Financial Treatment	Balance Sheet & Statement of Net Cost	Footnote disclosure	No disclosure

Note 19. Dedicated Collections

Dedicated Collections as of September 30*

(In billions of dollars)	Receipts		Disbursements		Trust Fund Net Assets		Less Intra-governmental Net Assets		Consolidated Assets	
	2002	2001	2002	2001	2002	2001	2002	2001	2002	2001
Federal Old-Age and Survivors Insurance Trust Fund	530.4	518.5	389.6	377.1	1,193.3	1085.0	1,192.2	1,083.8	0.8	1.2
Civil Service Retirement and Disability Fund	80.1	77.9	49.0	47.4	583.7	552.3	583.4	552.0	0.3	0.3
Federal Hospital Insurance Trust Fund (Medicare Part A).......	177.9	173.7	147.9	143.9	235.3	203.7	233.6	203.7	1.7	-
Military Retirement Fund	42.4	40.6	35.1	34.2	176.5	169.2	176.5	169.2	-	-
Federal Disability Insurance Trust Fund .	86.2	83.9	66.5	67.8	159.2	153.1	157.6	151.9	1.6	1.2
Unemployment Trust Fund	32.7	34.1	51.1	31.6	70.8	91.5	69.6	90.7	1.2	0.8
Federal Supplementary Medical Insurance Trust Fund (Medicare Part B)	105.6	95.3	108.9	98.4	40.8	42.7	39.5	42.7	1.3	-
Highway Trust Fund	32.2	31.5	37.7	37.4	22.0	26.2	21.0	26.2	1.0	-
Railroad Retirement Trust Fund...............	5.6	5.1	8.9	8.4	22.8	24.0	22.8	23.9	-	0.1
Airport and Airway Trust Fund...............	9.6	10.0	11.3	9.4	11.7	14.1	11.0	13.9	0.7	0.2
Hazardous Substance Superfund	1.0	1.1	1.5	1.3	3.3	4.3	3.3	3.8	-	0.5
Black Lung Disability Trust Fund...............	0.6	0.5	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.

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 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.

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: the Civil Service Retirement System (CSRS), for employees hired before 1984, and the Federal Employee Retirement System (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.

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 and related transportation purposes. DOT administers 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 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 20. Indian Trust Funds

The Indian Trust Funds differ from other dedicated collections reported in Note 19. 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 approximately 315 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 Fund contain two categories: the trust funds held for Indian tribes (considered non-Federal funds) and the 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 only the trust funds held for Indian tribes, since 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)	2002	2001
Receipts	434.7	536.1
Disbursements	383.4	467.3
Receipts in excess of disbursements	51.3	68.8
Trust fund balances, beginning of year	2,805.0	2,736.2
Trust fund balances, end of year	2,856.3	2,805.0

OST also maintains about 252,000 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 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)	2002	2001
Receipts	191.3	225.9
Disbursements	184.1	221.7
Receipts in excess of disbursements	7.2	4.2
Trust fund balances, beginning of year	404.1	399.9
Trust fund balances, end of year	411.3	404.1

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 investments 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 21. Subsequent Event/Department of Homeland Security

On March 1, 2003, the Department of Homeland Security (DHS) was created. This new Cabinet-level department merged 22 agencies and 170,000 employees. It is organized into four organizational divisions: Border and Transportation Security; Emergency Preparedness and Response; Chemical, Biological, Radiological and Nuclear Countermeasures; and Information Analysis and Infrastructure Protection.

The mission of DHS is to:

- Prevent terrorist attacks within the United States.
- Reduce America's vulnerability to terrorism.
- Minimize the damage and recover from attacks that do occur.

The mission of homeland security previously has been carried out by numerous Federal agencies protecting borders, securing infrastructure, regulating the flow of goods and people entering the country, and performing various other homeland security functions. DHS consolidates many of these vital functions into a single more efficient organization.

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United States Government Supplemental Information for the Year Ended September 30, 2002 (Unaudited)

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)	2002	2001	2002	2001	2002	2001
Asset Category:						
General property, plant and equipment	17.1	10.6	25.2	26.3	3.3	5.1
Heritage assets	1.0	0.6	1.1	1.0	-	-
National defense assets	1.2	1.1	1.2	1.2	-	-
Total stewardship assets	2.2	1.7	2.3	2.2	-	-
Total deferred maintenance	19.3	12.3	27.5	28.5	3.3	5.1

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 2002 is $342.8 billion.

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 2002 is $741.1 billion.

Tax Burden

The Internal Revenue Code provides for progressive rates of tax, whereby higher incomes are generally subject to higher rates of tax. 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 2000

	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	$793	$5,301	$15,368	$110,320
Percent of total deductions on taxable income	30%	31%	20%	19%
Percent of total credits against tax liability	22%	42%	17%	19%

Corporation Income Tax Returns for Tax Year 1999

	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	0.37%	0.50%	0.10%	1.00%
Average tax per return	$3,561	$168,393	$759,184	$14,844,845
Percent of total deductions on taxable income	26%	8%	7%	59%
Percent of total credits against tax liability	4%	1%	2%	93%

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 $5.1 billion and $7.7 billion for fiscal 2002 and 2001, respectively. For those under appeal, the estimated payout is $8.4 billion and $13.6 billion for fiscal 2002 and 2001, 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: List of 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 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 the Air Force (Air Force)
www.af.mil
Department of the Army (Army)
www.army.mil
Army Corps of Engineers
www.usace.army.mil
Department of the Navy (Navy)
www.navy.mil
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
Commodity Credit Corporation (CCC)
Commodity Futures Trading Commission (CFTC)
www.cftc.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

Entities Included, cont.

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
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)
Thrift Savings Fund