

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## Introduction

The Fiscal Year (FY) 2013 *Financial Report of the United States Government (Financial Report)* provides the President, Congress, and the American people with a comprehensive view of the Federal Government's finances, i.e., its financial position and condition, its revenues and costs, assets and liabilities, and other obligations and commitments. The *Financial Report* also discusses important financial issues and significant conditions that may affect future operations, including the need to achieve fiscal sustainability over the medium and long term.

Pursuant to 31 U.S.C. § 331(e)(1), the Department of the Treasury (Treasury), in cooperation with the Office of Management and Budget (OMB), must submit an audited (by the Government Accountability Office or GAO) financial statement for the preceding fiscal year, covering all accounts and associated activities of the executive branch of the United States Government<sup>1</sup> – the central component of the *Financial Report* – to the President and Congress no later than six months after the September 30 fiscal year end. To encourage timely and relevant reporting, OMB accelerated both individual agency and government-wide reporting deadlines.

The *Financial Report* is prepared from the audited financial statements of specifically designated federal agencies, including the Cabinet departments and many smaller, independent agencies (see organizational chart on the next page). As it has for the past sixteen years, GAO issued a “disclaimer” of opinion on the accrual-based, consolidated financial statements for the fiscal years ended September 30, 2013 and 2012. GAO also issued disclaimers of opinion on the 2013, 2012, 2011, and 2010 Statements of Social Insurance (SOSI), following an unqualified opinion on the 2009 SOSI, and a disclaimer of opinion on the 2013 and 2012 Statement of Changes in Social Insurance Amounts (SCSIA). A disclaimer of opinion indicates that sufficient information was not available for the auditors to determine whether the reported financial statements were fairly presented in accordance with Generally Accepted Accounting Principles (GAAP). In FY 2013, 32<sup>2</sup> of the 35 most significant agencies earned unqualified opinions on their financial statement audits.<sup>3</sup>

The FY 2013 *Financial Report* consists of:

- Management's Discussion and Analysis (MD&A), which provides management's perspectives on and analysis of information presented in the *Financial Report*, such as financial and performance trends;
- Principal financial statements and the related notes to the financial statements;
- Required Supplementary Information, Required Supplementary Stewardship Information, and Other Information; and
- GAO's audit report.

In addition, a Citizen's Guide is included to provide the American taxpayer with a quick reference to the key issues in the *Financial Report* and an overview of the Government's financial position and condition.

## Mission & Organization

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

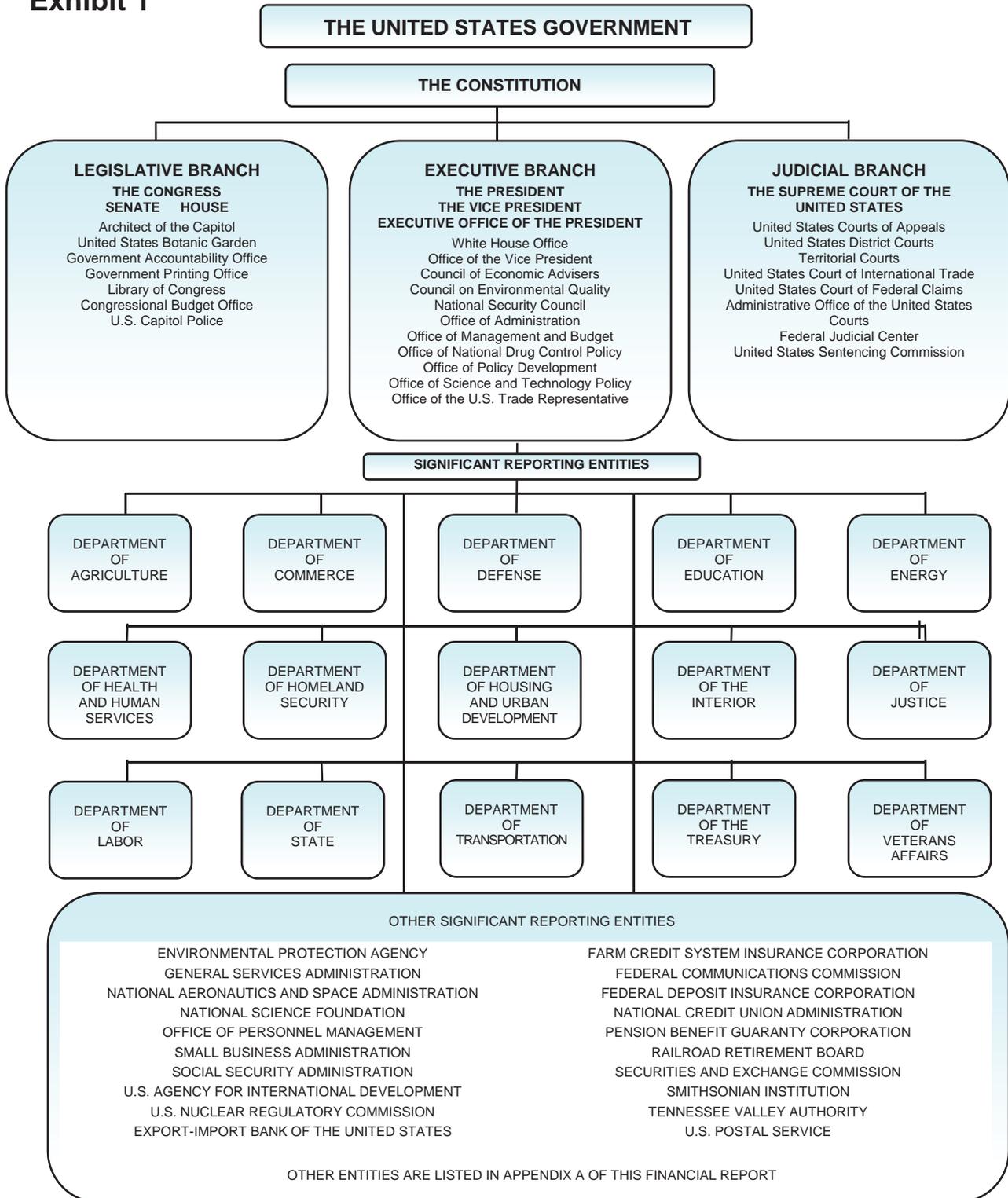
<sup>1</sup> The Government Management Reform Act of 1994 has required such reporting, covering the executive branch of the Government, beginning with financial statements prepared for FY 1997. Treasury and OMB have elected to include certain financial information on the legislative and judicial branches in consolidated financial statements as well.

<sup>2</sup> The 32 agencies include the Department of Health and Human Services, which received disclaimers of opinion on its 2013, 2012, 2011, and 2010 SOSI and on its 2013 and 2012 SCSIA.

<sup>3</sup> The Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), and the Farm Credit System Insurance Corporation (FCSIC) are among the 35 significant entities. However, because these entities operate on a calendar year basis (December 31 year-end), their 2013 audits are not yet complete. Statistic reflects 2012 audit results for these organizations.

transportation systems, protecting the environment, contributing to the security of energy resources, and helping States provide education. Exhibit 1 provides an overview of how the U.S. Government (Government) is organized.

**Exhibit 1**



## The Government's Financial Position and Condition

A complete assessment of the Government's financial or fiscal condition requires analysis of historical results, projections of future revenues and expenditures, and an assessment of the Government's long-term fiscal sustainability. This *Financial Report* discusses the Government's financial position at the end of the fiscal year, explains how and why the financial position changed during the year, and provides insight into how the Government's financial condition may change in the future.

<b>Table 1</b>				
<b>The Federal Government's Financial Position and Condition</b>				
Dollars in Billions	2013	2012	Increase / (Decrease)	
			\$	%
<b>FINANCIAL MEASURES</b>				
Gross Cost	\$ (3,940.9)	\$ (3,844.9)	\$ 96.0	2.5%
Less: Earned Revenue	\$ 415.5	\$ 350.8	\$ 64.7	18.4%
Gain/(Loss) from Changes in Assumptions	\$ (131.2)	\$ (320.2)	\$ (189.0)	(59%)
<b>Net Cost<sup>1</sup></b>	<b>\$ (3,656.6)</b>	<b>\$ (3,814.3)</b>	<b>\$ (157.7)</b>	<b>(4.1%)</b>
Less: Taxes and Other Revenue:	\$ 2,842.5	\$ 2,518.2	\$ 324.3	12.9%
Unmatched Transactions & Balances	\$ 9.0	\$ (20.2)	\$ (29.2)	(144.6%)
<b>Net Operating Cost<sup>2</sup></b>	<b>\$ (805.1)</b>	<b>\$ (1,316.3)</b>	<b>\$ (511.2)</b>	<b>(38.8%)</b>
<b>Assets<sup>3</sup>:</b>				
Cash & Other Monetary Assets	\$ 206.3	\$ 206.2	\$ 0.1	0.0%
Loans Receivable, Net	\$ 1,022.3	\$ 859.6	\$ 162.7	18.9%
Inventories & Related Property, Net	\$ 311.1	\$ 299.0	\$ 12.1	4.0%
Property, Plant & Equipment, Net	\$ 896.7	\$ 855.0	\$ 41.7	4.9%
Other	\$ 531.9	\$ 528.5	\$ 3.4	0.6%
<b>Total Assets</b>	<b>\$ 2,968.3</b>	<b>\$ 2,748.3</b>	<b>\$ 220.0</b>	<b>8.0%</b>
<b>Liabilities<sup>3</sup>:</b>				
Federal Debt Held by the Public & Accrued Interest	\$ (12,028.4)	\$ (11,332.3)	\$ 696.1	6.1%
Federal Employee & Veterans Benefits	\$ (6,538.3)	\$ (6,274.0)	\$ 264.3	4.2%
Other	\$ (1,310.9)	\$ (1,243.0)	\$ 67.9	5.5%
<b>Total Liabilities</b>	<b>\$ (19,877.6)</b>	<b>\$ (18,849.3)</b>	<b>\$ 1,028.3</b>	<b>5.5%</b>
<b>Net Position (Assets minus Liabilities)</b>	<b>\$ (16,909.3)</b>	<b>\$ (16,101.0)</b>	<b>\$ (808.3)</b>	<b>(5.0%)</b>
<b>SUSTAINABILITY MEASURES</b>				
<b>Social Insurance Net Expenditures<sup>4</sup>:</b>				
Social Security (OASDI)	\$ (12,294)	\$ (11,278)	\$ 1,016	9.0%
Medicare (Parts A, B, & D)	\$ (27,302)	\$ (27,174)	\$ 128	0.5%
Other	\$ (102)	\$ (102)	\$ 0	0.0%
<b>Total Social Insurance Net Expenditures</b>	<b>\$ (39,698)</b>	<b>\$ (38,554)</b>	<b>\$ 1,144</b>	<b>3.0%</b>
<b>Total Federal Government Noninterest Net Expenditures<sup>5</sup></b>	<b>\$ (4,000)</b>	<b>\$ (16,500)</b>	<b>\$ (12,500)</b>	<b>(75.8%)</b>
<b>BUDGET DEFICIT</b>				
<b>Unified Budget Deficit<sup>6</sup></b>	<b>\$ (680.3)</b>	<b>\$ (1,089.4)</b>	<b>\$ (409.1)</b>	<b>(37.6%)</b>

1 Source: Statement of Net Cost.

2 Source: Statements of Operations and Changes in Net Position.

3 Source: Balance Sheet.

4 Source: Statements of Social Insurance (SOSI). Amounts equal estimated present value of projected revenues and expenditures for scheduled benefits over the next 75 years of certain 'Social Insurance' programs (Social Security, Medicare Parts A, B, & D, Railroad Retirement - Black Lung is projected through 2040). Amounts reflect 'Open Group' totals (all current and projected program participants during the 75-year projection period).

5 Represents the 75-year projection of the Federal Government's receipts less non-interest spending as reported in the Statement of Long-Term Fiscal Projections in the Required Supplementary Information section of the *Financial Report*.

6 Source: Final Monthly Treasury Statement (as of 9/30/2013 and 9/30/2012).

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

## MANAGEMENT'S DISCUSSION AND ANALYSIS

Table 1 on the previous page and the following summarize the Federal Government's financial position:

- The Government's gross costs increased by 2.5 percent to \$3.9 trillion. Deducting \$415.5 billion in revenues earned for goods and services provided to the public (e.g., Medicare premiums, national park entry fees, and postal service fees) and adding \$131.2 billion in losses from changes in assumptions (e.g., interest rates, inflation, disability claims rates) shows that the Government's net cost decreased by \$157.7 billion (4.1 percent) to \$3.7 trillion during FY 2013.
- Taxes and other revenues increased \$324.3 billion (12.9 percent) to \$2.8 trillion, which, when offset against the Government's net cost, results in a "bottom line" net operating cost of \$805.1 billion.
- Comparing total 2013 Government assets of \$3.0 trillion to total liabilities of \$19.9 trillion yields a negative net position of \$16.9 trillion. Government liabilities are comprised mostly of \$12.0 trillion in federal debt held by the public and accrued interest payable<sup>4</sup> and \$6.5 trillion in federal employee and veteran benefits payable.
- The sum of debt held by the public (\$12.0 trillion) and intragovernmental debt (\$4.8 trillion) equals gross federal debt, which, with some adjustments is subject to the statutory debt limit. As of September 30, 2013, the Government's total debt subject to the debt limit was \$16.699 trillion, \$25 million under the limit. During 2013, Treasury began implementing "extraordinary measures" on a temporary basis, which were still in effect as of September 30, 2013, to enable the Government to protect the full faith and credit of the United States Government by continuing to pay the nation's bills.<sup>5</sup>

This *Financial Report* also contains information about potential impacts on the Government's future financial condition. Under federal accounting rules, social insurance expenditures, as reported in the Statement of Social Insurance (SOSI) and the Statement of Long-Term Fiscal Projections (included in the Required Supplementary Information section of the *Financial Report*) are not considered liabilities of the Government. They can, however, provide a valuable perspective on the sustainability of the Government's fiscal path:

- The SOSI compares the actuarial present value of the Government's projected expenditures for scheduled benefits for Social Security, Medicare Parts A, B and D, and other social insurance programs over 75 years<sup>6</sup> to a subset of the revenues<sup>7</sup> supporting these programs. For 2013, projected social insurance expenditures exceeded projected revenues by about \$39.7 trillion, a \$1.1 trillion increase over 2012 projections.
- From a government-wide perspective, projected expenditures for other major programs (including defense, Medicaid, and education) and future tax revenues will also affect the Government's future fiscal condition. Over the next 75 years, under current policy, the present value of the Government's total projected, non-interest expenditures (including its social insurance programs) are projected to exceed total projected receipts by \$4.0 trillion.

The Government's current financial position and long-term financial condition can be evaluated both in dollar terms and in relation to the economy as a whole. Gross Domestic Product (GDP) measures the size of the nation's economy in terms of the total value of all final goods and services that are produced in a year. Considering financial results relative to GDP is a useful indicator of the economy's capacity to sustain the Government's many programs.<sup>8</sup> For example:

- The unified budget deficit decreased from 6.8 percent of GDP (\$1.1 trillion) in FY 2012 to 4.1 percent of GDP (\$680.3 billion in FY 2013 as a result of outlays that were 20.8 percent of GDP (\$3.5 trillion) net of receipts that were 16.7 percent of GDP (\$2.8 trillion)<sup>9</sup>
- The budget deficit is primarily financed through borrowing from the public. As of September 30, 2013, debt held by the public, excluding interest payable, was \$12.0 trillion (72 percent of GDP).

<sup>4</sup> On the Government's balance sheet, debt held by the public and accrued interest payable consists of Treasury securities, net of unamortized discounts and premiums, and accrued interest payable. The "public" consists of individuals, corporations, state and local governments, Federal Reserve Banks, foreign governments, and other entities outside the Federal Government.

<sup>5</sup> As of October 17, 2013, the debt limit was suspended by action of P.L. 113-46 through February 7, 2014. As of February 15, 2014, P.L. 113-83 again suspended the debt limit, this time through March 15, 2015. (see Note 26 – Subsequent Events)

<sup>6</sup> The Black Lung Program is projected through September 30, 2040.

<sup>7</sup> Social Security and Medicare Part A are funded by the payroll taxes, revenue from taxation of benefits, and premiums that support those programs. Medicare Parts B and D are primarily financed by general revenues and premiums. By accounting convention, general revenues transferred to Medicare Parts B and D are eliminated in consolidation at the government-wide level and, as such, are not included in SOSI projections.

<sup>8</sup> Unless otherwise noted, percentages or shares of GDP referenced in this *Financial Report* reflect revised GDP figures per the Bureau of Economic Analysis (BEA). In July 2013, the BEA revised upward the historical values for GDP beginning with estimates for 1929. As a result, shares of GDP throughout the *Financial Report* are slightly lower than those reported in previous years.

<sup>9</sup> [Final Monthly Treasury Statement \(as of September 30, 2013 and 2012\), 10/30/13 press release.](#)

- The projected \$39.7 trillion net present value excess of expenditures over receipts over 75 years for the programs reported in the 2013 SOSI represents about 4.0 percent of the present value of GDP over 75 years. The excess of total projected non-interest spending over receipts of \$4.0 trillion discussed in the 'Statement of Long Term Fiscal Projections' in the Required Supplementary Information (RSI) section of the *Financial Report* represents 0.4 percent of GDP. As discussed in this *Financial Report*, these projections can, in turn, have a significant impact on projected debt as a percent of GDP.

## Fiscal Year 2013 Financial Statement Audit Results

For FY 2013, GAO issued a seventeenth consecutive disclaimer of audit opinion on the accrual-based, government-wide financial statements. In addition, GAO issued disclaimers of opinion on the 2013, 2012, 2011, and 2010 Statements of Social Insurance (SOSI), following an unqualified opinion on the 2009 SOSI, and disclaimers of opinion on the 2013 and 2012 Statement of Changes in Social Insurance Amounts (SCSIA). The SOSI and SCSIA disclaimers stem from significant uncertainties (discussed in note 24), primarily related to the achievement of projected reductions in Medicare cost growth as reflected in the 2013, 2012, 2011, and 2010 SOSI.

Twenty-two of the 24 agencies required to issue audited financial statements under the Chief Financial Officers (CFO) Act received unqualified audit opinions, as did 10 of 11 additional significant reporting agencies (see Table 2 and Appendix A).<sup>10</sup>

### The Government-wide Reporting Entity

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

A number of entities and organizations are excluded due to the nature of their operations, including the Federal Reserve System (considered to be an independent central bank under the general oversight of Congress), all fiduciary funds, and Government-Sponsored Enterprises (GSEs), including the Federal Home Loan Banks, the Federal National Mortgage Association (Fannie Mae), and the Federal Home Loan Mortgage Corporation (Freddie Mac). The Emergency Economic Stabilization Act (EESA) of 2008 gave the Secretary of the Treasury temporary authority to purchase and guarantee assets from a wide range of financial institutions through the Troubled Asset Relief Program (TARP). Following U.S. GAAP for federal entities, the Government has not consolidated into its financial statements the assets, liabilities, or results of operations of any financial organization or commercial entity in which Treasury holds either a direct, indirect, or

**Table 2: FY 2013 Agency Financial Statement Audit Results**

Chief Financial Officers (CFO) Act Agency	Audit Opinion
Department of Agriculture (USDA)	Unqualified
Department of Commerce (DOC)	Unqualified
Department of Defense (DOD)	Disclaimer
Department of Education (Education)	Unqualified
Department of Energy (DOE)	Unqualified
Department of Health and Human Services (HHS) <sup>1</sup>	Unqualified
Department of Homeland Security (DHS)	Unqualified
Department of Housing and Urban Development (HUD)	Qualified
Department of the Interior (DOI)	Unqualified
Department of Labor (DOL)	Unqualified
Department of Justice (DOJ)	Unqualified
Department of State (State)	Unqualified
Department of Transportation (DOT)	Unqualified
Department of the Treasury (Treasury)	Unqualified
Department of Veterans Affairs (VA)	Unqualified
Agency for International Development (USAID)	Unqualified
Environmental Protection Agency (EPA)	Unqualified
General Services Administration (GSA)	Unqualified
National Aeronautics and Space Administration (NASA)	Unqualified
National Science Foundation (NSF)	Unqualified
Nuclear Regulatory Commission (NRC)	Unqualified
Office of Personnel Management (OPM)	Unqualified
Small Business Administration (SBA)	Unqualified
Social Security Administration (SSA)	Unqualified
Other Significant Reporting Entities	
Export-Import Bank of the United States	Unqualified
Farm Credit System Insurance Corporation (FCSIC) <sup>2</sup>	Unqualified
Federal Communications Commission (FCC)	Unqualified
Federal Deposit Insurance Corporation (FDIC) <sup>2</sup>	Unqualified
National Credit Union Administration (NCUA) <sup>2</sup>	Unqualified
Pension Benefit Guaranty Corporation (PBGC)	Unqualified
Railroad Retirement Board (RRB)	Disclaimer
Securities and Exchange Commission (SEC)	Unqualified
Smithsonian Institution <sup>3</sup>	Unqualified
Tennessee Valley Authority (TVA)	Unqualified
U.S. Postal Service (USPS)	Unqualified

<sup>1</sup> Received disclaimer of opinion on Statement of Social Insurance and Statement of Changes in Social Insurance Amounts.

<sup>2</sup> Entities operate under calendar year (CY)-end. Opinions reflect CY 2012 audit results.

<sup>3</sup> Opinion on the most recent annual report, covering FY 2012.

<sup>10</sup> The 22 agencies include the Department of Health and Human Services, which received disclaimers of opinions on its 2013, 2012, 2011, and 2010 SOSI and its 2013 and 2012 SCSIA.

beneficial majority equity investment. Even though some of the equity investments are significant, under Statement of Federal Financial Accounting Concepts (SFFAC) No. 2, these entities meet the criteria of paragraph 50 and do not appear in the Federal Budget section "Federal Programs by Agency and Account." As such, these entities are not consolidated into the financial reports of the Government. However, the values of the investments in and any related liabilities to such entities are presented on the balance sheet. Appendix A includes a list of the agencies and entities contributing to this *Financial Report*.<sup>11</sup>

#### Limitations of the Financial Statements

The principal financial statements have been prepared to report the financial position and results of operations of the Federal Government, and the financial condition and changes in financial condition of its social insurance programs, pursuant to the requirements of 31 U.S.C. § 331(e)(1). These statements are in addition to the financial reports used to monitor and control budgetary resources that are prepared from the same books and records.

The following pages contain a more detailed discussion of the Government's financial results for FY 2013, the budget, the economy, the debt, and a long-term perspective about fiscal sustainability, including the Government's ability to meet its social insurance benefits obligations. The information in this *Financial Report*, when combined with the President's Budget, collectively presents information on the Government's financial position and condition.

## The President's Budget and The Financial Report

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

Treasury generally prepares the financial statements in this *Financial Report* on an "accrual basis" of accounting as prescribed by U.S. GAAP for federal entities.<sup>12</sup> These principles are tailored to the Government's unique characteristics and circumstances. For example, agencies prepare a uniquely structured "Statement of Net Cost," which is intended to present net Government resources used in its operations. Also, unique to Government is the preparation of separate statements to reconcile differences and articulate the relationship between the budget and financial accounting results.

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

\*See Statements of Changes in Cash Balance from Unified Budget and Other Activities and Reconciliations of Net Operating Cost and Unified Budget Deficits.

<sup>11</sup> Since programs are not administered at the government-wide level, performance goals and measures for the Federal Government, as a whole, are not reported here. The outcomes and results of those programs are addressed at the individual agency level and can be found in each agency's financial report.

<sup>12</sup> Under U.S. GAAP, most U.S. Government revenues are recognized on a 'modified cash' basis, or when they become measurable. The Statement of Social Insurance presents the present value of the estimated future revenues and expenditures for scheduled benefits over the next 75 years for the Social Security, Medicare, Railroad Retirement programs; and through September 30, 2040 for the Black Lung program.

## Budget Deficit vs. Net Operating Cost

The Government's primarily cash-based<sup>13</sup> budget deficit decreased nearly 38 percent from approximately \$1.1 trillion in FY 2012 to about \$680.3 billion in FY 2013 due to receipt increases stemming from the implementation of new tax laws under the American Taxpayer Relief Act of 2012 (ATRA), expiration of payroll tax relief provisions, and the ongoing economic recovery; as well as spending decreases associated with the defense drawdown, lower spending for unemployment claims, and budget sequester measures ushered in under the Budget Control Act (BCA) of 2011.<sup>14</sup> These actions had similar, corresponding effects on the Government's largely accrual-based net operating cost, which decreased nearly 39 percent from \$1.3 trillion in FY 2012 to \$805.1 billion in FY 2013.

The budget deficit is measured as the excess of outlays, or payments made by the Government, over receipts, or cash received by the Government. Net operating cost, on an accrual basis, is the excess of costs (what the Government has incurred, but has not necessarily paid) over revenues (what the Government has collected and expects to collect, but has not necessarily received). Net operating cost typically exceeds the budget deficit due largely to the inclusion of cost accruals associated with increases in estimated liabilities for the Government's postemployment benefit programs for its military and civilian employees and veterans. Similarly, the difference between the budget deficit and net operating cost can also be affected by changes in certain asset valuations, such as investments, and in other liabilities, such as estimated insurance and guarantee program liabilities. The longer-term estimated costs of these programs are included in the Government's net operating cost, calculated on an accrual basis as described above, but are not included in the largely cash-based budget deficit. In addition, the costs of certain assets, such as property plant and equipment, are recorded in the budget as outlays when purchased but are capitalized as assets and included in net operating cost as depreciation expense (an accrual cost) as they are used over the useful life of the asset. Significant changes in the Government's net operating cost, including those related to the aforementioned longer-term estimated costs, are discussed in the next section.

Dollars in Billions	2013	2012
<b>Net Operating Cost</b>	<b>\$ (805.1)</b>	<b>\$ (1,316.3)</b>
Change in:		
Federal Employee and Veteran Benefits Payable	\$ 264.3	\$ 481.8
Property, Plant, and Equipment, Net <sup>1</sup>	\$ (41.7)	\$ (2.2)
Investments in Government-Sponsored Enterprises (GSEs)	\$ (30.9)	\$ 42.3
Insurance and Guarantee Program Liabilities	\$ (26.4)	\$ (5.3)
Liabilities to GSEs	\$ (9.0)	\$ (307.2)
Other, Net	\$ (31.5)	\$ 17.5
Subtotal - Net Difference:	\$ 124.8	\$ 226.9
<b>Budget Deficit</b>	<b>\$ (680.3)</b>	<b>\$ (1,089.4)</b>

<sup>1</sup> Includes the net effect of: capitalized fixed assets, depreciation expense, and asset disposals and revaluations

The *Reconciliation of Net Operating Cost and Unified Budget Deficit Statement*, as summarized in Table 3, shows how the Government's net operating cost from the primarily accrual-based financial statements relates to the more widely-known and primarily cash-based budget deficit. Table 3 shows how many of the elements described above contribute to the \$124.8 billion net difference between the Government's budget deficit and net operating cost for FY 2013, predominantly due to the \$264.3 billion increase in liabilities for Federal employee and veteran benefits payable, the effects of which impact net operating cost, but not the budget deficit.

<sup>13</sup> Interest outlays on Treasury debt held by the public are recorded in the budget when interest accrues, not when the interest payment is made. For federal credit programs, outlays are recorded when loans are disbursed, in an amount representing the present value cost to the Government (excluding administrative costs), or the credit subsidy cost. Credit programs record cash payments to and from the public in nonbudgetary financing accounts.

<sup>14</sup> [Joint Statement of Secretary Lew and OMB Director Burwell on Budget Results for Fiscal Year 2013.](#)

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

The Government's financial position and condition have traditionally been expressed through the *Budget*, focusing on surpluses, deficits, and debt. However, this primarily cash-based discussion of the Government's net outlays (deficit) or net receipts (surplus) tells only part of the story. The Government's accrual-based net position, (the difference between its assets and liabilities), and its "bottom line" net operating cost (the difference between its revenues and costs) are also key financial indicators.

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

The Government's *Statement of Operations and Changes in Net Position*, much like a corporation's income statement, shows the Government's "bottom line" and its impact on net position (i.e., assets net of liabilities). The Government nets its costs against both: (1) earned revenues from Government programs (e.g., Medicare premiums, national park entry fees, and postal service fees) to derive net cost; and (2) taxes and other revenue to arrive at the Government's "bottom line" net operating cost.

Dollars in Billions	2013		2012		Increase / (Decrease)	
	\$	%	\$	%	\$	%
<b>Gross Cost</b>	<b>(3,940.9)</b>		<b>(3,844.9)</b>		<b>96.0</b>	<b>2.5%</b>
Less: Earned Revenue <sup>1</sup>	415.5		350.8		64.7	18.4%
Gain/(Loss) from Changes in Assumptions <sup>2</sup>	(131.2)		(320.2)		(189.0)	(59%)
<b>Net Cost</b>	<b>(3,656.6)</b>		<b>(3,814.3)</b>		<b>(157.7)</b>	<b>(4.1%)</b>
Less: Taxes and Other Revenue	2,842.5		2,518.2		324.3	12.9%
Unmatched Transactions and Balances <sup>3</sup>	9.0		(20.2)		(29.2)	(144.6%)
<b>Net Operating Cost</b>	<b>(805.1)</b>		<b>(1,316.3)</b>		<b>(511.2)</b>	<b>(38.8%)</b>

1: Revenues earned for goods and services provided (e.g., Medicare premiums, national park entry fees, and postal fees)

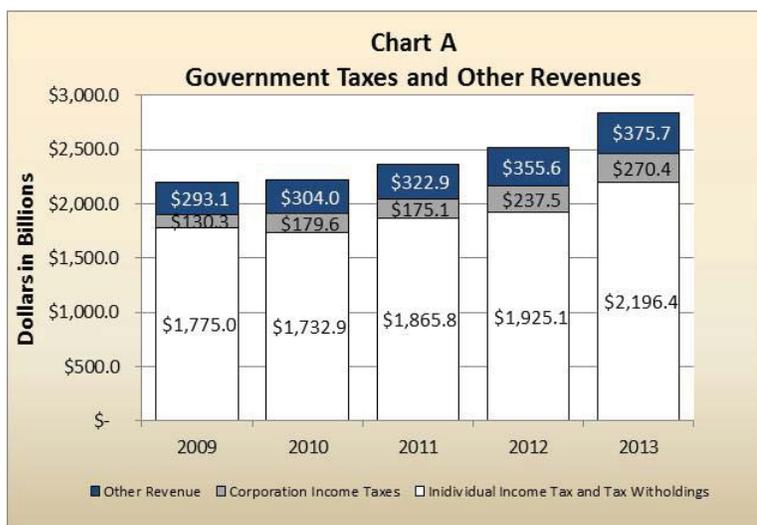
2: Changes in assumptions used to estimate liabilities for federal employee pensions and other retirement and postemployment benefits.

3: Primarily represents net unreconciled differences in intragovernmental activity and balances between federal agencies.

Table 4 shows that the Government's "bottom line" net operating cost decreased significantly from \$1,316.3 billion in FY 2012 to \$805.1 billion in FY 2013. As referenced earlier and discussed further below, this nearly 39 percent decrease is attributable to both revenue increases and cost decreases over the past fiscal year.

### Revenue: "What Came In"

The *Statement of Net Cost* reports "earned" revenue generated by federal programs (e.g., Medicare premiums paid by program participants, national park entry fees, and postal service fees). The *Statement of Operations and Changes in Net Position* shows the Government's taxes and other revenues (i.e., revenues other than "earned"). Chart A shows that increases in each of the three taxes and other revenue categories shown - individual income tax and withholdings, corporation income taxes, and other revenues - combined to increase total Government taxes and other revenues by \$324.3 billion (12.9 percent) to more than \$2.8 trillion for FY 2013. This change is primarily attributed to an increase in ordinary, capital gains, and dividend income tax rates for individuals, coupled with an increase in corporation income tax collections and a reduction in tax refunds.<sup>15</sup> As noted in the earlier



<sup>15</sup> Department of the Treasury FY 2013 Agency Financial Report, p. 29

discussion of budget receipts, these increases largely stem from the implementation of ATRA, the expiration of payroll tax relief provisions, and the ongoing economic recovery. Earned revenues are not shown in Chart A (see Table 4 for earned revenues). Together, individual income tax and tax withholdings and corporation income taxes accounted for about 87 percent of total revenues in FY 2013. The remaining 13 percent consists of various other taxes and receipts, including excise taxes, unemployment taxes, and customs duties.

### Cost: “What Went Out”

The *Statement of Net Cost* also shows how much it costs to operate the Federal Government, recognizing expenses when they happen, regardless of when payment is made (accrual basis). It shows the derivation of the Government's *net cost* or the net of: (1) the costs of goods produced and services rendered by the Government, (2) the earned revenues generated by those goods and services during the fiscal year, and (3) gains or losses from changes in assumptions impacting longer-term estimated costs. This amount, in turn, is offset against the Government's taxes and other revenue in the *Statement of Operations and Changes in Net Position* to calculate the “bottom line” or *net operating cost*.

The Government's net cost (gross cost less earned revenue and gain/loss from changes in assumptions) decreased \$157.7 billion to \$3,656.6 billion during FY 2013. Net cost is typically impacted by a variety of offsetting increases and decreases. For FY 2013, the single most significant driver of the decrease was a \$189 billion decrease in losses from changes in assumptions associated with the Government's civilian and military benefits programs. The Department of Defense (DOD), the Department of Veterans Affairs (VA), and the Office of Personnel Management (OPM) each attributed changes in their respective agency total net costs largely to decreases in losses from changes in assumptions related to these programs. DOD, VA, and OPM, and other agencies administering similar programs employ a complex series of assumptions, including but not limited to interest rates, beneficiary eligibility, life expectancy, medical cost levels, compensation levels, disability claims rates, and cost of living to make annual actuarial projections of their long-term benefits liabilities and their related costs. In fact, for DOD a \$133.3 billion decrease in losses from changes in actuarial assumptions accounted for the majority of the more than \$200 billion decrease in DOD's total net cost during FY 2013.

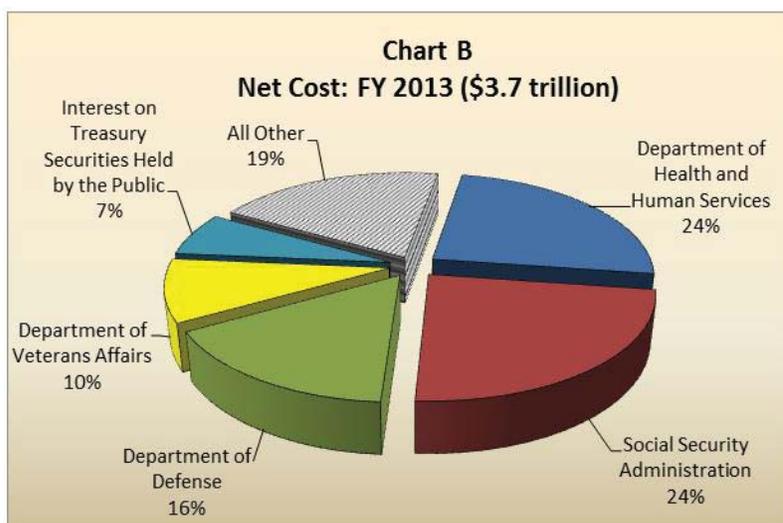


Chart B shows the composition of the Government's net cost. In FY 2013, almost two-thirds of total net cost came from DOD, the Social Security Administration (SSA), and the Department of Health and Human Services (HHS), which have consistently incurred the largest agency shares of the Government's total net cost in recent years, as shown in Charts B and C. The bulk of HHS and SSA net costs (which totaled \$895.7 billion and \$867.0 billion in FY 2013, respectively) are attributable to major social insurance programs administered by these agencies, e.g., Medicare by HHS and Social Security by SSA. The *Statement of Social Insurance* (SOSI) and the related information in this *Financial Report*, including the broader discussion of the Government's long-term fiscal projections, discuss the projected future revenues, expenditures, and sustainability of these programs in greater detail. DOD's net costs of \$577.4 billion relate primarily to operations, readiness, and support; personnel; research; procurement; and retirement and health benefits (noted earlier). Charts B and C show that the Department of Veterans Affairs (VA) as well as interest on debt held by the public were also significant contributors to the Government's net cost for FY 2013. The combined other agencies included in the Government's FY 2013 Statement of Net Cost accounted for 19 percent of the Government's total net cost for FY 2013.

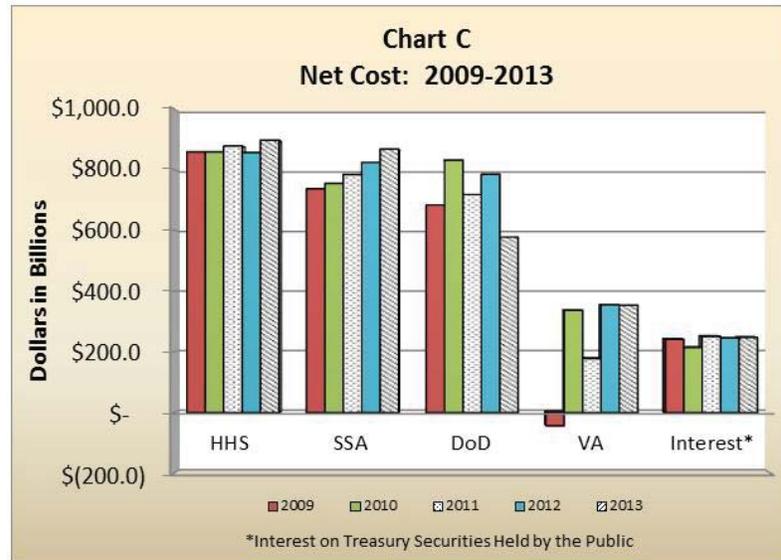
Among these other agencies, according to the Statement of Net Cost in this *Financial Report*, additional significant changes in the Government's total net cost included, but were not limited to: (1) a \$32.9 billion cost decrease at the Department of Education, including a \$24 billion decrease associated with reductions in the projected long-term costs of its direct student loan programs; (2) a \$31.4 billion decrease at the Department of Housing and Urban Development related largely to its Federal Housing Administration (FHA) programs; and (3) a \$22.5 billion decrease at the Department of Labor, primarily due to decreases in unemployment benefits provided under existing

## MANAGEMENT'S DISCUSSION AND ANALYSIS

statute which reduced the length of coverage, and lower levels of unemployment as compared to FY 2012.<sup>16</sup> These cost decreases were partially offset by cost increases in the SSA's Old Age Survivors and Disability Income (OASDI) and HHS' Medicare and Medicaid programs.

In addition, the FY 2013 Statement of Net Cost includes net revenues for Treasury for a second consecutive year. Treasury's net revenue in FY 2012 was largely attributable to a \$288.7 billion reduction in the contingent liability to the GSEs associated with GSE Senior Preferred Stock Purchase Agreements (SPSPAs). In FY 2013, the remaining \$9.0 billion contingent liability was eliminated.<sup>17</sup> Treasury investments made through the SPSPAs help maintain the solvency of GSEs, specifically Fannie Mae and Freddie Mac. During FY 2012, Treasury amended the SPSPA dividend provision, which commenced with the quarter ending March 31, 2013. Under this revision the GSEs no longer make draws to fund dividend payments to Treasury, since dividend payments are limited to the amount of the positive net worth in excess of a capital reserve amount. This change, as well as federal income tax benefits and other improvements in GSE financial performance, also contributed to a \$77.3 billion increase in senior preferred stock dividends to \$95.7 billion to Treasury in FY 2013. In addition, a \$30.9 billion gain on GSE investments was also recognized by Treasury in FY 2013, compared to a \$42.3 billion loss in 2012.<sup>18</sup>

As noted earlier, taxes and other revenues of \$2,842.5 billion are deducted from the total net cost of \$3,656.6 billion (including actuarial costs) to derive the Government's "bottom line" net operating cost of \$805.1 billion.<sup>19</sup> As previously shown in Table 4, the increase in taxes and other revenues, combined with the decrease in net costs, result in a net decrease of \$511.2 billion or 38.8 percent compared to the FY 2012 net operating cost of \$1,316.3 billion.



<sup>16</sup> Department of Labor FY 2013 Agency Financial Report, p. 25

<sup>17</sup> [Department of the Treasury FY 2013 Agency Financial Report](#), p. 29. Treasury's payments to the GSEs during FY 2012 reduced its contingent liability by an additional \$18.5 billion for a total contingent liability reduction of \$307.2 billion. See also Note 9 – Investments in and Liabilities to GSEs – of this *Financial Report*.

<sup>18</sup> [Department of the Treasury FY 2013 Agency Financial Report](#), p. 29. See also Note 9 – Investments in and Liabilities to GSEs – of this *Financial Report*.

<sup>19</sup> As shown in Table 4, net operating cost includes an adjustment for unmatched transactions and balances. These amounts are described in greater detail in the Other Information section of this *Financial Report*.

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

The Government's net position at the end of the year is derived by netting the Government's assets against its liabilities, as presented in the *Balance Sheet* (summarized in Table 5). It is important to note that the balance sheet does not include the financial value of the Government's sovereign powers to tax, regulate commerce, and set monetary policy. It also excludes its control over nonoperational resources, including national and natural resources, for which the Government is a steward. In addition, as is the case with the *Statement of Operations and Changes in Net Position*, the *Balance Sheet* includes a separate presentation of the portion of

net position related to funds from dedicated collections. Moreover, the Government's exposures are broader than the liabilities presented on the balance sheet, when such items as the Government's future social insurance exposures (namely, Medicare and Social Security), as well as other fiscal projections, commitments and contingencies, are taken into account. These exposures are discussed later in this Management Discussion and Analysis (MD&A) section as well as in the required supplementary disclosures of this *Financial Report*.

### Assets – "What We Own"

As of September 30, 2013, the Government held about \$3.0 trillion in assets, an increase of \$220.0 billion (8.0 percent). The Government's assets are comprised mostly of net loans receivable (\$1,022.3 billion) and net property, plant, and equipment (\$896.7 billion).<sup>20</sup> The Department of Education's (Education's) direct loan programs accounted for \$824.9 billion (80.7 percent) of total net loans receivable. Education's credit program receivables balances increased by 27 percent (\$143.7 billion) during FY 2012 and 23 percent (\$153.2 billion) during FY 2013 largely due to increased direct loan disbursements, attributable to the continued effect of 2011 legislation requiring a transition for new loans from guaranteed student loans to full direct lending by Education.<sup>21</sup>

Following the financial crisis in 2008, the Government's assets grew with the implementation of market stabilization and economic recovery initiatives. However, in recent years, with the ongoing wind-down of these recovery programs, the balances of many of these investments have declined principally through repayments and sales.<sup>22</sup> For example:

- Through the Troubled Asset Relief Program (TARP), Treasury made direct loans and equity investments, and entered into other credit programs. As of September 30, 2013, Treasury has collected a total of \$273.4 billion for all TARP bank support programs through dividends, interest, repayments, sales, and other income - \$27.9 billion more than the \$245.5 billion originally invested. No more taxpayer money is being invested in banks under TARP. The final investment under the Capital Purchase Program (CPP) – the largest bank program under TARP – was made in December 2009. Treasury is focused on recovering

Net Position Dollars in Billions	2013		2012		Increase (Decrease)	
	\$	%	\$	%	\$	%
<b>Assets</b>						
Cash & Other Monetary Assets	\$ 206.3		\$ 206.2		\$ 0.1	0.0%
Loans Receivable and Mortgage-Backed Securities, Net	\$ 1,022.3		\$ 859.6		\$ 162.7	18.9%
Inventories & Related Property, Net	\$ 311.1		\$ 299.0		\$ 12.1	4.0%
Property, Plant & Equipment, Net	\$ 896.7		\$ 855.0		\$ 41.7	4.9%
Other	\$ 531.9		\$ 528.5		\$ 3.4	0.6%
<b>Total Assets</b>	<b>\$ 2,968.3</b>		<b>\$ 2,748.3</b>		<b>\$ 220.0</b>	<b>8.0%</b>
<b>Less: Liabilities, comprised of:</b>						
Federal Debt Held by the Public & Accrued Interest	\$ (12,028.4)		\$ (11,332.3)		\$ 696.1	6.1%
Federal Employee & Veteran Benefits	\$ (6,538.3)		\$ (6,274.0)		\$ 264.3	4.2%
Other	\$ (1,310.9)		\$ (1,243.0)		\$ 67.9	5.5%
<b>Total Liabilities</b>	<b>\$ (19,877.6)</b>		<b>\$ (18,849.3)</b>		<b>\$ 1,028.3</b>	<b>5.5%</b>
<b>Net Position (Assets Minus Liabilities)</b>	<b>\$ (16,909.3)</b>		<b>\$ (16,101.0)</b>		<b>\$ (808.3)</b>	<b>(5.0%)</b>

<sup>20</sup> For financial reporting purposes, other than multi-use heritage assets, stewardship assets are not recorded as part of Property, Plant, and Equipment. Stewardship assets are comprised of stewardship land and heritage assets. Stewardship land consists of public domain land (e.g., national parks, wildlife refuges). Heritage assets include national monuments and historical sites that among other characteristics are of historical, natural, cultural, educational, or artistic significance. See Note 25 – Stewardship Land and Heritage Assets.

<sup>21</sup> With the enactment of the SAFRA Act, formerly known as the Student Aid and Fiscal Responsibility Act, which was included as part of the Health Care and Education Reconciliation Act of 2010 (HCERA) (Pub. L. 111-152), beginning in July 2010, no new loans were originated under the Federal Family Education Loan (FFEL) Program (<http://studentaid.ed.gov/sites/default/files/fsawg/datacenter/library/FY2013FederalStudentAidAnnualReport.pdf>). See also: [U.S. Department of Education FY 2013 Agency Financial Report](#) p. 23.

<sup>22</sup> As of September 30, 2013, TARP Direct Loans and Equity Investments and Investments in GSEs represented 0.6 percent and 4.7 percent of total assets, respectively.

TARP funds in a manner that continues to promote the nation's financial stability while maximizing returns on behalf of the taxpayers.<sup>23</sup>

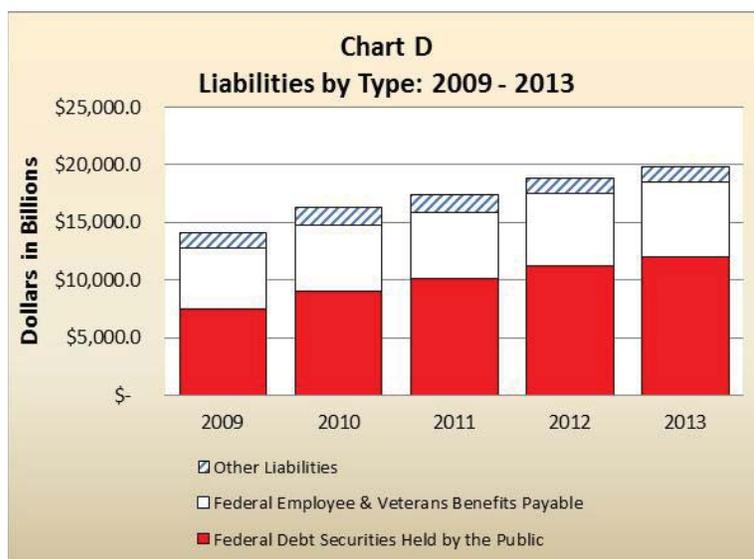
- Treasury continues to wind down the Automotive Industry Financing Program with the sale of 399 million shares of General Motors (GM) common stock during FY 2013. The remaining shares were sold in December 2013. These sales were conducted according to the plan announced in December 2012 to sell Treasury's remaining shares in GM within the next 12-15 months, subject to market conditions.<sup>24</sup>
- Treasury exited its remaining holdings in the American International Group, Inc. (AIG) Investment Program in December 2012 and sold remaining warrants in March 2013. As of September 30, 2013, Treasury does not hold any residual interest in AIG.<sup>25</sup>
- As noted earlier, amounts invested in the GSEs through the SPSPAs help maintain the solvency of Fannie Mae and Freddie Mac, since Treasury will disburse funds to the GSEs if, at the end of any quarter, the liabilities of either GSE exceeds its assets. As of September 30, 2013, the fair value of Treasury's portfolio of SPSPA investments totaled \$140.2 billion compared to \$109.3 billion as of September 30, 2012. Additionally, as noted earlier, as a result of the amended SPSPAs, coupled with the GSE's long-term financial forecasts within a specific time horizon, Treasury's contingent liability associated with the GSE program decreased by \$9.0 billion and \$288.7 billion at the end of FYs 2013 and 2012, respectively.<sup>26</sup>

Beyond these assets, other significant resources are available to the Government, including stewardship assets, such as natural resources, and the Government's power to tax and set monetary policy.

### Liabilities – “What We Owe”

As indicated in Table 5 and Chart D, of the Government's \$19.9 trillion in total liabilities, the largest liability is federal debt held by the public and accrued interest, the balance of which increased \$696.1 billion (6.1 percent) to \$12.0 trillion as of September 30, 2013.

The other major component of the Government's liabilities is federal employee postemployment and veteran benefits payable (i.e., the Government's pension and other benefit plans for its military and civilian employees), which increased \$264.3 billion (4.2 percent) during FY 2013, from \$6,274.0 billion to \$6,538.3 billion. OPM administers the largest civilian pension plan, covering nearly 2.7 million current employees and 2.5 million annuitants and survivors.<sup>27</sup> The military pension plan covers more than three million current military personnel (including active service, reserve, and National Guard) and approximately 2.2 million retirees and annuitants.<sup>28</sup>



### Federal Debt

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

<sup>23</sup> Department of the Treasury, Office of Financial Stability FY 2013 Agency Financial Report, p. 10.

<sup>24</sup> Department of the Treasury, Office of Financial Stability FY 2013 Agency Financial Report, p. ix; Department of the Treasury FY 2013 Agency Financial Report, p. 27.

<sup>25</sup> Department of the Treasury, Office of Financial Stability FY 2013 Agency Financial Report, p. ix.

<sup>26</sup> U.S. Department of the Treasury FY 2013 Agency Financial Report, p. 26. Treasury's payments to the GSEs during FY 2012 reduced its contingent liability by an additional \$18.5 billion for a total contingent liability reduction of \$307.2 billion. See also Note 9 – Investments in and Liabilities to GSEs – of this *Financial Report*.

<sup>27</sup> OPM FY 2013 Agency Financial Report, p. 1.

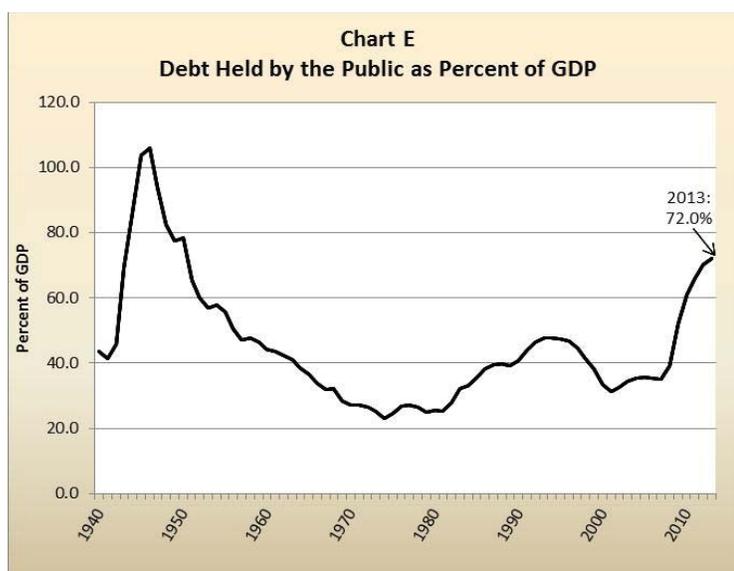
<sup>28</sup> DOD FY 2013 Agency Financial Report, p.7; DOD Military Retirement Fund (MRF) financial statements, p. 13.

and changes in cash and other monetary assets. It also explains how a budget surplus or deficit normally affects changes in debt balances.

The Government's publicly-held debt, or federal debt held by the public, and accrued interest, which is reported on the Government's balance sheet as a liability, is comprised of Treasury securities, such as bills, notes, and bonds, net of unamortized discounts and premiums; and accrued interest payable. The "public" consists of individuals, corporations, state and local governments, Federal Reserve Banks, foreign governments, and other entities outside the Federal Government. Federal debt held by the public and accrued interest totaled \$12.0 trillion as of September 30, 2013. As indicated above, budget surpluses have typically resulted in borrowing reductions, and budget deficits have conversely yielded borrowing increases. However, the Government's debt operations are generally much more complex than this would imply. Each year, trillions of dollars of debt matures and new debt is issued to take its place. In FY 2013, new borrowings were \$8.1 trillion and repayments of maturing debt held by the public were \$7.4 trillion. Both represented increases over new borrowings and debt repayments as compared to FY 2012.

In addition to debt held by the public, the Government has about \$4.8 trillion in intragovernmental debt outstanding, which arises when one part of the Government borrows from another. It represents debt issued by the Treasury and held by Government accounts, including the Social Security (\$2.8 trillion) and Medicare (\$273.4 billion) trust funds. Intragovernmental debt is primarily held in Government trust funds in the form of special nonmarketable securities by various parts of the Government. Laws establishing Government trust funds generally require excess trust fund receipts (including interest earnings) over disbursements to be invested in these special securities. Because these amounts are both liabilities of the Treasury and assets of the Government trust funds, they are eliminated as part of the consolidation process for the government-wide financial statements (see Note 12). When those securities are redeemed, e.g., to pay future Social Security benefits, the Government will need to obtain the resources necessary to reimburse the trust funds. The sum of debt held by the public and intragovernmental debt equals gross federal debt, which (with some adjustments), is subject to a statutory ceiling (i.e., the debt limit). At the end of FY 2013, debt subject to the statutory limit was \$16.699 trillion, \$25 million under the debt limit.

Prior to 1917, the Congress approved each debt issuance. In 1917, to facilitate planning in World War I, Congress established a dollar ceiling for federal borrowing. With the Public Debt Act of 1941 (Public Law 77-7), Congress and the President set an overall limit of \$65 billion on Treasury debt obligations that could be outstanding at any one time. Since then, Congress and the President have enacted a number of debt limit increases. Recently, pursuant to the BCA, the debt limit was raised by a combined \$2.1 trillion to \$16.394 trillion between August 2011 and January 2012. In February 2013, pursuant to the No Budget, No Pay Act of 2013 (Public Law 113-3), Congress suspended the debt limit, enabling the debt to increase as needed through May 18, 2013 in accordance with payment requirements, ultimately to an adjusted debt limit of \$16.699 trillion, where it remained through the end of the fiscal year. Because the debt limit had not yet been raised before the suspension period ended, Treasury began implementing "extraordinary measures", on a temporary basis, which were still in effect on September 30, 2013, to enable the Government to protect the full faith and credit of the U.S. Government by continuing to pay the nation's bills. As of October 17, 2013, P.L. 113-46 again suspended the debt limit, this time through February 7, 2014. As of February 15, 2014, P.L. 113-83 again suspended the debt limit, this time through March 15, 2015.<sup>29</sup> It is important to note that increasing or suspending the debt limit does not increase



<sup>29</sup> A delay in raising the statutory debt limit existed as of September 30, 2013. When delays in raising the statutory debt limit occur, Treasury often must deviate from its normal debt management operations and take a number of extraordinary actions to meet the Government's obligations as they come due without exceeding the debt limit. Many extraordinary actions taken by Treasury during the period of May 20, 2013, through September 30, 2013 resulted in federal debt securities not being issued to certain federal government accounts. As a result of Treasury securities not being issued to the Federal Retirement Thrift Investment Board (FRTIB) Thrift Savings Plan (TSP), Treasury reported miscellaneous liabilities in the amount of \$120.4 billion that represent uninvested principal of and related interest for the TSP that would have been reported as Federal Debt Securities Held by the Public and Accrued Interest had there not been a delay in raising the statutory debt limit as of September 30, 2013, and had the securities been issued. See Note 17, Other Liabilities, and Note 26, Subsequent Events, for more information.

spending or authorize new spending; rather, it permits the United States to continue to honor pre-existing commitments to its citizens, businesses, and investors domestically and around the world.

The federal debt held by the public measured as a percent of GDP (debt-to-GDP ratio) (Chart E) compares the country's debt to the size of its economy, making this measure sensitive to changes in both. Over time, the debt-to-GDP ratio has varied widely. For most of the nation's history, the debt-to-GDP ratio has tended to increase during wartime and decline during peacetime. That pattern continued to hold following World War II until the 1970s. As shown in Chart E, wartime spending and borrowing had pushed the debt-to-GDP ratio to an all-time high of 106 percent in 1946, but it decreased rapidly in the post-war years, falling to 79 percent by 1950, 44 percent in 1960, and the postwar low point of 23 percent in 1974. Since then, the ratio has increased, growing rapidly from the mid-1970s until the early 1990s. In the 1990s, strong economic growth and fundamental fiscal decisions, including measures to reduce the federal deficit and implementation of binding "Pay As You Go" ("PAYGO") rules, generated a significant decline in the debt-to-GDP ratio over the course of the 1990s, from a peak of 48 percent in 1993-1995, to 31 percent in 2001. During the last decade, much of this progress was undone as PAYGO rules were allowed to lapse, significant tax cuts were implemented, entitlements were expanded, and spending related to defense and homeland security increased. By September 2008, the debt-to-GDP ratio was 39 percent of GDP. The extraordinary demands of the recent economic and fiscal crisis and the consequent actions taken by the Federal Government, combined with slower economic growth in the wake of the crisis, pushed the debt-to-GDP ratio up to about 72 percent as of September 30, 2013.<sup>30</sup>

## The Economy in Fiscal Year 2013

A review of the nation's key macroeconomic indicators can help place the discussion of the Government's financial results in a broader context. As summarized in Table 6, the economy continued to expand, but at a slower rate, during FY 2013. Job growth picked up. The unemployment rate declined during FY 2013 but remained above the 5.5 percent average that prevailed in the 1990s and 2000s.

After rising 3.1 percent during FY 2012, real GDP growth slowed to 2.0 percent over the four quarters of FY 2013. Consumer spending rose 1.9 percent during FY 2013, down from a gain of 2.2 percent during FY 2012. Residential fixed investment strengthened during FY 2013, rising by 14.2 percent over the four quarters of FY 2013, compared with an increase of 13.6 percent during FY 2012. Nonresidential fixed investment grew 3.5 percent, slowing from a 5.0 percent increase during the previous fiscal year.

Labor market conditions improved further during FY 2013, despite a moderation in the pace of job growth towards the end of the fiscal year. The economy added 2.4 million total nonfarm payroll jobs during FY 2013, slightly more than the 2.1 million nonfarm payroll jobs added during FY 2012. On a monthly basis, total nonfarm payroll employment advanced at an average rate of 198,000 jobs, slightly faster than the average monthly increase of 178,000 in FY 2012. The number of unemployed persons fell from 12.1 million in September 2012 to 11.2 million in September 2013. The unemployment rate declined 0.6 percentage point, from 7.8 percent in September 2012 to 7.2 percent in September 2013. At the end of FY 2013, the unemployment rate was 2.8 percentage points lower than the recent peak of 10.0 percent, reached in October 2009.

Inflation continued to decelerate, mainly reflecting lower energy and food price inflation. The overall price level, as measured by the consumer price index (CPI), rose 1.2 percent during FY 2013. In FY 2012, the CPI had increased by 2.0 percent. Underlying core inflation (the CPI excluding food and energy) also decelerated, increasing 1.7 percent during FY 2013, down from 2.0 percent the previous fiscal year. The level of core inflation in FY 2013 was low by historical standards.

**Table 6: National Economic Indicators\***

	FY 2013	FY 2012
Real GDP Growth	2.0%	3.1%
Residential Investment Growth	14.2%	13.6%
Average monthly payroll job change (thousands)	198	178
Unemployment rate (percent, end of period)	7.2%	7.8%
Consumer Price Index (CPI)	1.2%	2.0%
CPI, excluding food and energy	1.7%	2.0%
Treasury constant maturity 10-year rate (end of period)	2.64%	1.65%
Moody's Baa bond rate (end of period)	4.7%	5.4%

\* Some FY2012 data may differ from the FY2012 *Financial Report* due to updates and revisions

<sup>30</sup> The debt/GDP ratios were calculated using National Income and Product Accounts (NIPA)-revised GDP figures, resulting in a slight decline in the debt/GDP ratio when compared to the unrevised historical series (see MD&A footnote 8).

Real wages for private production and nonsupervisory workers rose during FY 2013, following a decline in the previous fiscal year, as nominal wage growth accelerated and inflation moderated. The level of corporate profits increased in FY 2013, but at a somewhat slower pace than in the previous fiscal year. Federal spending declined, and federal tax receipts grew in FY 2013. As a result, the federal unified budget deficit fell to \$680.3 billion in FY 2013, and also narrowed as a share of the economy to 4.1 percent of GDP from 6.8 percent in FY 2012.

This economic performance occurred against a backdrop of generally stable conditions in financial markets in FY 2013. Yields on corporate bonds of moderate risk were about 307 basis points above the rate on 10-year Treasury securities at the end of FY 2012. This spread decreased and remained below that level throughout the following fiscal year, ending FY 2013 at 275 basis points. The difference between the 3-month London Interbank Offered Rate (LIBOR) and the 3-month Treasury rate stood at 30 basis points at the end of FY 2012. This spread generally narrowed over the course of the latest fiscal year, ending FY 2013 at 26 basis points.

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

While the Government’s immediate priority is to continue to foster economic recovery, there are longer-term fiscal challenges that must ultimately be addressed. Persistent growth of health care costs and the aging of the population due to the retirement of the “baby boom” generation and increasing longevity will make it increasingly difficult to fund critical social programs, including Medicare, Medicaid, and Social Security.

### Fiscal Sustainability

An important purpose of the *Financial Report* is to help citizens understand current fiscal policy and the importance and magnitude of policy reforms necessary to make it sustainable. A sustainable policy is one where the debt-to-GDP ratio is stable or declining over the long term.

To determine if current fiscal policies are sustainable, the projections discussed here assume current policy will be sustained indefinitely and draw out the implications for the growth of debt held by the public as a share of GDP.<sup>31</sup> The projections are therefore neither forecasts nor predictions. As policy changes are enacted, actual financial outcomes will of course be different than those projected.

The projections in this *Financial Report* indicate that current policy is not sustainable. The debt-to-GDP ratio is projected to reach 277 percent in 2088 and to rise continuously thereafter. Preventing the debt-to-GDP ratio from rising over the next 75 years is estimated to require some combination of spending reductions and revenue increases that amount to 1.7 percent of GDP over the period. While this estimate of the “75-year fiscal gap” is highly uncertain, it is nevertheless nearly certain that current fiscal policies cannot be sustained indefinitely.

It is important to address the Government’s fiscal imbalances soon. Delaying action increases the magnitude of spending reductions and/or revenue increases necessary to stabilize the debt-to-GDP ratio. Relative to a reform that begins immediately, for example, it is estimated that the magnitude of reforms necessary to close the 75-year fiscal gap is more than 20 percent larger if reforms are delayed by just ten years, and more than 50 percent larger if reform is delayed 20 years.

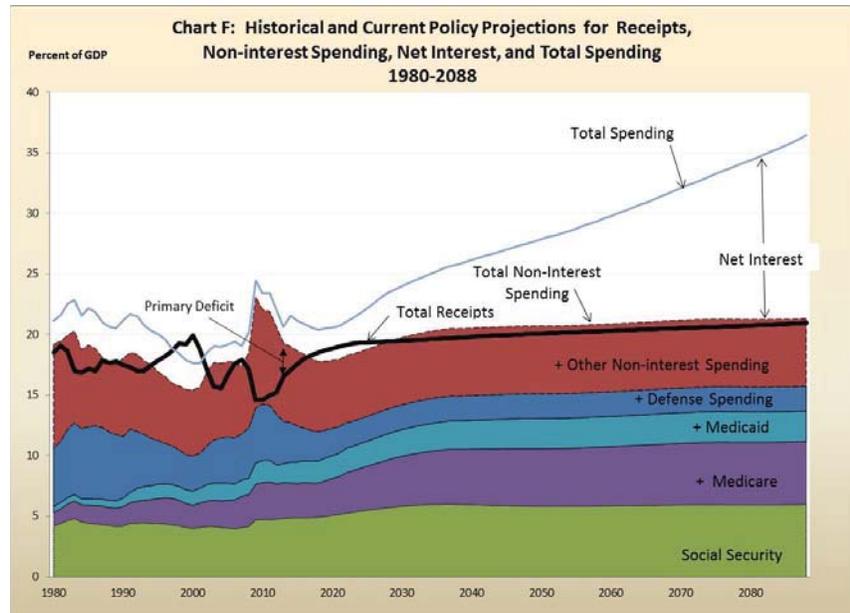
The estimates of the cost of policy delay in this *Financial Report* assume policy does not affect GDP or other economic variables. Reducing deficits too abruptly would be counterproductive if it slows the economy’s recovery. Conversely, delaying fiscal adjustments for too long raises the risk that growing federal debt would increase interest rates and slow economic growth. In the near term, it is crucial to strike the proper balance between deficit reduction and economic growth.

<sup>31</sup> Current policy in the projections is based on current law, but includes extension of certain policies that expire under current law but are routinely extended or otherwise expected to continue, such as reauthorization of the Supplemental Nutrition Assistance Program.

## The Primary Deficit, Interest, and Debt

The primary deficit – the difference between non-interest spending and receipts – is the only determinant of the debt-to-GDP ratio that the Government controls directly. (The other determinants are interest rates and growth in GDP). Chart F shows receipts, non-interest spending, and the difference – the primary deficit – expressed as a share of GDP (primary deficit-to-GDP ratio). The primary deficit-to-GDP ratio grew rapidly in 2009 due to the financial crisis and the recession and the policies pursued to combat both. The ratio stayed large from 2010 to 2012 despite shrinking in each successive year, and fell significantly in 2013. The primary deficit is projected to shrink in the next few years as spending reductions called for in the BCA take effect and the economy recovers, becoming a primary surplus in 2017 that peaks at 1.1 percent of GDP in 2021.

Between 2022 and 2037, however, increased spending for Social Security and health programs due to continued aging of the population is expected to cause the primary balance to steadily decline and become a primary deficit starting in 2029 that grows to 0.8 percent of GDP by 2036. After 2037, the projected primary deficit-to-GDP ratio slowly declines to 0.4 percent in 2088 as the impact of the baby boom generation retiring dissipates.



of the population is expected to cause the primary balance to steadily decline and become a primary deficit starting in 2029 that grows to 0.8 percent of GDP by 2036. After 2037, the projected primary deficit-to-GDP ratio slowly declines to 0.4 percent in 2088 as the impact of the baby boom generation retiring dissipates.

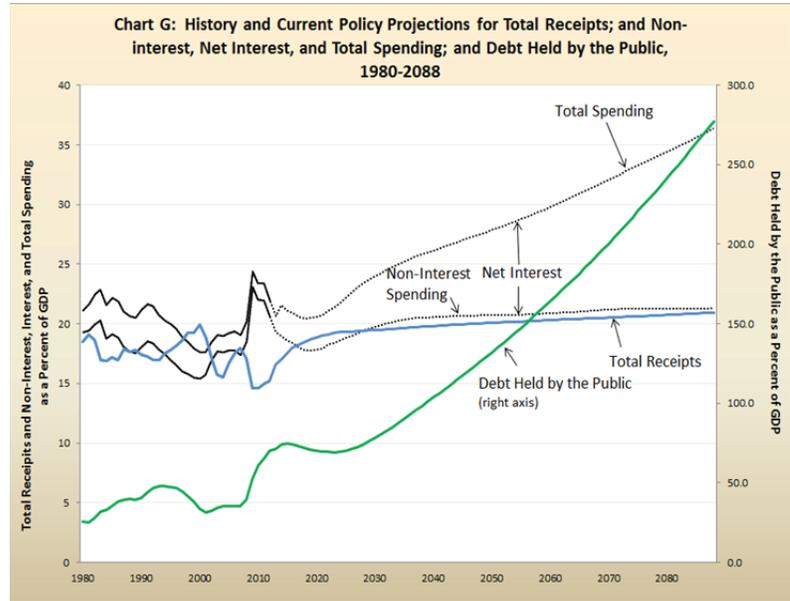
The revenue share of GDP fell substantially in 2009 and 2010 and remained low in 2011 and 2012 because of the recession and tax reductions enacted as part of the American Recovery and Reinvestment Act of 2009 (ARRA) and the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010. The share rose to 17 percent in 2013 and is projected to return to near its long-run average as the economy recovers and higher tax rates called for by ATRA take effect. After the economy has fully recovered around 2020, receipts are projected to grow slightly more rapidly than GDP as increases in real incomes cause more taxpayers and a larger share of income to fall into the higher individual income tax brackets.

The non-interest spending share of GDP is projected to stay at or below its current level of about 19 percent until 2026, and to then rise gradually to 20.6 percent of GDP in 2042 and 21.3 percent of GDP in 2088. The reductions in the non-interest spending share of GDP over the next two years are mostly due to the expected reductions in spending for overseas contingency operations, caps on discretionary spending, and the automatic spending limits mandated by the BCA, and the subsequent increases are principally due to growth in Medicare, Medicaid, and Social Security spending (see Chart F). The retirement of the baby boom generation over the next 25 years is projected to increase the Social Security, Medicare, and Medicaid spending shares of GDP by about 1.2 percentage points, 1.6 percentage points and 0.8 percentage points, respectively. After 2038, the Social Security spending share of GDP gradually declines and then returns to 2038 levels, while the Medicare and Medicaid spending share of GDP continues to increase, albeit at a slower rate, due to projected increases in health care costs. The Affordable Care Act (ACA)<sup>32</sup> provision of health insurance subsidies and expanded Medicaid coverage boost federal spending and other ACA provisions significantly reduce per-beneficiary Medicare and Medicaid cost growth. On net, the ACA is projected to substantially reduce the cost growth rate of federal expenditures for Medicare over the next 75 years. However, there is uncertainty about whether the projected cost savings, productivity improvements, and reductions in physician payment rates will be sustained in a manner consistent with the projected cost growth over time.

<sup>32</sup> P.L. 111-148, as amended by P.L. 111-152. The ACA expands health insurance coverage, provides health insurance subsidies for low-income individuals and families, includes many measures designed to reduce health care cost growth, and reduces the annual increases in Medicare payment rates.

The primary deficit-to-GDP projections and Chart F, along with projections for interest rates, determine the debt-to-GDP ratio projections shown in Chart G. That ratio was 72 percent at the end of FY 2013 and under current policy is projected to be 69 percent in 2023, 112 percent in 2043, and 277 percent in 2088. The continuous rise of the debt-to-GDP ratio after 2023 indicates that current policy is unsustainable.

The debt projections in Chart G are substantially lower than those projected in last year’s *Financial Report*. The projected debt-to-GDP ratio in 2087 shown in Chart G is 272 percent, which compares with 395 percent projected in last year’s *Financial Report*. Many factors contributed to the improvement. Most notable were: (i) improvements in the outlook for Medicare finances and for Medicaid spending as reflected in the 2013 Medicare Trustees report and the 2012 Medicaid Actuarial Report, respectively, and (ii) the enactment of the ATRA, which allowed the 2001/2003 tax cuts to expire for taxpayers with incomes above \$400,000 for individuals and above \$450,000 for couples. The long-term projections of current policy in the FY 2012 *Financial Report* assumed that all of the 2001/2003 tax cuts would be extended.



### The Fiscal Gap and the Cost of Delaying Policy Reform

The 75-year fiscal gap is one measure of the degree to which current fiscal policy is unsustainable. It is the amount by which primary surpluses over the next 75 years must rise above current-policy levels in order to prevent the debt-to-GDP ratio from rising. It is estimated that running primary surpluses that average 1.3 percent of GDP over the next 75 years would result in the 2088 debt-to-GDP ratio equaling its level in fiscal year 2013, which compares with primary deficits that average 0.4 percent of GDP under current policies. The 75-year fiscal gap is therefore 1.7 percent of GDP, which is 8.6 percent of the 75-year present value of projected receipts and 8.4 percent of the 75-year present value of non-interest spending.

It is noteworthy that preventing the debt-to-GDP ratio from rising over the next 75 years requires that primary surpluses be substantially positive on average. This is true because projected GDP growth rates are, on average, smaller than the projected government borrowing rate over the next 75 years. The implication is that debt would grow faster than GDP if primary surpluses were zero on average. For example, if the primary surplus was precisely zero in every year, then debt would grow at the rate of interest in every year, which would be faster than GDP growth.

Table 7 illustrates the cost of delaying policy to close the fiscal gap by comparing three policies that begin on different dates. The first policy begins immediately and calls for increasing primary surpluses by 1.7 percent of GDP in every year between 2014 and 2088. This is accomplished by invoking some combination of spending reductions and revenue increases that amount to 1.7 percent of GDP in every year over the 75-year projection period. The second policy in Table 7 begins in 2024. Because debt grows unabated between 2014 and 2024 and the same fiscal consolidation must be compressed into ten fewer years, this policy change is more abrupt, calling for primary surplus increases amounting to 2.1 percent of GDP in every year between 2024 and 2088. Similarly, if debt is allowed to accumulate unabated for 20 years, then closing the 75-year fiscal gap would require even more abrupt primary surplus increases amounting to 2.6 percent of GDP in every year between 2034 and 2088. The differences between the primary surplus boost starting in 2024 and 2034 (2.1 and 2.6 percent of GDP, respectively) and the primary surplus boost starting in 2014 (1.7 percent of GDP) is a measure of the additional burden policy delay

Period of Delay	Change in Average Primary Surplus
No Delay: Reform in 2014.....	1.7 percent of GDP between 2014 and 2088
Ten Years: Reform in 2024.....	2.1 percent of GDP between 2024 and 2088
Twenty Years: Reform in 2034..	2.6 percent of GDP between 2034 and 2088

Note: Reforms taking place in 2013, 2023, and 2033 from the 2012 Financial Report were 2.7, 3.2, and 4.1 percent of GDP.

would impose on future generations. Future generations are harmed by a policy delay of this sort because the higher the primary surplus is during their lifetimes the greater the difference is between the taxes they pay and the programmatic spending from which they benefit.

## Conclusion

The Government took significant steps towards a sustainable fiscal policy by enacting the ACA in 2010, the BCA in 2011, and ATRA in 2013. The ACA holds the prospect of lowering long-term per-beneficiary spending growth for Medicare and Medicaid, the BCA significantly curtails discretionary spending, and ATRA increases revenues. Together, these three laws substantially reduce the estimated long-term fiscal gap. But even with the new laws, the debt-to-GDP ratio is projected to remain about flat over the next ten years and then commence a continuous rise over the remaining projection period and beyond if current policies are kept in place. This trend implies that current policies are not sustainable. Subject to the important caveat that changes in policy are not so abrupt that they slow the economy's recovery, the sooner policies are put in place to avert these trends, the smaller the revenue increases and/or spending decreases will need to be to return the Government to a sustainable fiscal path over the long term.

While this *Financial Report's* projections of expenditures and receipts under current policy are highly uncertain, it is nevertheless nearly certain that current policy cannot be sustained indefinitely.

These and other issues concerning fiscal sustainability are discussed in further detail in the Required Supplementary Information section of this *Financial Report*.

## Statement of Social Insurance – Challenges Continue

The preceding analysis of the Government's long-term fiscal projections considered Government receipts and spending as a whole. The Statement of Social Insurance (SOSI) provides a more focused perspective of the Government's "social insurance" programs: Social Security, Medicare, Railroad Retirement, and Black Lung.<sup>33</sup> For these programs, the SOSI reports: (1) the actuarial present value of all future program revenue (mainly taxes and premiums) - excluding interest - to be received from or on behalf of current and future participants; (2) the estimated future scheduled expenditures to be paid to or on behalf of current and future participants; and (3) the difference between (1) and (2). Amounts reported in the SOSI and in the Required Supplementary Information section in this *Financial Report* are based on each program's official actuarial calculations. By accounting convention, the transfers of general revenues are eliminated in the consolidation of the SOSI at the government-wide level and as such, the general revenues that are used to finance Medicare Parts B and D are not included in these calculations even though the expenditures on these programs are included. For the FY 2013 and 2012 SOSI, the amounts eliminated totaled \$22.5 trillion and \$21.6 trillion, respectively. SOSI programs and amounts are included in the broader fiscal sustainability analysis in the previous section, although on a slightly different basis (as described in the Required Supplementary Information section of this *Financial Report*).

The SOSI provides perspective on the Government's long-term estimated exposures and costs for social insurance programs. While these expenditures are not considered Government liabilities, they do have the potential to become expenses and liabilities in the future, based on the continuation of the social insurance programs' provisions contained in current law. The social insurance trust funds account for all related program income and expenses. Medicare and Social Security taxes, premiums, and other income are credited to the funds; fund disbursements may only be made for benefit payments and program administrative costs. Any excess revenues are invested in special non-marketable U.S. Government securities at a market rate of interest. The trust funds represent the accumulated value, including interest, of all prior program surpluses, and provide automatic funding authority to pay for future benefits.

<sup>33</sup> The Black Lung Benefits Act (BLBA) provides for monthly payments and medical benefits to coal miners totally disabled from pneumoconiosis (black lung disease) arising from their employment in or around the nation's coal mines. See <http://www.dol.gov/compliance/topics/benefits-comp-blacklung.htm>

Table 8 summarizes amounts reported in the SOSI, showing that net social insurance expenditures are projected to be \$39.7 trillion as of January 1, 2013 for the "Open Group", an increase of \$1.1 trillion over net expenditures of \$38.6 trillion projected in the 2012 *Financial Report*.<sup>34</sup> Table 9 summarizes the principal reasons for the changes in projected social insurance amounts during 2013 and 2012. For the current valuation (as of January 1, 2013), most of the combined change from the past year is attributable to a \$1.8 trillion increase in the present value of negative net cash outflow attributable to a change in the valuation period (e.g., replacing a small negative net cash flow for 2012 with a much larger negative net cash flow for 2087). This was largely offset by a \$1.0 trillion decrease in the present value of negative net cash outflow from changes in methodology and programmatic data for the OASDI program, including, but not limited to: (1) modifying the alignment of projected labor force participation with future trends in disability, longevity, and population levels, (2) updating ultimate age-sex specific unemployment rates based on the relative levels of long-term historical patterns, and (3) modeling the insured status of citizens and legal permanent residents separately from other immigrants. Projections for both the OASDI and Medicare Part A (Hospital Insurance) programs ( were also affected by changes in: (1) law – particularly various provisions of the ATRA; and (2) demographic assumptions (e.g., increased assumed immigration of individuals attaining legal permanent resident (LPR) status, decreased assumed immigration of those without LPR status, and lower assumed mortality and fertility rates). Economic and health care (for Medicare) assumptions (e.g., health care costs, taxable earnings, price inflation, and real interest rates) also impact the projections. For both OASDI and Medicare Part A: (1) the real interest rate is projected to be lower over the first 10 years of the current valuation; and (2) the starting economic values and near-term economic growth rates were updated. The effects of these changes on HHS are reported separately in Table 9 as HHS also includes the effect of specific healthcare assumptions in this category, including but not limited to utilization rate and case mix increase assumptions for skilled nursing facilities and lower projected Medicare Advantage program costs.<sup>35</sup>

As shown in the five-year SOSI, projected net expenditures for Medicare Parts A and B declined significantly between FY 2009 and FY 2010 reflecting provisions of the ACA. As reported in Note 24, there continues to be uncertainty about whether the projected cost savings, productivity improvements, and reductions in physician payment rates will be sustained in a manner consistent with the projected cost growth over time. Note 24 includes an alternative projection to illustrate the uncertainty of projected Medicare costs. As indicated earlier, GAO disclaimed opinions on the 2013, 2012, 2011 and 2010 SOSI because of these significant uncertainties.

Dollars in Billions	2013		2012		Increase / (Decrease)	
					\$	%
<b>Open Group (Net):</b>						
Social Security (OASDI)	\$ (12,294)	\$ (11,278)	\$ 1,016	9.0%		
Medicare (Parts A, B, & D)	\$ (27,302)	\$ (27,174)	\$ 128	0.5%		
Other	\$ (102)	\$ (102)	\$ 0	0.0%		
<b>Total Social Insurance Expenditures, Net (Open Group)</b>	<b>\$ (39,698)</b>	<b>\$ (38,554)</b>	<b>\$ 1,144</b>	<b>3.0%</b>		
<b>Total Social Insurance Expenditures, Net (Closed Group)</b>	<b>\$ (53,974)</b>	<b>\$ (51,604)</b>	<b>\$ 2,370</b>	<b>4.6%</b>		
<b>Social Insurance Net Expenditures as a % of Gross Domestic Product (GDP)*</b>						
<b>Open Group</b>						
Social Security (OASDI)	(1.2%)	(1.2%)				
Medicare (Parts A, B, & D)	(2.9%)	(3.0%)				
Other	0.0%	0.0%				
<b>Total (Open Group)</b>	<b>(4.0%)</b>	<b>(4.2%)</b>				
<b>Total (Closed Group)</b>	<b>(5.5%)</b>	<b>(5.6%)</b>				

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

\* GDP values used are from the 2013 & 2012 Social Security and Medicare Trustees Reports and represent the present value of GDP over the 75-year projection period. As the GDP used for Social Security and Medicare differ slightly in the Trust Fund Reports, the two values are averaged to estimate the 'Other' and Total Net Social Insurance Expenditures as % of GDP.

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

<sup>34</sup> 'Closed' Group and 'Open' Group differ by the population included in each calculation. From the SOSI, the 'Closed' Group includes: (1) participants who have attained eligibility and (2) participants who have not attained eligibility. The 'Open' Group adds future participants to the 'Closed' Group. See 'Social Insurance' in the Required Supplementary Information section in this *Financial Report* for more information.

<sup>35</sup> [FY 2013 HHS Agency Financial Report, pp 118-123, FY 2013 SSA Agency Financial Report, pp 70-73](#)

Costs as a percent of GDP of both Medicare and Social Security, which are analyzed annually in the Medicare and Social Security Trustees' Reports, are projected to increase substantially through 2035, because: (1) the number of beneficiaries rises rapidly as the "baby-boom" generation retires; and (2) the lower birth rates that have persisted since the baby boom cause slower growth in the labor force and GDP.<sup>36</sup> According to the Medicare Trustees' Report, under current law, including the assumption of the full implementation of ACA program changes, spending on Medicare is projected to rise from 3.6 percent of GDP in 2011 to 6.5 percent in 2086 (based on the Trustees intermediate set of assumptions). The Hospital Insurance (HI) Trust Fund is now expected to remain solvent until 2026, (two years later than reported last year), at which point tax income is estimated to be sufficient to pay 87 percent of estimated HI costs, declining to 73 percent by 2087.

As for Social Security, combined spending is projected to increase gradually from its current level of 5.0 percent of GDP to about 6.2 percent by 2035, declining to 6.0 percent by 2050 and remaining between 6.0 and 6.2 percent through 2087. The Social Security Trustees' Report indicates that annual OASDI income, including interest on trust fund assets, will exceed annual cost and trust fund assets will increase every year until 2021, at which time it will be necessary to begin drawing down on trust fund assets to cover part of expenditures until assets are exhausted in 2033 (no change from last year's Report), at which point continuing tax income would be sufficient to pay 77 percent of scheduled benefits in 2033 and 72 percent in 2087.<sup>37</sup>

As noted earlier, it is apparent that these programs are on a fiscally unsustainable path (as was previously discussed and as noted in the Trustees' Reports). Additional information from the Trustees Reports may be found in the Required Supplementary Information section of this *Financial Report*.

Dollars in Billions	2013	2012
<b>Net Present Value (NPV) - Open Group (Beginning of the Year)</b>	<b>\$ (38,554)</b>	<b>(33,830)</b>
<b>Changes In:</b>		
Valuation Period	\$ (1,813)	\$ (1,613)
Demographic data and assumptions	\$ (285)	\$ 518
Economic data and assumptions <sup>1</sup>	\$ (273)	\$ (1,039)
Law or policy	\$ (520)	\$ 193
Methodology and programmatic data <sup>1</sup>	\$ 1,034	\$ (471)
Economic and other healthcare assumptions <sup>2</sup>	\$ (94)	\$ (2,601)
Change in projection base <sup>2</sup>	\$ 807	\$ 289
Net Change in Open Group measure	\$ (1,144)	\$ (4,724)
<b>NPV - Open Group (End of the Year)</b>	<b>\$ (39,698)</b>	<b>\$ (38,554)</b>

<sup>1</sup> Relates to SSA.

<sup>2</sup> Relates to HHS.

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

## Systems, Controls, and Legal Compliance

### Systems

As federal agencies demonstrate success in obtaining opinions on their audited financial statements, the Federal Government continues to face challenges in implementing financial systems that meet federal requirements. The number of CFO Act agencies reporting non-compliance with one or more of the three Section 803(a) requirements of the Federal Financial Management Improvement Act (FFMIA) in FY 2013 was 9 in both FY 2013 and FY 2012, and the number of auditors reporting non-compliance with one or more of the three Section 803(a) FFMIA requirements was 11 in both FY 2013 and FY 2012. These results underscore the importance of current initiatives to standardize the financial management practices across the Federal Government.

Building on recent policies—including OMB Memoranda M-10-26, *Immediate Review of Financial Systems IT Projects*, and M-13-08, *Improving Financial Systems through Shared Services*—OMB issued Appendix D to Circular No. A-123 which defines new requirements for determining compliance with the FFMIA. The goal of this Appendix is to transform the Federal Government's compliance framework so that it will contribute to efforts to reduce the cost, risk, and complexity of financial system modernizations. The objective of this approach will be to provide additional flexibility for federal agencies to initiate smaller-scale financial modernizations as long as relevant financial management outcomes (e.g., clean audits, proper controls, timely reporting) are maintained. The Appendix:

- Replaces "check the box" compliance approaches with an outcome-based approach to assess FFMIA compliance and establishes a series of financial management goals that are common to all federal agencies;

<sup>36</sup> 2013 Annual Trustees Reports on Social Security and Medicare (Summary), p. 2.

<sup>37</sup> 2013 Annual Trustees Reports on Social Security and Medicare (Summary), pp. 3, 10.

- Removes unnecessary financial management system requirements that drive complexity and cost and focuses on requirements that emphasize the Federal Government's business and information needs;
- Eliminates the lengthy and resource-intensive financial system software test and certification program and the requirement that financial management system requirements be met through a single technology product and emphasizes the deployment of newer, cost-effective technology through shared service approaches; and
- Solidifies Treasury's role in achieving Government-wide financial systems policy goals by adding responsibilities to develop and maintain, in coordination with OMB and Federal agencies, Federal Financial Management System Requirements and to publish the requirements in the *Treasury Financial Manual*.

Appendix D will be effective for FY 2014 and OMB plans to continue to work closely with Treasury, the Chief Financial Officers Council and the President's Council of Inspectors General on Integrity and Efficiency to implement the guidance.

## Controls

Federal managers have a fundamental responsibility to develop and maintain effective internal controls. Effective internal controls help to ensure that programs are managed with integrity and resources are used efficiently and effectively through three objectives: effective and efficient operations, reliable financial reporting, and compliance with applicable laws and regulations. The safeguarding of assets is a subcomponent of each objective.

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

In FY 2013, the total number of material weaknesses for Chief Financial Officers (CFO) Act agencies decreased to 29, compared to 32 in FY 2012. Effective internal controls are a challenge not only at the agency level, but also at the government-wide level. GAO reported that at the government-wide level, material weaknesses resulted in ineffective internal control over financial reporting. While progress is being made at many agencies and across the Government in identifying and resolving internal control deficiencies, continued diligence and commitment are needed.

## Legal Compliance

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

## Financial Management Progress and Priorities

Since the passage of the CFO Act of 1990, the federal financial community has made important strides in instilling strong accounting and financial reporting practices. This year, 23 of the 24 CFO Act agencies obtained an opinion from the independent auditors on their financial statements. Out of the 24 major "CFO Act" agencies, there were 22 clean opinions,<sup>38</sup> 1 qualified opinion, and only one remaining disclaimer in FY 2013. In addition, 29 auditor-identified material weaknesses were reported in FY 2013, an approximate 52 percent decline from the 61 material weaknesses that were identified at the start of this past decade. An increasing number of federal agencies have initiated and sustained disciplined and consistent financial reporting operations, implemented effective internal

<sup>38</sup> The 22 agencies include HHS, which received a clean opinion on all statements except the Statement of Social Insurance and the Statement of Changes in Social Insurance, both of which received a disclaimer of opinion.

controls around financial reporting, and have successfully integrated transaction processing and accounting records. These efforts have resulted in improved results on financial statement audits. However, weaknesses in basic financial management practices and other limitations continue to prevent one major agency, and the Government as a whole, from achieving an audit opinion.

Today, accountability means providing transparent information to the public about where and how federal dollars are being spent. It means protecting against fraud. It means avoiding wasteful or excessive use of taxpayer funds. It means ensuring that we are not only responsible stewards of taxpayer dollars, but frugal stewards as well, looking for every opportunity to save money and create greater efficiencies.

We have come a long way since the passage of the CFO Act in 1990. Today, the federal financial management community is focused on three important improvement initiatives:

- Improving the quality, utility, and transparency of financial information;
- Protecting against waste, fraud, and abuse; and
- Helping agencies maximize the impact of their limited financial resources.

### **Improve the Quality, Utility, and Transparency of Federal Financial Information**

USAspending.gov was established to provide clear information on federal award spending. Continuing to improve the quality, utility and transparency of this federal spending information is a foundational Administration commitment to open government, as identified in the U.S. Government's National Action Plan for Open Government. To continue our efforts to improve the quality of spending data, OMB issued guidance in June 2013, directing agencies to validate the award-level data submitted to USAspending.gov. To align our federal spending and financial management transparency efforts, the Administration has transferred responsibility for USAspending.gov from GSA to Treasury. Treasury's leadership in executing a government-wide federal spending transparency vision will leverage existing financial reporting and offer opportunities to link data across multiple data sources for a more comprehensive public view. Treasury's work will enable the Federal Government to move forward in achieving the objective of making spending data more useful, accurate, and timely – consistent with the agency's other work through financial reporting, work on improper payment, among other priority areas. Over the next year, USAspending.gov will reflect improvements in both website usability and functionality, leveraging the lessons and successes learned from Recovery Act reporting and data display.

Moving forward, in concert with the Government Accountability & Transparency Board, OMB will continue to collaborate with both federal and non-federal stakeholders to evolve our government wide spending transparency framework to effectively provide the public with transparent information about how federal dollars are being spent. In addition, we will strengthen linkages between agency financial and performance data to provide better information on federal spending and impact.

### **Protect Against Waste, Fraud, and Abuse**

#### **Improper Payments**

Addressing improper payments is a central component of the Administration's overall efforts to eliminate waste, fraud, and abuse. In FY 2009, the improper payment rate was 5.42 percent. Since then, the Administration, working together with Congress, has substantially reduced improper payments by strengthening accountability and transparency through annual reviews by agency inspectors general, and expanded requirements for high-priority programs. As a result of this concerted effort, the improper payment rate declined from 3.74 percent in FY 2012 to 3.53 percent in FY 2013, when Department of Defense (DOD) commercial payments are considered. When DOD commercial payments are excluded from the government-wide figures, the rate declined from 4.35 percent in FY 2012 to 4.00 percent in FY 2013<sup>39</sup>. Over the past year, we reduced improper payment rates in major programs across the government, including Medicaid, Medicare Advantage (Part C), Unemployment Insurance, and others. Furthermore, agencies recovered more than \$22 billion in overpayments through payment recapture audits and other methods in FY 2013.

Moving forward, we are focusing our actions toward a specific goal: to reach a government-wide improper payment rate of 3 percent or less by the end of FY 2016. In doing so, we are revising OMB Circular A-123, Appendix C, in order to reduce reporting burden and create a more granular taxonomy of improper payments. We are also conducting a comprehensive analysis of agency-specific corrective actions to identify programs with the highest potential for substantially reducing improper payments. In addition, we are working to improve the completeness of government-wide improper payment testing of all high risk programs. Finally, we are advancing

<sup>39</sup> More information about DOD improper payments can be found in DOD's Agency Financial Report (see <http://comptroller.defense.gov/FinancialManagement/Reports/afr2013.aspx>).

data analytics and improved technologies to prevent improper payments before they happen. In doing so, we established a Do Not Pay System of Record and strategy to screen federal payments. This includes obtaining necessary authorities and agreements to utilize the Full Death Master File, verifying that privacy protections are in place, and enforcing the disposition process on payments to deceased individuals, among other things.

### **Improving Grants Management**

On December 26, 2013, OMB published final guidance to better target risk and reduce waste, fraud, and abuse (2 CFR Part 200—Uniform Administrative Requirements, Cost Principles, And Audit Requirements for Federal Awards). This final guidance was developed by the interagency Council on Financial Assistance Reform (COFAR) to improve effectiveness for the approximately \$600 billion awarded annually in federal financial assistance. Representing a two-year collaborative effort across the Federal Government and its partners -- State and local governments, Indian tribes, research and higher education institutions, nonprofit organizations, and the audit community, the guidance rethinks and reforms the rules that govern our stewardship of federal dollars. It streamlines eight existing OMB Circulars on financial management into one consolidated set of guidance in the CFR. Specifically, the revised policies emphasize risk-based decision making to reduce administrative burden and waste, fraud, and abuse by:

- Eliminating duplicative and conflicting guidance;
- Focusing on performance over compliance for accountability;
- Encouraging efficient use of information technology and shared services;
- Providing for consistent and transparent treatment of costs;
- Limiting allowable costs to make the best use of federal resources;
- Setting standard business processes using data definitions;
- Encouraging non-federal entities to have family-friendly policies;
- Strengthening oversight; and
- Targeting audit requirements on risk of waste, fraud, and abuse.

Moving forward, the COFAR will work closely with federal agencies to develop, issue, and implement regulations for the new guidance by the effective date of December 26, 2014. The COFAR will also work with federal and non-federal stakeholders to develop additional training and outreach resources, and establish metrics that will measure the effectiveness of the new policies. In addition, OMB and its partners are continuing complementary work to strengthen program outcomes through innovative and effective use of grant-making models, performance metrics, and evaluation, as described in OMB Memorandum M-13-17 on *Next Steps in the Evidence and Innovation Agenda*.

## **Help Agencies Maximize the Impact of their Limited Financial Resources**

### **Improving Effectiveness and Efficiency in Financial Operations and Systems**

The Administration is making significant progress in the effort to minimize the costs and risks associated with agency financial systems modernization. In 2013, OMB issued M-13-08: *Improving Financial Systems Through Shared Services*. This new guidance directs all executive agencies to use, with limited exceptions, a shared service solution for future modernizations of core accounting or mixed systems and names the Office of Financial Innovation and Transformation (FIT) at the Department of the Treasury as OMB's partner in evaluating shared service providers and agency modernization plans. In 2013, two cabinet level Departments began working with Federal Shared Service Providers (FSSPs) to plan migration to shared services.

In 2014, OMB and FIT will build on these efforts and focus on improving cost, quality, and performance in agency and shared service financial management. Major emphasis areas will be:

- Identifying and naming any new entrants to the FSSP community;
- Developing and publishing performance and cost information for all FSSPs in a product services catalog;
- Developing meaningful benchmarks and metrics to measure the cost, quality, and performance of financial operations throughout the government; and
- Developing a sound governance model to support greater use of shared services by agencies while ensuring adequate input on major decisions by customer agencies.

### **Driving Real Property Efficiencies through Better Data and Data Analytics**

The federal real estate inventory contains over 360,000 building assets, 485,000 separate structures, and 43 million acres of federal land. Within the inventory, there are opportunities for savings by reducing federally-occupied space and using space more efficiently. The Government is pursuing a long-term strategy to maximize the efficiency of the real estate portfolio by implementing a policy to freeze growth in the portfolio, improving the quality of real property data, and using quality data to identify opportunities to consolidate and reduce the size of the

real estate inventory. Over the next year, the Government intends to continue its efforts to freeze real property growth under the existing “Freeze the Footprint” Policy (OMB Memorandum 12-12), develop and collect performance metrics/benchmarks to measure efficiency/effectiveness of real property use, improve the consistency and quality of inventory real property data, and identify government-wide standards to continue to improve the efficiency of our real property use.

## Conclusion

The Federal Government has seen significant progress in financial management since the passage of the CFO Act more than 20 years ago. Yet significant challenges remain. The issues we face in the Government today require our financial managers to move beyond the status quo and to generate a higher return on investment for our financial management activities. The steps outlined above leverage the tools and capacities in place today, and refocus energies on critical and emerging priorities – cutting wasteful spending, improving the efficiency of our operations and information technology, and laying a foundation for data quality and collaboration as we enter a new era of transparency and open Government.

## Additional Information

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

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