Financial Report
of the
United States Government
1998

Contents

A MESSAGE FROM THE SECRETARY OF THE TREASURY

Attached is the fiscal year 1998 Financial Report of the United States Government, formerly known as the Consolidated Financial Statements of the U.S. Government. The Administration initiated the development of this financial report in order to create what we believe will be a useful management tool for policy-makers and a source of useful information for the public. Last year, for the first time, the United States Government prepared comprehensive financial statements covering all of its myriad activities and subjected them to audit. This year, for the second time, the Administration presents the Financial Report of the United States Government, including audited financial statements that cover the Executive Branch, as well as parts of the Legislative and Judicial branches of the United States Government.

The publication of this second annual financial report represents one component of the Clinton Administration's continuing efforts to improve the management and efficiency of the United States Government. In 1994, the Administration supported the Government Management Reform Act, which mandated the issuance of these audited financial statements. The Administration has supported the Federal Accounting Standards Advisory Board in creating the accounting standards that form the basis for the financial statements included in this financial report.

These accounting standards generally are based on the accrual basis of accounting, which differs from the cash basis of accounting used in the reporting of budget results. The principal differences between these two accounting methods pertain to the timing of the measurement and recognition of revenues and expenses and the inclusion of a presentation of assets and liabilities. Each method is a useful tool for looking at the government's operations for different purposes.

A great deal of work has been done, but the development of this new method of reporting is an immense task and a great deal of additional effort will be necessary to create and implement an entirely new system of reporting on the operations of the U.S. Government. We are working hard toward that goal to complement our existing budget reporting. The audit report from the General Accounting Office (GAO) discusses many areas in which the reliability of the current financial statements must be enhanced and improved. As a result, the GAO was unable to render an opinion on these statements. The Administration is committed to continuing its work with the GAO, Federal agencies, and other interested parties to achieve the President's goal of receiving an unqualified opinion from the GAO on the Financial Report of the United States Government. We believe that the publication of this financial report is an important step in providing the American public with useful information about their government's assets, liabilities and operations.

Robert E. Rubin

Robert E. Rubin

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Financial Report of the United States Government, Fiscal 1998

Management's Discussion and Analysis

Introduction

No other entity in the world compares in size and scope to the U.S. Government, which has continuing responsibilities for the general welfare of its citizens and for national defense. The U.S. Government's comprehensive financial report, prepared in accordance with Federal accounting standards, includes all of its activities.

Effective management of the U.S. Government has been hampered by a lack of comprehensive financial information. The Administration remains committed to providing reliable information about the financial position of the U.S. Government, the cost of its operations, and the financing sources used to fund operations. Such information will ultimately prove extremely helpful to policy-makers and the public.

To improve the quality of financial information, in 1990 the Office of Management and Budget (OMB), Treasury, and the U.S. General Accounting Office (GAO) established the Federal Accounting Standards Advisory Board (FASAB) to develop accounting standards for the U.S. Government. In 1994, the President signed the Government Management Reform Act, which requires annual financial statements for the 24 major agencies and for the U.S. Government as a whole.

The Administration appreciates the work of the GAO in subjecting these financial statements to audit and looks forward to working with the GAO, Federal agencies and other interested parties in its continuing effort to improve the reliability of Federal financial information. The effort to produce a comprehensive and reliable set of financial statements for the U.S. Government, which began in 1997, is ongoing and improvements are clearly necessary. Because of current limitations that are discussed in GAO's Report, the GAO is unable to render an opinion on these financial statements. The challenges involved in developing timely, reliable, and comprehensive financial information should not, however, obscure the progress that has been made or the insights provided by preparation and audit of these statements. The Administration's accomplishments are presented later in this discussion and analysis.

"The Administration is committed to improving the reliability of the financial information . . ."

The Administration is committed to improving the reliability of the financial information to achieve its goal of an unqualified opinion on the financial statements of individual agencies and the U.S. Government. The Administration's goals for individual agencies are reflected in the Federal Financial Management Status Report and Five-Year Plan issued by the OMB and the Governmentwide Chief Financial Officers (CFOs) Council. That document reflects the dates by which agencies are expected to achieve the Administration's objectives.

The accompanying Financial Report is required by 31 United States Code 331(e)(1) and consists of Management's Discussion and Analysis (MD&A), a Statement of Operations and Changes in Net Position, a Statement of Net Cost, a Balance Sheet, Stewardship Information, Notes to the Financial Statements, and Supplemental Information. Each section is preceded by a description of the section's contents. The Supplemental Information section describes the major functions of the U.S. Government.

Management's Discussion and Analysis, cont.

Reporting Entity and Basis of Accounting

The MD&A explains the Federal reporting entity, the basis of accounting used to prepare these financial statements, and presents selected financial and economic information intended to assist readers in their assessment of the U.S. Government's financial operations and status. It also summarizes financial management initiatives designed to continue improving the reliability of the financial statements and to address the issues identified in GAO's report on the U.S. Government's 1998 financial statements.

Coverage

The financial statements cover the executive branch, as well as parts of the legislative and judicial branches of the U.S. Government. A list of the significant entities included in these financial statements is included in the Appendix. Information from the legislative and judicial branches is limited because those entities are not required to prepare comprehensive financial statements. In addition, Government-sponsored enterprises (such as Federal Home Loan Banks and the Federal National Mortgage Association) are excluded because they are privately owned. The Federal Reserve System is also excluded because monetary policy is conducted separately from and independently of the other central Government functions.

Accounting Standards

The accounting standards used in the preparation of the accompanying financial statements were developed by the Federal Accounting Standards Advisory Board (FASAB); approved by Treasury, OMB and GAO as the FASAB principals; and issued by OMB and GAO. The standards are tailored to the U.S. Government's unique characteristics and special needs. For example, land not used in U.S. Government operations (stewardship land) and weapon systems and support property used in the performance of military missions and vessels held as part of the National Defense Reserve Fleet (national defense assets) are reported in the Stewardship Information section rather than on the Balance Sheet.

The financial statements of the U.S. Government are prepared generally on the accrual basis of accounting. Under the accrual basis, transactions are reported when the events giving rise to the transactions occur, rather than when cash is received or paid (cash basis). By contrast, Federal budgetary reporting is generally on the cash basis in accordance with accepted budget concepts and policies.

The most significant difference between these two bases involves the timing of recognition and measurement of revenues and costs. For example, Federal accounting standards require recognition of liabilities for costs related to environmental cleanup when the events resulting in such costs occur. By contrast, budget concepts and policies require the recognition of such costs at the time payment is made. The effects of these differences are reflected in the "Reconciliation of the Excess of Net Cost Over Revenue to the Unified Budget Surplus," which is presented in the Supplemental Information section of this Financial Report.

In fiscal 1998, there was a budget surplus of $69.2 billion. The excess of net cost over revenue figure contained in these financial statements for fiscal 1998 is $133.8 billion. This difference is attributable to factors discussed immediately above. The primary components of the difference that have been identified are increases in accrued veteran compensation benefits, $109.4 billion; increases in actuarial expenses for Federal employees and military pensions and health benefits, $39.8 billion; and an increase in environmental liabilities, $12.8 billion.

This Financial Report does not include information on natural resources (depletable resources, such as mineral deposits and petroleum or renewable resources, such as timber) because standards have not yet been developed for recognizing and measuring these assets.

Finally, a thorough assessment of the U.S. Government's financial status should recognize its sovereign powers to raise revenue and regulate commerce. These powers are not reflected in the accompanying statements, but should be considered in a comprehensive assessment of the U.S. Government's overall financial condition.

Implementation of New Accounting Standards

While the FASAB completed work on a basic set of accounting standards in 1996, some standards did not become effective until fiscal 1998. Standards becoming effective in fiscal 1998 require that the value of national defense assets be removed from the Balance Sheet and that information about these assets be reported in the Stewardship Information section of the Financial Report. These assets were valued at $655.2 billion when reported on the fiscal 1997 Balance Sheet. FASAB has initiated a project to identify and research user information needs for national defense assets.

In addition, standards effective for the first time in 1998 require current services assessment information showing both the short-term and medium-term direction of current programs. The current services assessment presents actual receipt and outlay data for all programs for the year for which the financial statements are prepared (the base year) and estimates for 6 years subsequent to the base year. This assessment will thus facilitate evaluation of the sufficiency of future resources to sustain public services and to meet current and future obligations as they become due.

Standards becoming effective in future years require reporting of annual Federal expenses for stewardship investments, which include:

- Non-Federal physical property: the Federal investment in properties owned by State and local governments (e.g., highways and airports).
- Human capital: investments in education and training programs financed by the U.S. Government for the benefit of the public.
- Research and development: the U.S. Government's investments in basic and applied research and development.

The annual expense related to these investments included in the Statement of Net Cost will be separately

Economic and Budgetary Results

Very strong economic growth continued through fiscal 1998. The Asian financial crisis and weakness abroad had some negative impacts on the U.S. economy, chiefly through exports and volatility in financial markets, but the domestic economy surged forward. Job gains were very solid over the year ending in September and the unemployment rate held near 28-year lows. At the same time, inflation was very well contained, with the rate of inflation dropping to levels not seen since the mid-1960's. Strong growth in incomes and a rising stock market led to a boost in Federal tax receipts in fiscal 1998, contributing to the first Federal unified budget surplus in 29 years.

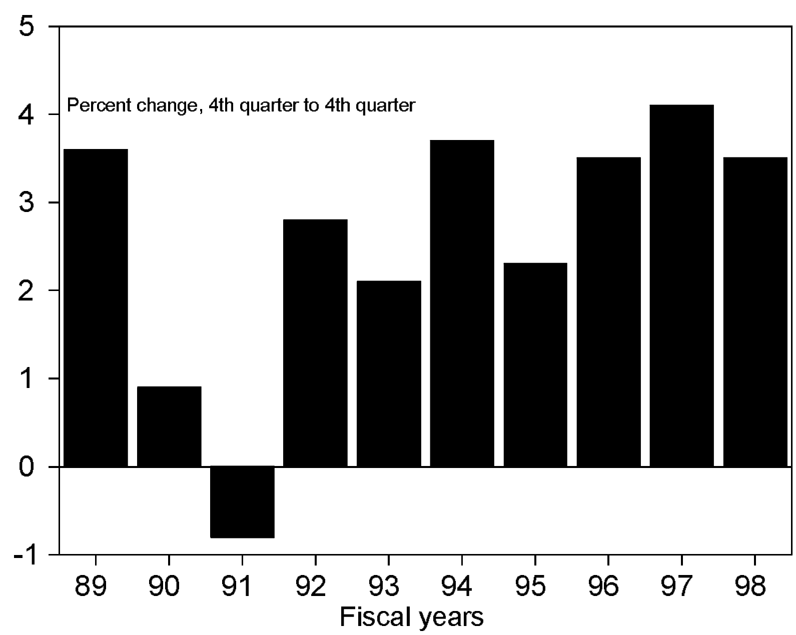
The Economy in Fiscal 1998

Real gross domestic product (GDP) grew by 3.5 percent across the four quarters of fiscal 1998 (which encompasses the fourth quarter of calendar 1997 through the third quarter of calendar 1998). Over the past 3 fiscal years, real growth averaged a robust 3.7 percent.

The household sector accounted for much of the gain in 1998, with consumer spending and residential investment growing very rapidly. Consumer purchases swelled by 4.7 percent over the fiscal year, the most rapid rate of advance in 15 years. Investment in new housing jumped by 12 percent and the home ownership rate hit an all-time high. The gains in spending were fueled by rising employment and income and by the wealth effects of the rapid increases in stock prices over the past few years.

Partly offsetting strength in the domestic economy was a sizable deteri-

Growth of Real GDP



oration in the foreign trade balance due to weakening global financial and economic conditions. U.S. exports in real terms fell by 2.3 percent over the fiscal year, while imports grew by 8.3 percent. The widening trade deficit acted as a considerable drag on real GDP growth, particularly in the first half of calendar 1998 when it subtracted more than 2 percentage points from growth. U.S. agricultural and manufacturing industries were most affected by the loss of exports and other consequences of the global situation. Manufacturing production and capacity utilization slowed over the year, and factory employment declined by 137,000 from March through September.

Employment growth in other sectors of the economy was very strong in fiscal 1998, and labor markets continued to be very tight. About 3.1 million jobs were added during the year, the same as in the previous fiscal year. The unemployment rate held between 4.3 and 4.7 percent throughout the fiscal year, the lowest readings in 28 years. The share of the working-age population with a job averaged 64 percent, a new fiscal-year record, and long-term unemployment fell. Workers enjoyed an acceleration in wage and salary growth, which increased by 4 percent over the fiscal year. This was considerably faster than the rate of inflation and resulted in solid gains in real wages and salaries.

Despite strong economic growth and very low rates of unemployment, price pressures did not build up during the year. Falling prices for imported goods, energy and food held down growth in commodity prices and the overall rate of inflation as well. Consumer prices edged up just 1.4 percent over the fiscal year, the smallest inflation rate since the mid-1960's. Excluding the food and energy components, the underlying "core" rate of consumer price inflation was 2.4 percent, up a bit from 2.2 percent in the previous fiscal year, which had been the lowest core rate since the mid-1960's.

Budget Results

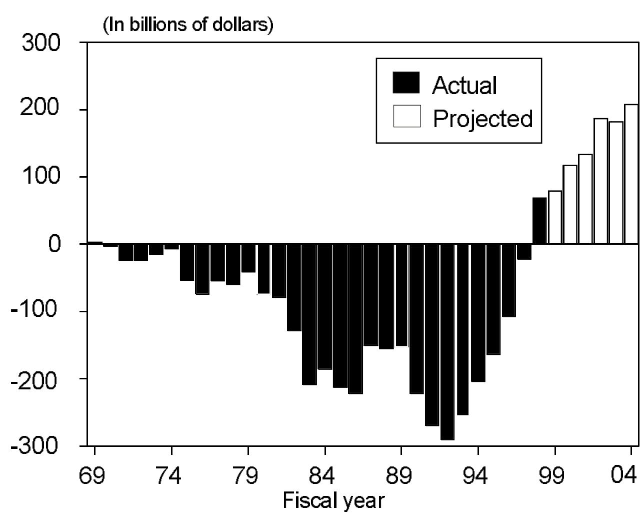
The unified Federal budget was in surplus by $69.2 billion in fiscal 1998, the first Federal surplus since 1969. This represented 0.8 percent of GDP, the highest share of GDP for a surplus in more than 40 years, and resulted in a reduction in the level of Federal debt held by the public for the first time in 29 years. Passage of deficit reduction programs in conjunction with strong economic growth placed the budget on its path toward surplus after the annual deficit reached an all-time high of $290 billion in fiscal 1992.

"The expanding economy over the course of the year brought a surge in tax revenue in 1998, which far outpaced modest gains in Federal outlays."

The expanding economy over the course of the year brought a surge in tax revenue in 1998, which far outpaced modest gains in Federal outlays. Receipts increased by 9.0 percent in fiscal 1998 to $1,722 billion, faster than gains over the previous several years. Growth was led by a more than 12 percent increase in individual income tax payments, reflecting rapid job and income growth as well as high levels of capital gains from the rising stock market. That was more than enough to offset a slowdown in corporate profits tax receipts, which grew by 3-1/2 percent in fiscal 1998 compared with 6 percent in the prior year. Corporate profits weakened a bit over the year primarily due to the impacts of the global situation on earnings, particularly among manufacturing firms.

Growth of outlays was held to just 3.2 percent in fiscal 1998, with outlays rising to $1,653 billion. Outlays in relation to GDP were the smallest since 1974, dipping to a 19.7 percent share from 20.0 percent in fiscal 1997. The underlying improvement over the year was even greater than the

Unified Federal Budget Moves from Deficit to Surplus



Budget, cont.

summary figure suggests, as outlays in fiscal 1997 were held down by large inflows to the deposit insurance account which were not repeated in fiscal 1998. (These inflows are treated as negative outlays in budget accounting.) Excluding the deposit insurance account and other similar factors, outlays increased by less than 2-1/2 percent in fiscal 1998.

Defense spending dipped slightly in fiscal year 1998 after increasing by $4.8 billion in the prior year. That increase followed 4 years of reductions in defense spending. Outlays for income support (excluding Federal retirement payments) were smaller than a year ago, reflecting the expansion of employment and rising income in 1998. Net interest payments declined by $0.7 billion. Growth in Medicare slowed sharply compared with previous years due in part to slower processing of payments, but expanded use of managed care plans and lower-than-expected payments for inpatient hospital services also contributed.

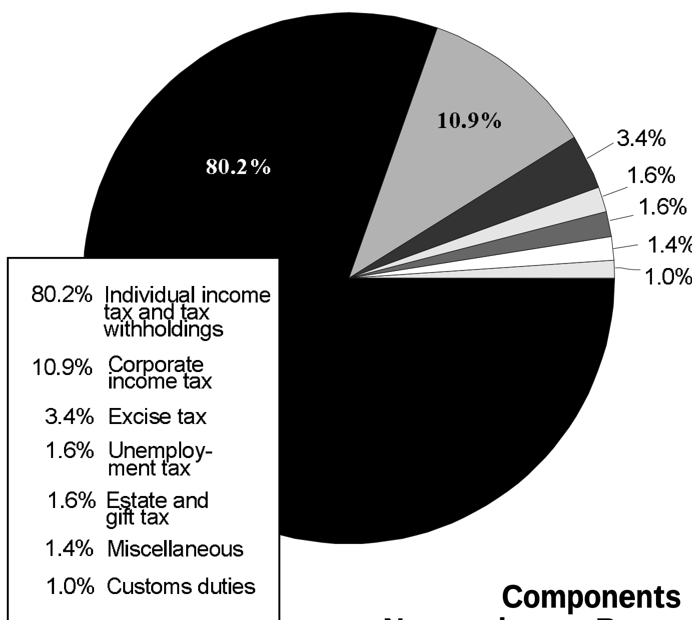
The unified budget in fiscal 1999 is expected to post a slightly larger surplus than the $69.2 billion recorded in fiscal 1998. New projections from the Fiscal Year 2000 Budget show surpluses growing throughout the forecast horizon, accumulating to $2.4 trillion over the period 2000-2009. These results are similar to the forecasts of the Congressional Budget Office, which yield an even larger cumulative surplus of $2.6 trillion over that 10-year span.

Revenue and Expense Summary

Revenue

Non-exchange revenue is the U.S. Government's primary source of revenue, and totaled $1,712.8 billion in 1998. More than 95 percent of this total came from tax receipts, with the remainder coming from customs duties and other miscellaneous receipts.

Earned revenues are inflows of resources that arise from exchange transactions. Exchange transactions occur when each party to the transaction sacrifices value and receives value in return -- for example, when the U.S. Government sells goods or services to the public. During 1998, the U.S. Government earned $168.9 billion in exchange revenue including $2.8 billion from the sale of the Elk Hills Naval Petroleum Reserve by the Department of Energy. Of these revenues, $161.5 billion are offset against the gross cost of the related functions to arrive at the function's net cost. The U.S. Government also earned $7.4 billion that was not offset against the cost of any function, e.g., royalties on the Outer Continental Shelf lands.

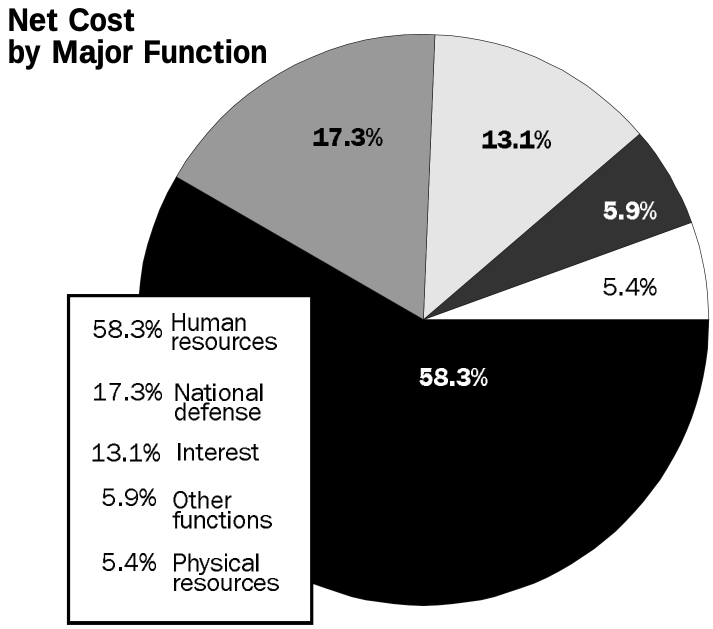


Components of Non-exchange Revenue by Major Source

Detail may not add to totals due to rounding.

Expenses by Function

The net cost of U.S. Government operations was $1,854 billion for 1998. Net cost represents the gross cost of operations less attributable earned revenues. The Statement of Net Cost reflects the cost incurred to carry out the national priorities identified by the President and the Congress and how the net cost was financed. The functions and subfunctions used to accumulate costs associated with the national priorities are identified in the President's budget and described in detail in the Supplemental Information section of this report. The accompanying chart presents the percentage of the net cost of U.S. Government operations represented by each of the U.S. Government's major functions.

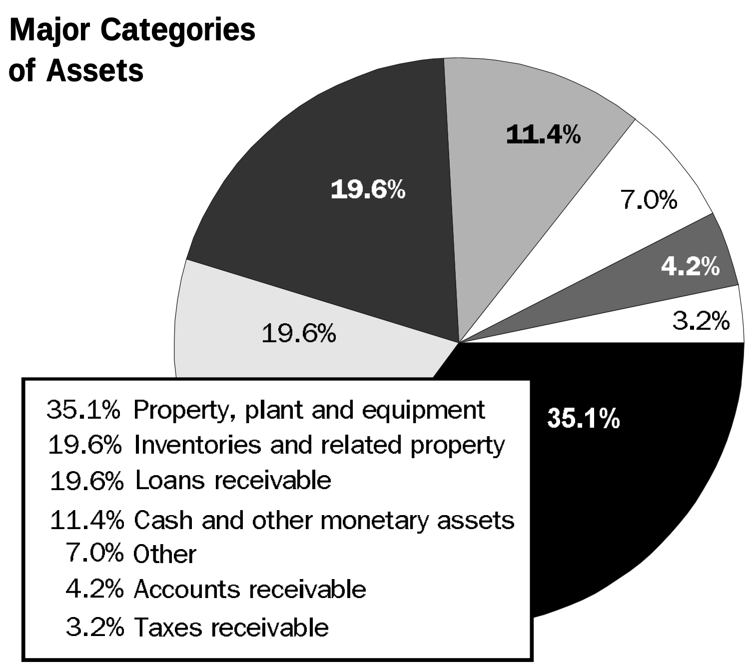


Detail may not add to totals due to rounding.

Asset and Liability Summary

Assets

The assets of the U.S. Government are the resources available to pay liabilities or to satisfy future service needs. The accompanying chart depicts the major categories of reported assets as of September 30, 1998 as a percentage of reported total assets. Detailed information about the components of these asset categories can be found in the notes to the financial statements. The assets presented on the Balance Sheet are not a comprehensive list of Federal resources. For example, the U.S. Government's most important financial resource, its ability to tax and regulate commerce, cannot be quantified and is not reflected. Natural resources, stewardship land (national parks, forests and grazing lands), national defense assets and heritage assets are other examples of resources that are not included in the $852.8 billion of Federal assets reported on the Balance Sheet at the end of fiscal 1998.



Detail may not add to totals due to rounding.

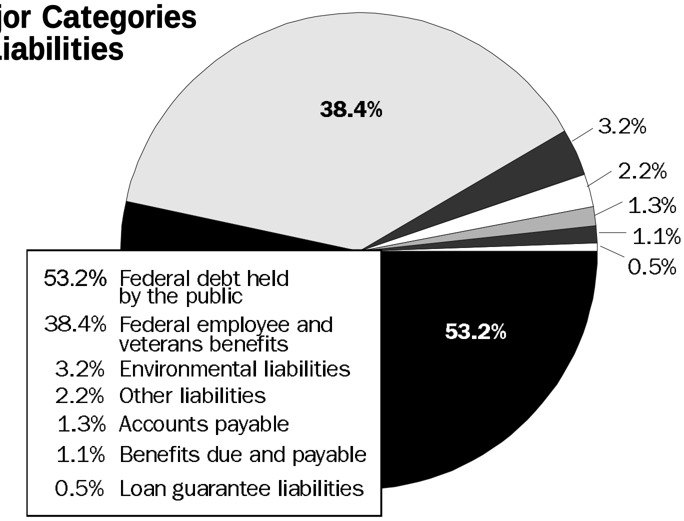
Liabilities

At the end of fiscal 1998, the U.S. Government reported liabilities of $6,987.2 billion. These liabilities are probable and measurable future outflows of resources arising out of past transactions or events. The largest component of these liabilities ($3,717.7 billion) is represented by Federal debt securities held by the public. The next largest component ($2,685.1 billion) relates to pension, disability and health care costs for veterans, and Federal civilian and military employees. Included in this component is a Department of Veterans Affairs program whereby veterans or their dependents receive compensation benefits if the veteran was disabled or died from military service-connected causes. Changes in the actuarial methodology and the interest rate assumption resulted in a liability increase of $381 billion. This liability increase coupled with the removal from the Balance Sheet of $655.2 billion in national defense assets were the major factors in causing the net position of the U.S. Government to decrease by $1.1 trillion in fiscal 1998. The national defense assets were removed from the Balance Sheet as a result of implementing a new accounting standard.

"Another liability, which will likely require substantial future budgetary resources to liquidate, is related to environmental cleanup costs."

Another liability, which will likely require substantial future budgetary resources to liquidate, is related to environmental cleanup costs. As of September 30, 1998, the cost of cleaning up environmental contamination was estimated to be $224.5 billion. The accompanying chart presents the percentage of total Federal liabilities represented by each of the categories of liabilities reported on the Balance Sheet. Additional details about the U.S. Government's reported liabilities can be found in the notes to the financial statements.

Major Categories of Liabilities



Detail may not add to totals due to rounding.

Future Commitments

The U.S. Government has substantial future commitments to its citizens, including the provision of social insurance through the Social Security and Medicare programs. The FASAB continues to discuss the content and format for reporting of these commitments.

Financial Condition of the Social Security Trust Funds

Two trust funds have been established by law to finance the Social Security program (OASDI): Federal Old-Age and Survivors Insurance (OASI) and Federal Disability Insurance (DI). OASI pays retirement and survivors benefits , and DI pays benefits after a worker becomes disabled. OASDI revenues consist primarily of taxes on earnings that are paid by employees, their employers, and the self-employed. OASDI also receives revenue from taxation of part of Social Security benefits. Revenues that are not needed to pay current benefits or administrative expenses are invested in Treasury securities to earn interest for the trust funds. The securities issued to the trust funds are guaranteed as to both principal and interest and backed

"The Administration intends to work with Congress on a bipartisan basis to enact long-term Social Security solvency and reform in 1999."

Social Security, cont.

by the full faith and credit of the U.S. Government.

The Board of Trustees of the OASI and DI Trust Funds provides the President and the Congress with short-range (10 years) and long-range (75 years) actuarial estimates of each trust fund. Because of the inherent uncertainty in estimates for as long as 75 years into the future, the Social Security Trustees use three alternative sets of economic and demographic assumptions to show a range of possibilities. Most analysts use the Trustees' intermediate or "best estimate" set of assumptions to evaluate the financial condition of the Social Security program.

The 75-year estimates assume that future workers (except for those working in types of employment not mandatorily covered by the program) are covered by Social Security once they enter the labor force. The estimates reflect the impact of the retirement of the baby boomers, as well as changing demographics (e.g., an increase in life expectancy and a decline in the birth rate). For example, in 1960, 5.1 workers paid for every beneficiary. Today, the ratio of workers to beneficiary is 3.4 to 1 and 32 years from now, when all of the baby boom generation has retired, the ratio will drop to approximately 2 to 1. The retirement component of the program is financed largely on a "pay-as-you-go" basis, i.e., current retirement benefits are largely financed by current payroll contributions.

"With no change in the program, in 2013 the trust funds are expected to begin using interest on their investments to cover the cash shortfall and to pay benefits."

Under current legislation and using intermediate assumptions, the Trustees estimated in their 1998 report that by 2013 cash disbursements for the programs will exceed cash receipts and by 2032 the combined trust fund assets, primarily investments in Treasury securities, will be exhausted. With no change in the program, in 2013 the trust funds are expected to begin using interest on their investments to cover the cash shortfall and to pay benefits. Starting in 2021, they would begin redeeming their investments in Treasury securities to provide the needed funding. In 2032 trust fund assets would be exhausted; at that time, dedicated tax revenues would be sufficient to pay approximately 75 percent of the benefits due.

The Administration intends to work with Congress on a bipartisan basis to enact long-term Social Security solvency and reform in 1999. Acting sooner rather than later to address the long-term financing needs of the program will make the required changes less severe and disruptive and ensure that Social Security works as well for future generations as it has for past generations. Additional information about the Social Security program can be found in the Stewardship Information section of this Financial Report.

Financial Condition of the Medicare Trust Funds

Two trust funds have been established to finance the Medicare program. The Medicare Part A Hospital Insurance (HI) Trust Fund is financed by a 2.9 percent tax on wages and salaries required to be paid equally by employees and employers. The Medicare Part B Supplementary Medical Insurance (SMI) Trust Fund receives premium payments on behalf of Medicare beneficiaries who have elected coverage. The Balanced Budget Act of 1997 provides that the SMI premium is set at 25 percent of program costs. The remainder of the costs is funded by Congressional appropriations.

The 1998 trustees' report projects that the HI trust fund's assets will be depleted by 2008 using intermediate or "best estimate" assumptions. Additional information about the Medicare program can be found in the Stewardship Information section of this Financial Report.

Accomplishments and Actions Taken to Address Financial Reporting Issues

The Administration's Priority Management Objectives included in the fiscal 1999 and 2000 Budgets of the U.S. Government include improving financial management information as part of its plan for strengthening Governmentwide management. Audits of agency financial statements disclose that agencies have made substantial progress in correcting financial management deficiencies that impede compliance with Federal accounting standards and, accordingly, improved financial management. The following exhibit illustrates agency progress as measured by the increasing number of unqualified audit opinions on their financial statements. (Audits for all of the 24 major agencies were not required until fiscal 1996.)

While progress has been made, recent audits disclosed that major agencies continue to have serious financial management problems, which preclude compliance with numerous Federal accounting standards. These agencies must satisfactorily address these problems in order to receive an unqualified opinion on their financial statements and for the U.S. Government to receive an unqualified opinion on its financial statements. The exhibit on the following page correlates the most critical problem areas with the agencies responsible for taking corrective action. The exhibit also highlights that the Department of Defense has serious deficiencies in all but one issue area and all agencies have problems with accounting for intragovernmental transactions.

"Audits of agency financial statements disclose that agencies have made substantial progress in correcting financial management deficiencies . . ."

With respect to intragovernmental transactions, the problem pertains to identifying and eliminating transactions between agencies. The audit of the U.S. Government's financial statements for fiscal 1997 disclosed that agencies cannot effectively identify transactions with other agencies so they can be eliminated for governmentwide reporting. If these transactions are not properly eliminated, total U.S. Government assets, liabilities, revenues and expenses will be misstated by the amount of these transactions.

The U.S. Government's ability to correctly identify these items improved in fiscal 1998. In addition, the Administration has organized a task force to address the intragovernmental transactions issue. The task force expects to complete its work in the near future.

In addition to the foregoing obstacles, because the U.S. Government calculates the budget surplus on the basis of cash receipts and disbursements and calculates operating results for financial statement purposes on the accrual basis of accounting, Treasury must, but currently cannot, reconcile these two amounts in order to fully explain to readers why the reported amounts differ.

Number of Agencies with or Anticipating Unqualified Audit Opinions for the Fiscal Years Indicated

(Of 24 agencies covered)

1991	1993	1996	1997	1998*	1999*	2000*
1	1	6	11	13	20	23**

* Anticipated results
** DOD does not anticipate an unqualified opinion on its financial statements before the year 2003.

Obstacles to an Unqualified Opinion of the Financial Statements of the U.S. Government

Entity	Property, Plant and Equipment	Inventory	Loans, Accounts Receivable and Loan Guarantees	Environ-mental Liabilities	Pension, Health and Other Liabilities	Unrecon-ciled Dis-bursements	Intragovern-mental Transac-tions
USDA	X		X				X
DOD	X	X		X	X	X	X
Education			X				X
HHS			X				X
HUD			X				X
Transportation (FAA)	X						X
VA			X				X
OPM							X
All other							X

President's Goal and Direction to Agencies

The President's Budget for fiscal 1999 set as a goal an unqualified opinion on the U.S. Government's financial statements. The President issued a Memorandum to the Heads of Federal Agencies on May 26, 1998, advising them of the Administration's goal and directing them to develop corrective action plans for addressing obstacles to achieving the goal and to submit quarterly progress reports. All named agencies submitted the required plans and progress reports.

Discussion with Agency Officials

A team of senior managers from the OMB, the Treasury, and the GAO met with senior agency officials to discuss agency plans and prospects for successfully meeting planned goals. The conclusion of the team is that, while progress has been made since the March 1998 release of the report on audit of the fiscal 1997 financial statements of the U.S. Government, much remains to be done in the areas presented in the aforementioned exhibit.

Ongoing Monitoring and Assistance Activities

The OMB, the Treasury, and the GAO are monitoring agencies' progress by (1) reviewing quarterly progress reports from all the agencies listed in the aforementioned exhibit on their progress in meeting the goals and milestones set out in the action plans required by the President's May 26, 1998, Memorandum; (2) meeting regularly with officials of those agencies with the most formidable obstacles to their progress in achieving planned goals; and, (3) providing necessary advice and assistance.

Management Initiatives

Manage the Year 2000 (Y2K) Computer Problem

There is no more immediate management challenge facing the U.S. Government and industry worldwide than the impending shift of dates from the year 1999 to the year 2000. The Administration is committed to ensuring that Federal agencies meet the challenges posed by the Year 2000 (Y2K) computer problem. Since November, the U.S. Government has made substantial progress toward fixing the problem. As of February 12, 1999:

- Of the 6,399 mission critical systems, 79 percent are now fully compliant, up from 61 percent in December. These compliant systems include systems that have been repaired or replaced as well as those that were already compliant.
- Of the remaining 1,354 mission critical systems that are not yet compliant, 966 (71 percent) are being repaired, 270 (20 percent) are being replaced, and 118 (9 percent) will be retired.
- Of the 4,130 mission critical systems being repaired, 96 percent have completed renovation, 87 percent have completed validation and 76 percent have completed implementation and are fully compliant.

OMB, in cooperation with the President's Council on Year 2000 Conversion, continues to work closely with individual agencies. Since December, most agencies have made significant progress toward meeting the governmentwide goals, although several agencies remain behind schedule. As of February 12, 1999:

- Five agencies (the Environmental Protection Agency, National Science Foundation, Nuclear Regulatory Commission, Small Business Administration and Social Security Administration) report that their mission critical systems are now 100 percent compliant.
- Three agencies (the U.S. Agency for International Development, Department of Health and Human Services and Department of Transportation) are not making adequate progress and have been rated in Tier I.

Year 2000 Status
Mission Critical Systems

	All Systems	Systems Being Repaired			
Agency Status	Y2K Compliant	Assessment Complete	Renovation Complete	Validation Complete	Implementation Complete
Tier III: NASA, FEMA, Education, OMB, HUD, Interior, GSA, VA, SBA, EPA, NSF, NRC, SSA	96%	100%	100%	99%	96%
Tier II: Agriculture, Commerce, Defense, Energy, Justice, Labor, State, Treasury	77%	100%	94%	83%	74%
Tier I: U.S. Agency for International Development, Health and Human Services, Transportation	63%	100%	98%	79%	42%
All agencies	79%	100%	96%	87%	76%

Agencies now estimate that, from Fiscal 1996 through Fiscal 2000, they will spend $6.8 billion fixing the problem, an increase from the February estimate of $6.4 billion. This increase is not unexpected, and OMB and the Congress continue to work closely with the agencies to ensure that they have adequate funding through allocations from the supplemental contingent emergency reserve.

While agencies expect that their mission critical systems will be ready by December 31, they also are developing business continuity and contingency plans (BCCPs) to ensure program delivery in the event of a system failure or malfunction, whether within or outside the agency. Additionally, those agencies that are behind schedule are emphasizing completion of their remaining mission critical systems.

As agencies complete work on fixing their mission critical systems, they are now focusing on demonstrating that programs and services, especially those critical to public safety, health and well-being, will be operational. In addition, new guidance from OMB will direct agencies to work with other Federal agencies, State and local governments, the private sector, and others to assure the readiness of 40 high-impact public programs.

Use Results to Improve Program Management

The Government Performance and Results Act (GPRA) makes U.S. Government agencies more accountable by focusing managers and policy makers on agency performance. GPRA can fundamentally change how the U.S. Government carries out its programs and makes funding decisions. GPRA requires Federal agencies to periodically develop long-range strategic plans and annually prepare performance plans and performance reports. The annual plans set specific performance targets for an agency's programs and activities. The combination of GPRA plans and reports introduces an unprecedented degree of managerial and institutional accountability for accomplishing program goals. Key to achieving success is making the plans useful to Congress, the President, and agency management.

In fiscal 2000, agencies will submit to Congress and the President the first of their annual reports on program performance. These reports, covering fiscal 1999, will compare actual performance to the performance target levels in the annual plans for that year, and provide an explanation for any goal not met. With these reports, the first phase of GPRA implementation will be complete.

During fiscal 2000, agencies will also be revising and updating strategic plans for submission to Congress and OMB by September 2000. All GPRA plans and reports are publicly available, and can often be found on individual agency web sites.

Additional Information

Additional details about the information contained in these financial statements can be found in the financial statements of the individual agencies listed in the Appendix. In addition, related U.S. Government publications such as the "Budget of the United States Government," the "Treasury Bulletin," the "Monthly Treasury Statement of Receipts and Outlays of the United States Government," the "Monthly Statement of the Public Debt of the United States," and the Trustee's reports for the Social Security and Medicare programs may be of interest.

Comptroller General
of the United States
Washington, D.C. 20548

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March 31, 1999

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

Implementation of important legislative reforms is underway to promote greater accountability in managing the finances of our national government. These reforms include requirements for annual audited financial statements for 24 major departments and agencies as well as preparation of the financial statements of the U.S. government, which GAO is required to audit. The report on our audit of these financial statements for fiscal year 1998 is enclosed.

These financial reporting requirements are prompting steady improvements in federal financial accountability, and there has been progress toward meeting the related legislative objectives. At the same time, several major departments are not yet able to produce auditable financial statements on a consistent basis. There are major obstacles to overcome, both at the agency level and in preparing reliable financial statements for the U.S. government.

The executive branch recognizes the extent and severity of the financial management deficiencies and that addressing them will require concerted improvement efforts across government. The administration has set goals for completing timely audits and receiving unqualified opinions for individual agencies as well as the financial state-

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ments of the U.S. government. With a concerted effort, the federal government, as a whole, can continue to make progress toward achieving accountability and generating reliable financial and management information on a regular basis. Annual financial audits represent an important means to assure continued progress in connection with improving federal financial management.

While obtaining unqualified “clean” audit opinions on federal financial statements is an important objective, it is not an end in and of itself. The key is to take steps to continuously improve internal controls and underlying financial and management information systems as a means to assure accountability, increase the economy, improve the efficiency, and enhance the effectiveness of government. These systems must generate timely, accurate, and useful information on an ongoing basis, not just as of the end of the fiscal year.

Reliable financial information is essential for analyzing the government’s financial condition and helping inform budget deliberations by providing additional information beyond that provided in the budget. The budget of the federal government is primarily formulated on a cash basis which also is generally the basis for calculating the annual budget surplus or deficit. The financial statements are prepared generally on the accrual basis of accounting. The most significant difference is the timing of recognition and measurement of revenues and costs. Accrual information can be used with budgetary information to provide a valuable perspective on the costs of agency programs and the government’s assets and long-term commitments.

We appreciate the cooperation and assistance we received from the Chief Financial Officers and Inspectors General throughout government, as well as Department of Treasury and Office of Management and Budget officials, in carrying out our responsibility to audit the government’s financial statements. We look forward to continuing to work with these officials and the Congress to achieve the goals and objectives associated with financial management reform.

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Our report was prepared under the direction of Gene L. Dodaro, Assistant Comptroller General, and Robert F. Dacey, Director, Consolidated Audit and Computer Security Issues. If you have any questions, please contact me on (202) 512-5500 or them on (202) 512-3317.

David M. Walker
Comptroller General
of the United States

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Comptroller General
of the United States
Washington, D.C. 20548

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

The Secretary of the Treasury, in coordination with the Director of the Office of Management and Budget (OMB), is required to annually submit financial statements for the U.S. Government to the President and the Congress.[1] GAO is required to audit these statements. This is our report on our audit of the financial statements of the U.S. government for fiscal year 1998.[2]

In summary, significant financial systems weaknesses, problems with fundamental recordkeeping and financial reporting, incomplete documentation, and weak internal controls, including computer controls, continue to prevent the government from accurately reporting a significant portion of its assets, liabilities, and costs. These deficiencies affect the reliability of the accompanying financial statements and much of the related information in the 1998 Financial Report of the United States Government, as well as the underlying financial information. They also affect the government's ability to accurately measure the full cost and financial performance of programs and manage its operations. Major problems included the federal government's inability to:

- properly account for and report (1) billions of dollars of property, equipment, materials, and supplies and (2) certain stewardship assets;

[1] The Government Management Reform Act of 1994 requires such reporting beginning with financial statements prepared for fiscal year 1997.

[2] Our report on the fiscal year 1997 financial statements is entitled Financial Audit: 1997 Consolidated Financial Statements of the United States Government (GAO/AIMD-98-127, March 31, 1998).

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- properly estimate the cost of most major federal credit programs and the related loans receivable and loan guarantee liabilities;
- estimate and reliably report material amounts of environmental and disposal liabilities and related costs;
- determine the proper amount of various reported liabilities, including postretirement health benefits for military employees, accounts payable, and other liabilities;
- accurately report major portions of the net cost of government operations;
- determine the full extent of improper payments that occur in major programs and that are estimated to involve billions of dollars annually;
- ensure that all disbursements are properly recorded; and
- properly prepare the federal government's financial statements, including balancing the statements, accounting for billions of dollars of transactions between governmental entities, and properly and consistently compiling the information in the financial statements.

Such deficiencies prevented us from being able to form an opinion on the reliability of the accompanying financial statements. These deficiencies significantly impair the federal government's ability to adequately safeguard assets, properly record transactions, and comply with selected provisions of laws and regulations related to financial reporting. Additionally, (1) serious computer security weaknesses expose the government's financial and other sensitive information to inappropriate disclosure, destruction, modification, and fraud, and critical operations to disruption and (2) material control weaknesses affect the government's tax collection activities. Further, tests for compliance with selected provisions of laws and regulations related to financial reporting disclosed material instances of noncompliance discussed later in this report. Also, the financial management systems of almost all agencies were found not to be in compliance with the requirements of the Federal Financial Management Improvement Act of 1996.

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Our audit and the Inspectors General (IG) audits of major component agencies' financial statements for fiscal year 1998 continue to result in (1) an identification and analysis of deficiencies in the government's recordkeeping, financial reporting, and control systems and (2) recommendations to correct them. Fixing these problems represents a significant challenge because of the size and complexity of the government and the discipline needed to follow sound financial management and reporting practices.

In response to our report on the federal government's fiscal year 1997 financial statements, on which we also disclaimed an opinion, the President required heads of agencies with significant financial management deficiencies to submit corrective action plans to OMB. Further, the President has designated financial management reform as a top management priority. Action is underway across government to address the pervasive, generally long-standing problems discussed in this report.

This report provides our (1) disclaimer of opinion on the government's fiscal year 1998 financial statements, (2) report on internal control, and (3) report on compliance with selected provisions of laws and regulations related to financial reporting. It also presents information on the Year 2000 computing challenge and highlights certain long-term financing issues facing government. Our report provides illustrations of the identified material deficiencies. A more complete discussion of these issues may be found in individual agency reports. The objectives, scope, and methodology of our work are discussed in the appendix to this report. We provided a draft of this report to Department of the Treasury and OMB officials, who expressed their commitment to address the deficiencies this report outlines. Our work was done in accordance with generally accepted government auditing standards.

DISCLAIMER OF OPINION

Because we were unable to determine the reliability of significant portions of the accompanying financial statements for the reasons described above, we are unable to, and we do not, express an opinion on the accompanying financial statements for fiscal year 1998. However, we were able to determine that certain amounts reported for environmental and disposal liabilities are understated by a material amount.

Because of the serious deficiencies in the government's systems, recordkeeping, documentation, financial reporting, and controls, amounts reported in the financial statements and related notes do not provide a reliable source of information for decision-making by the government or the public. These deficiencies also affect the reliability of information contained in the accompanying Management's Discussion and Analysis and any other financial management information—including information used to manage the government day-to-day and certain budget information reported by agencies—which is taken from the same data sources as the financial statements.

Further, while we have not audited and do not express an opinion on the Stewardship Information and Supplemental Information included in the accompanying Financial Report, we noted certain material omissions related to the presentation of national defense assets and issues related to the reconciliation of the results of operations to budget results, which are discussed below.

Also, as discussed in note 14 to the financial statements, the government adopted certain accounting standards in fiscal year 1998, primarily related to reporting national defense assets, which include major weapons systems, as part of Stewardship Information.

Material Deficiencies

The following sections describe material deficiencies we identified and discuss their effects on the financial statements and the management of government operations. Each of these deficiencies constitutes a material weakness in internal control.[3]

[3] A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by errors, fraud, or noncompliance in amounts that would be material to the financial statements may occur and not be detected on a timely basis by employees in the normal course of performing their duties.

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General Property, Plant, and Equipment and Inventories and Related Property

The federal government—one of the world's largest holders of physical assets—does not have adequate systems and controls to ensure the accuracy of information about the amount of assets held to support its domestic and global operations. A majority of the $466 billion of these reported assets is not adequately supported by financial and/or logistical records. Assets that are not adequately supported include: (1) buildings, structures, facilities, and equipment, (2) various government-owned assets that are in the hands of private sector contractors, and (3) operating materials and supplies comprised largely of ammunition, defense repairable items (such as navigational computers, landing gear, and transmissions), and other military supplies. Also, the government cannot ensure that all assets are reported. Further, national defense asset unit information reported as Stewardship Information was incomplete because it did not include major national defense support equipment, such as uninstalled engines, and national defense assets held by some military units were not reported.

Because the government lacks complete and reliable information to support its asset holdings, it could not satisfactorily determine that all assets were included in the financial statements, verify that reported assets actually exist, or substantiate the amounts at which they were valued. For example, periodic physical counts have shown that property records contain significant error rates. Further, weak controls significantly impair the government's ability to detect and investigate fraud or theft of assets. Also, deferred maintenance information was not reported.

Accurate asset information is necessary for the government to (1) know the assets it owns and their location and condition, (2) safeguard its assets from physical deterioration, theft, or loss, (3) account for acquisitions and disposals of such assets, (4) prevent unnecessary storage and maintenance costs or purchase of assets already on hand, and (5) determine the full costs of government programs that use these assets.

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Loans Receivable and Loan Guarantee Liabilities

Most federal credit agencies responsible for federal lending programs were unable to properly estimate the cost of these programs in accordance with federal accounting standards and budgeting requirements. As of the end of fiscal year 1998, the government reported $167 billion of loans receivable and $38 billion of liabilities for estimated losses related to estimated future defaults of guaranteed loans. However, the net loan amounts expected to be collected and guarantee amounts expected to be paid could not be reasonably estimated because of a lack of adequate historical data or other evidence. Reliable information about the cost of credit programs is important in supporting annual budget requests for these programs, making future budgetary decisions, managing program costs, and measuring the performance of credit activities. Federal credit programs include direct loans and loan guarantees for farms, rural utilities, low and moderate income housing, small businesses, veterans' mortgages, and student loans.

Environmental and Disposal Liabilities

Liabilities for remediation of environmental contamination and disposal of hazardous waste, reported at $225 billion, were materially understated by at least tens of billions of dollars primarily because no estimate was reported for environmental and disposal liabilities associated with certain major weapons systems, such as aircraft, missiles, ships and submarines, and for ammunition. Further, only a small portion of the total cost, estimated to be over $10 billion, to remove unexploded ordnance from training ranges has been reported. Additionally, significant portions of the government's reported liability for environmental management and legacy waste related to nuclear weapons development lacked adequate support, were not complete, and did not reflect material changes in cleanup scope, costs, or schedules. Properly stating these liabilities and improving internal controls supporting the process for their estimation could assist in determining priorities for cleanup and disposal activities and allow for appropriate consideration of future budgetary resources needed to carry out these activities.

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Liabilities

Adequate systems and cost data were not available to accurately estimate the reported $223 billion military postretirement health benefits liability included in federal employee and veteran benefits payable. Information used to develop such estimates did not include the full cost of providing health care benefits. Also, some agencies do not maintain adequate records or have systems to ensure that accurate and complete data were used to estimate a reported $90 billion of accounts payable and a reported $155 billion in other liabilities. For example, a liability was not reported for certain amounts owed to contractors that, under the terms of the contracts, were held by the government pending the acceptance of goods or services. Further, the government was unable to provide adequate information to determine whether commitments and contingencies were complete and properly reported. These problems significantly affect the determination of the full cost of the government's current operations, the value of its assets, and the extent of its liabilities.

Cost of Government Operations

The government was unable to support significant portions of the more than $1.8 trillion reported as the total net cost of government operations. The previously discussed material deficiencies in reporting assets and liabilities and the lack of effective cash disbursement reconciliations, as discussed below, affect reported net costs. Further, we were unable to determine whether the amounts reported in the individual net cost categories on the Statement of Net Cost and in the subfunction detail in Supplemental Information were properly classified. Accurate cost information is important to the federal government's ability to control and reduce costs, assess performance, evaluate programs, and set fees to recover costs where required.

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Improper Payments

The government is unable to determine the full extent of improper payments—that is, payments made for other than valid, authorized purposes. Across government, improper payments occur in a variety of programs and activities, including those related to contract management, federal financial assistance, and tax refunds. Reported estimates of improper payments total billions of dollars annually. Such payments can result from incomplete or inaccurate data used to make payment decisions, insufficient monitoring and oversight, or other deficiencies in agency information systems and weaknesses in internal control. The risk of improper payments is increased in programs involving (1) complex criteria for computing payments, (2) a significant volume of transactions, or (3) an emphasis on expediting payments. The reasons for improper payments range from inadvertent errors to fraud and abuse.

The full extent of improper payments, however, is unknown because many agencies have not estimated the magnitude of improper payments in their programs, nor have they considered this issue in their annual performance plans. The use of appropriate performance measures relating to improper payments can provide management focus on reducing related losses. For example, the Department of Health and Human Services (HHS) has reported a national estimate of improper payments in its Medicare fee-for-service benefits since fiscal year 1996. For fiscal year 1998, the Department reported estimated improper payments of $12.6 billion, or more than 7 percent, of Medicare fee-for-service benefits—down from about $20 billion, or 11 percent, reported for fiscal year 1997 and $23.2 billion, or 14 percent, for fiscal year 1996. Analysis of improper Medicare payments helped lead to the implementation of several initiatives intended to reduce improper payments. Annual estimates of improper payments in future audited financial statements will provide information on the progress of these initiatives.

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Cash Disbursement Activity

Several major agencies are not effectively reconciling cash disbursements. These reconciliations are intended to be a key control to detect and correct errors and other misstatements in financial records in a timely manner—similar in concept to individuals reconciling personal checkbooks with a bank's records each month. There continued to be billions of dollars of unresolved gross differences between agencies' and Treasury records of cash disbursements as of the end of fiscal year 1998. As a result, the government is unable to ensure that all disbursements are properly recorded. Improperly recorded disbursements could result in misstatements in the financial statements and in certain data provided by agencies for inclusion in the President's budget concerning fiscal year 1998 obligations and outlays.

Preparation of Financial Statements

The government does not have sufficient systems, controls, or procedures to properly prepare financial statements for the U.S. government. Such deficiencies, described below, impair the government's ability to (1) properly balance the government's financial statements and account for billions of dollars of transactions between governmental entities, (2) properly and consistently compile the information in the financial statements, and (3) effectively reconcile the results of operations reported in the financial statements with budget results.

Unreconciled Transactions. To make the financial statements balance, Treasury recorded a net $24 billion item on the Statement of Operations and Changes in Net Position, which it labeled unreconciled transactions. Treasury attributes this net out-of-balance amount to the government's inability to properly identify and eliminate transactions between federal government entities and to agency adjustments that affected net position. Certain intragovernmental accounts do not reconcile by a total of more than $250 billion.

Agencies' accounts can be out of balance with each other, for example, when one or the other of the affected agencies does not properly

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record a transaction with another agency or the agencies record the transactions in different accounting periods. These out-of-balance conditions can be detected and corrected by instituting procedures for reconciling transactions between agencies on a regular basis and in a timely manner. Generally, such reconciliations are not performed. These unreconciled transactions result in material misstatements of assets, liabilities, revenues, and/or costs.

Financial Statement Compilation. The federal government cannot ensure that the information in the financial statements of the U.S. government is properly and consistently compiled. To prepare the federal government's financial statements, about 70 agencies submit data to Treasury on approximately 2,000 separate reporting components, each having many account balances. However, several major agencies were unable to provide assurance that all agency amounts included in these financial statements reconciled with their agency financial statements. In addition, material adjustments and reclassifications were required to (1) make the financial statements more consistent with agency financial statements, (2) correct identified inconsistencies in reporting similar transactions, (3) conform footnote information to related financial statement line items, and (4) record other audit adjustments.

These problems are compounded by the substantial volume of information submitted and limitations in the federal government's general ledger account structure. As a result, additional misclassifications and misstatements in the government's financial statements could exist.

Reconciling the Results of Operations With Budget Results. The federal government did not have a process to obtain information to effectively reconcile the reported $134 billion excess of net cost over revenue and a reported unified budget surplus of $69 billion. Consequently, it could not identify all of the items needed to reconcile these amounts. Certain differences are expected to occur because the financial statements of the U.S. government are prepared on the accrual basis in accordance with federal accounting standards, which is a different basis than the budget. Under accrual accounting, transactions are reported when the events giving rise to the transactions occur, rather than when cash is received or paid. By contrast, federal budgetary reporting is generally on the cash basis in accordance with accepted budget concepts and policies.

Beginning in fiscal year 1998, major agencies were required by federal accounting standards to reconcile their reported net costs to budget information, which could provide a basis for preparing the reconciliation in the 1998 Financial Report of the United States Government. However, significant amounts reported in certain agency reconciliations, including unliquidated obligations and certain other budget information, lacked adequate supporting information and may be unreliable. For example, significant weaknesses in Department of Defense (DOD) systems and controls resulted in reported obligations incurred that may have exceeded available budget authority for certain appropriations. Further, significant amounts of Defense transactions were not applied or were incorrectly applied to specific budget appropriations, which could misstate certain reported budget information. Once the federal government produces reliable financial statements, an effective reconciliation could help provide additional assurance of the reliability of budget results.

INEFFECTIVE INTERNAL CONTROL

Because of the effects of the material weaknesses discussed below, the federal government has not maintained effective internal control to ensure that (1) transactions are properly recorded, processed, and summarized to permit the preparation of financial statements and stewardship information in accordance with federal accounting standards, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition and (2) transactions are executed in accordance with laws governing the use of budget authority and with other laws and regulations that could have a direct and material effect on the financial statements and other laws, regulations, and governmentwide policies identified by OMB Bulletin 98-08.[4] Individual agency financial statement audit reports describe the effects of

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[4] OMB Bulletin 98-08, Audit Requirements for Federal Financial Statements, August 24, 1998, as amended January 25, 1999.

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such weaknesses on specific agencies and identify additional internal control weaknesses, some of which are material to individual agencies.

In addition to the material weaknesses related to the deficiencies discussed in our disclaimer on the financial statements, we found that (1) widespread and serious computer control weaknesses affect virtually all federal agencies and significantly contribute to many of the material deficiencies discussed above and (2) material control weaknesses affect the government's tax collection activities. Due to the deficiencies noted throughout this report, additional material weaknesses may exist that have not been reported.

Computer Security Weaknesses

Continuing serious and widespread computer security weaknesses are placing enormous amounts of federal assets at risk of fraud and misuse, financial information at risk of unauthorized modification or destruction, sensitive information at risk of inappropriate disclosure, and critical operations at risk of disruption. Significant computer security weaknesses in systems that handle the government's unclassified information have been reported in each of the major federal agencies. The most serious reported problem is inadequately restricted access to sensitive data. Other types of weaknesses pertain to not adequately segregating duties to help ensure that people do not conduct unauthorized actions without detection, preventing unauthorized software from being implemented, and mitigating and recovering from unplanned interruptions in computer service. In today's highly computerized and interconnected environment, such weaknesses are vulnerable to exploitation by outside intruders as well as authorized users with malicious intent.

The consequences of computer security weaknesses could be devastating and costly—for instance, placing billions of dollars of payments and collections at risk of fraud and impairing military operations. Also, identified weaknesses at federal entities such as the Internal Revenue Service (IRS), the HHS's Health Care Financing Administration, the Social Security Administration (SSA), the Department of State, and the Department of Veterans Affairs place tax, medical and other sensitive records at risk of unauthorized disclosure, modification, and destruction.

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The government cannot estimate the full magnitude of actual damage and loss resulting from federal computer security weaknesses because it is likely that many such incidents are either not detected or not reported. However, GAO and agency reviews and documented incidents, such as the following, illustrate the potential for negative impacts.

- Attackers have accessed systems and stolen, modified, and destroyed both data and software at DOD and shut down entire systems.
- We have been successful, as part of computer security reviews, in readily gaining unauthorized access to systems that would allow intruders to read, modify, or delete data for whatever purpose they had in mind. Tests by agencies have revealed similar results.
- SSA's IG has reported criminal convictions involving SSA employees, most of which involved creating fictitious identities, fraudulently selling SSA cards, misappropriating refunds, or abusing access to confidential information.
- IRS has identified incidents of employees browsing taxpayer data and inappropriately using other systems containing taxpayer data.

GAO and the IGs have issued numerous reports that identify information security weaknesses in the federal government and made recommendations to address them. Also, GAO has reported information security as a high-risk area across government since February 1997.[5] Agencies need to fully institute a framework for assessing risk and ensuring that necessary policies and controls are in place and remain effective on an ongoing basis.

Tax Collection Activities

The federal government continues to have material weaknesses in controls related to its tax collection activities, which affect its ability to efficiently and effectively account for and collect the government's revenue. This situation results in the need for extensive, costly, and time-consuming ad hoc

[5] High-Risk Series: An Update (GAO/HR-99-1, January 1999), High-Risk Series: An Overview (GAO/HR-97-1, February 1997), and High-Risk Series: Information Management and Technology (GAO/HR-97-9, February 1997).

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programming and analysis, as well as material audit adjustments, to prepare basic financial information—an approach that cannot be used to prepare such information on a timely, routine basis to assist in ongoing decision-making. Additionally, the severity of the system deficiencies that give rise to the need to resort to such procedures for financial reporting purposes, as well as deficient physical safeguards, result in burden to taxpayers and lost revenue.

Serious financial management system deficiencies continue to affect the federal government's ability to effectively manage its taxes receivable and other unpaid assessments.[6] The lack of appropriate subsidiary systems to track the status of taxpayer accounts affects the government's ability to make informed decisions about collection efforts. This weakness has resulted in the government pursuing collection efforts against individual taxpayers who had already paid their taxes in full. The federal government also continues to be vulnerable to loss of tax revenue due to weaknesses in preventive controls over disbursements for tax refunds. The government does not perform sufficient up-front verification procedures to ensure the validity of amounts claimed by taxpayers as overpayments prior to making disbursements for refunds. Additionally, delays in recording tax amounts owed result in lost opportunities to retain or offset overpayments made by a taxpayer for one period to collect on outstanding amounts owed for another period, resulting in lost revenue. Finally, serious deficiencies in physical controls over cash, checks, and sensitive data received from taxpayers increase both the government's and the taxpayers' exposure to losses and increases the risk of taxpayers becoming victims of crimes committed through identity fraud.

[6] Other unpaid assessments consist of amounts for which (1) neither the taxpayer nor a court has affirmed are owed or (2) the government does not expect further collections due to factors such as the taxpayer's death, bankruptcy, or insolvency.

NONCOMPLIANCE WITH CERTAIN LAWS AND REGULATIONS

Our objective was not to, and we do not, express an opinion on overall compliance with laws and regulations. Tests for compliance with selected provisions of laws and regulations related to financial reporting disclosed that, as discussed earlier, the federal government makes improper payments in major programs such as Medicare. Additionally, as described below, we noted that federal systems do not substantially comply with federal financial management systems requirements. We caution that noncompliance other than that discussed in our report may occur and not be detected by these tests and that our limited testing may not be sufficient for other purposes. Further, the scope of our tests was limited by the material deficiencies discussed above. Other instances of noncompliance, some of which are material to individual federal agencies, are reported in the individual agency financial statement audit reports.

Noncompliance with the Federal Financial Management Improvement Act of 1996

The Federal Financial Management Improvement Act (FFMIA) of 1996 requires auditors performing financial audits to report whether agencies' financial management systems comply substantially with federal accounting standards, financial systems requirements, and the government's standard general ledger at the transaction level. For fiscal year 1997, agency financial auditors reported that 20 of 24 major agencies' financial systems did not comply with the Act's requirements. Similar results are expected for fiscal year 1998. Noncompliance with FFMIA, which we further discuss in our report, Financial Management: Federal Financial Management Improvement Act Results for Fiscal Year 1997 (GAO/AIMD-98-268, September 30, 1998), is indicative of the overall continuing poor condition of agency financial systems.

The majority of federal agencies' financial management systems do not meet systems requirements and cannot provide reliable financial information for managing day-to-day government operations and holding managers accountable. For many agencies, the preparation of financial statements requires considerable reliance on ad hoc programming and analysis of data produced by inadequate financial systems that are not integrated, reconciled, and often require significant adjustments. For example, the DOD Inspector General reported that the Department recorded more than $1.5 trillion in adjustments to component financial statements that were not supported by adequate audit trails or sufficient evidence to determine their validity. The significant financial management deficiencies discussed throughout this report underscore the challenge.

YEAR 2000 COMPUTING CHALLENGE

The federal government—with its widespread dependence on large-scale, complex computer systems to deliver vital public services and carry out its massive operations—faces an especially enormous and difficult task. Unless adequately confronted, Year 2000 computing challenges could lead to serious disruptions in key federal operations, ranging from national defense to benefit payments to air traffic management. Consequently, in February 1997, GAO designated the Year 2000 computing challenge across government as a high-risk area.

In response to a growing recognition of the challenge and urging from congressional leaders and others, the administration strengthened the government's Year 2000 preparation. In February 1998, the President took a major step in establishing the President's Council on Year 2000 Conversion. He established the goal that no system critical to the federal government's mission experience disruption because of the Year 2000 challenge, and charged agency heads with ensuring that this issue receives the highest priority attention.

GAO has issued over 90 reports and testimony statements detailing specific findings and made well over 100 recommendations related to the Year 2000 readiness of the government as a whole and of a wide range of individual agencies. In addition, to help agencies mitigate their Year 2000 risk, we produced a series of guides on Year 2000 readiness, business continuity and contingency planning, and testing.

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While much has been accomplished in addressing the Year 2000 challenge, risks remain. Our reviews of federal Year 2000 programs have found uneven progress; some major agencies are behind schedule. Complete and thorough Year 2000 testing is essential to providing reasonable assurance that new or modified systems will be able to process dates correctly and not jeopardize agencies' ability to perform core business operations. Moreover, adequate business continuity and contingency plans must be successfully completed throughout government.

FINANCIAL STATEMENTS AND BUDGET DECISIONS: ADDING THE LONG-TERM PERSPECTIVE

A view of the long-term sustainability of fiscal policies can assist decisionmakers in considering the government's financial position and making decisions about resource allocation. Such a view requires projections of spending and revenues into the future. In this context, the sovereign power to tax and the commitments of social insurance programs—such as Social Security and Medicare—must be considered.

Commitments for the Social Security and Medicare programs are included in the Stewardship Information accompanying the financial statements. The government's 75 year estimates of the present value of expenditures in excess of contributions for the Social Security (Old Age Survivors and Disability Insurance (OASDI)) and Medicare (Part A) programs amounted to $3.8 trillion and $4.0 trillion, respectively, as of September 30, 1998. The government's projections also indicate that Social Security and health care costs will absorb an increasing share of the federal budget.

In fiscal year 1998, Social Security trust funds surpluses of $99 billion offset a $30 billion deficit in the rest of the budget, resulting in the $69 billion unified budget surplus. However, as discussed in the accompanying Stewardship Information, using the government's best estimates as of September 30, 1998, cash disbursements of the Social Security trust funds (OASDI) are expected to exceed cash receipts beginning in fiscal year 2013. Cash disbursements of Medicare's Hospital Insurance Program (Part A) have exceeded receipts for several years.

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When receipts exceed disbursements, trust funds invest the surplus in Treasury securities, which are assets to the trust funds and liabilities to the Treasury. As disclosed in note 9 and 17, both the investments and liabilities, which amounted to $1.8 trillion at September 30, 1998, are netted out in the accompanying financial statements.

Expected cash shortfalls in the trust funds will require them to redeem their investments in Treasury securities. When this occurs, the government must fund these redemptions through use of future surpluses if available, lower relative spending for other federal programs, higher relative taxes, and/or greater relative borrowing from the public. Further, under the government's September 30, 1998 projections, absent any program or financing change, the Medicare Part A Trust Fund and Social Security trust funds will exhaust their Treasury security holdings in 2008 and 2032, respectively.

There is general recognition that the Social Security and Medicare Hospital Insurance (Part A) programs require changes from their current form. This is why today various proposals are being considered to deal with the long-term solvency and sustainability of these two programs. The fact that Medicare is already drawing down its Treasury securities holdings, and that it is expected that Social Security will need to do so in less than 15 years, highlights the importance of acting soon in order to avoid more dramatic changes in the future.

We are working with OMB, the Treasury, and other agencies across government to provide recommendations for fixing the major deficiencies cited in our audit. Considerable effort is now being exerted to address the problems, and several agencies, such as SSA, have made good progress toward achieving financial management reform goals. We have designated the most serious situations as high-risk, including financial management at DOD, IRS, the Forest Service, and the Federal Aviation Administration, as well as information security and the Year 2000 challenge.

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In addition, the continued coordinated efforts of Treasury and OMB will be required to provide solutions for certain governmentwide deficiencies, such as the inability to properly identify and eliminate transactions between federal entities and the compilation of the financial statements. We will continue to provide suggestions for resolving governmentwide problems and to evaluate progress in overcoming them.

David M. Walker
Comptroller General
of the United States

March 19, 1999

OBJECTIVES, SCOPE, AND METHODOLOGY

The federal government is responsible for

- preparing the annual financial statements accurately and in conformity with the basis of accounting described in note 1 to the financial statements;
- establishing, maintaining, and assessing internal control to provide reasonable assurance that the broad control objectives of the Federal Managers' Financial Integrity Act (FMFIA) are met[7]; and
- complying with applicable laws and regulations.

Our objective was to audit the fiscal year 1998 financial statements.

The Government Management Reform Act expanded on the requirements of the CFO Act by requiring that the IGs of 24 major federal agencies annually audit agencywide financial statements prepared by these agencies.[8] Our work was performed in close coordination and cooperation with the IGs to achieve our joint audit objectives. This work included separate GAO audits of certain material agency components, as discussed below. Our audit approach focused on the Departments of the Treasury, Defense, and Health and Human Services and the Social Security Administration. These agencies comprise a major portion of the amounts reported in the federal government's financial statements. At other federal agencies, we focused largely on accounts that are material to the financial statements. Additionally, for certain agencies, information has been included in these financial statements but the agencies have not, at this date, finalized their individual financial statements for fiscal year 1998. Therefore, we were

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[7] The FMFIA requires agency managers to evaluate and report annually to the President and the Congress on the adequacy of their internal controls and accounting systems and what is being done to correct the problems.

[8] GMRA authorized OMB to designate agency components that also would receive a financial statement audit.

unable to determine the reliability of the amounts included in the accompanying financial statements for these agencies. We performed sufficient audit work to provide our report on the financial statements, internal control, and compliance with laws and regulations.

We separately audited the following material agency components.

- We audited and expressed an unqualified opinion on the IRS Statement of Custodial Activity for fiscal year 1998. IRS was able to reliably report on the results of its custodial activities, including nearly $1.8 trillion of tax revenue, $151 billion of tax refunds, and $26 billion of net federal taxes receivable. However, we issued a qualified opinion on the IRS administrative balance sheet, disclaimed an opinion on its administrative statements of net cost, changes in net position, budgetary resources, and financing, and reported numerous material internal control weaknesses.[9]

- We audited and expressed an unqualified opinion on the Schedule of Federal Debt Managed by Treasury's Bureau of the Public Debt for the fiscal year ended September 30, 1998.[10] This schedule reported (1) $3.7 trillion of federal debt held by the public comprising individuals, corporations, state or local governments, the Federal Reserve System, and foreign governments and central banks, (2) $1.8 trillion of federal debt held by federal entities, such as the Social Security trust funds, and (3) $243 billion of interest on federal debt held by the public.

- We performed audit procedures on cash balances maintained and internal controls over the cash receipts and disbursements processed by Treasury on behalf of the federal government. We provided the results of our work to the Treasury Office of Inspector General for

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[9] Financial Audit: IRS' Fiscal Year 1998 Financial Statements (GAO/AIMD-99-75, March 1, 1999).

[10] Financial Audit: Bureau of the Public Debt's Fiscal Years 1998 and 1997 Schedules of Federal Debt (GAO/AIMD-99-70, March 1, 1999).

consideration in its audit of Treasury's fiscal year 1998 departmentwide financial statements.

- We audited and expressed unqualified opinions on the December 31, 1997, financial statements for the funds administered by the Federal Deposit Insurance Corporation (FDIC), including the Bank Insurance Fund, the Savings Association Insurance Fund, and the FSLIC Resolution Fund.[11] In addition, we performed audit procedures and tests of internal controls for cash, investments, and other material balances of the funds administered by FDIC as of September 30, 1998.

At the 24 CFO Act agencies and other agencies, we reviewed the fiscal year 1998 financial statement audits performed by the IGs or their contractors and, for certain agencies, assisted in the development of audit plans for fiscal year 1998 audits. Financial statements and audit reports for these agencies provide additional information about the operations of each of these entities. For example, these audits have identified numerous internal control and accounting systems weaknesses and noncompliance, some of which are material to the respective agencies or components. Further, as of the completion of our field work on March 19, 1999, 15 of the 24 CFO Act agencies had received audit opinions or disclaimers on their fiscal year 1998 financial statements. Of the 15 agencies, 7 received unqualified opinions. These agencies are the

Social Security Administration,
Department of Labor,
General Services Administration,
National Science Foundation,
National Aeronautics and Space Administration,
Nuclear Regulatory Commission, and
Federal Emergency Management Agency.

[11] Financial Audit: Federal Deposit Insurance Corporation's 1997 and 1996 Financial Statements (GAO/AIMD-98-204, June 29, 1998).

Financial Statements of the United States Government for the Year Ended September 30, 1998

Statement of Operations and Changes in Net Position

This Statement reports the results of Government operations. This includes revenues principally generated by the Government's sovereign power to tax, levy duties, and assess fines and penalties. The statement covers the net cost of Government operations, net of revenue earned from the sale of goods and services to the public. It also includes any adjustments and unreconciled transactions that affect the net position.

Revenue

The main source of revenue for Government operations consists of taxes and other revenue the Federal Government generates under its sovereign powers or receives by donation.

"Individual income tax and tax withholdings" consist of Federal income taxes, and Social Security and Medicare taxes, net of refunds.

"Miscellaneous earned revenue" consists of earned revenues received from the public with virtually no associated cost. This category includes revenues generated from spectrum auctions and rents and royalties on the Outer Continental Shelf Lands.

Net Cost of Government Operations

The Statement of Net Cost presents the "Net cost of Government operations," which is gross cost minus earned revenue.

Unreconciled Transactions

"Unreconciled transactions" are adjustments made to balance the change in Net Position.

Net Position—Beginning of Period

The "Net position—beginning of period" reflects the net position reported on the prior year's Balance Sheet.

Prior Period Adjustments

"Changes in accounting principles" is the retroactive effect of applying new Federal Financial Accounting Standards.

"Other adjustments" are revisions to correct the beginning net position.

Net Position—End of Period

This amount reflects the net position on the current year's Balance Sheet.

Statement of Net Cost

This statement reports the net cost of fiscal 1998 Government operations. It also shows the cost to carry out national priorities as determined by law.

It also categorizes costs by major function. It presents costs in much the same way as does the budget, except that costs are allocated to functions based on accounting standards. Thus, this statement reports costs on an accrual basis and allocates them differently than the budget. For example, this statement allocates the cost of pensions and retiree health benefits among all the functions that employ workers. The budget categorizes pension payments to retirees as a subfunction, found under "Income security." The budget categorizes agency contributions to retirement funds as intragovernmental outlays distributed among all the functions that employ workers. A description of each of the functions and the components of net cost for the activities included in each function is presented in Supplemental Information as "Net cost detail."

The Statement contains the following three components for each function:

- The gross cost of Government operations.
- The revenues earned from the public for goods and services.
- The net cost of Government operations, which is gross cost less revenue earned.

Gross Cost

"Gross cost" includes the full cost of all functions. These costs may be directly traced, assigned on a cause and effect basis, or reasonably allocated to the function.

Earned Revenue

This is revenue the Government earned by providing goods and services to the public at a price.

Net Cost

The "Net cost" of Government operations is computed by subtracting "Earned revenues" from "Gross cost."

Balance Sheet

This Balance Sheet shows the Government's assets and liabilities. It alone does not provide a complete picture of the Government's financial resources nor the current and future claims on them. However, when combined with Stewardship Information, this information presents a more comprehensive understanding of the Government's financial position. Most line items on the Balance Sheet are described in the Notes to the Financial Statements. The first note, for example, provides information on the accounting policies for assets and liabilities.

Assets

Assets included on the Balance Sheet are resources of the Federal Government that remain available to meet future needs. The most significant assets reported in the Balance Sheet are loans receivable and inventories, as well as property, plant and equipment. There are, however, other significant resources available to the Government that extend beyond the assets presented in this Financial Statement. Those assets include the Government's sovereign powers to tax, regulate commerce and set monetary policy. They also include natural resources.

A change in accounting standards, effective as of October 1, 1997, created a new class of assets, termed Stewardship Assets. Selected assets now are highlighted separately from the Balance Sheet under Stewardship Information. As steward of these assets, it is incumbent on the Government to demonstrate accountability by including these assets in its financial reports.

National defense assets

"National defense assets" are weapon systems and supporting assets used by the military for the Nation's common defense and general welfare. The predominant reporting objectives for national defense assets are their availability to defend the country in times of need. These objectives are best measured in non-financial terms. Effective October 1, 1997, national defense assets totaling $655.2 billion were reclassified from the Balance Sheet to Stewardship Information. Examples of those assets include aircraft carriers, submarines, tanks and missiles.

Stewardship land

"Stewardship land" is land owned by the Federal Government and set aside for the use and enjoyment of present and future generations. The Federal Government does not expect to use this land to meet its obligations, unlike the assets listed on the Balance Sheet. Stewardship land is measured in non-financial units such as acres of land and lakes, miles of parkways, and wild and scenic rivers. Examples of stewardship land include historic parks, national forests, wilderness areas and land used to enhance ecosystems to encourage animal and plant species and to conserve nature.

Heritage assets

"Heritage assets" are Government-owned assets that have one or more of the following characteristics: historical or natural significance; cultural, educational, or artistic importance; or significant architectural features. The cost of heritage assets often is not determinable or relevant to their significance. Like stewardship land, the Government does not expect to use these assets to meet its obligations. The most relevant information about heritage assets is non-financial. Instead, information on their existence provides the best measure of the Government's custodial responsibility. Examples of heritage assets include: the Declaration of Independence, the Constitution, and the Bill of Rights preserved by the National Archives. Also included are national monuments such as the Vietnam Veterans Memorial, Jefferson Memorial and the Washington Monument as well as art and cultural treasures at the Smithsonian Institution and the Library of Congress. Many other sites such as the battlefields, historic structures and national historic landmarks also are placed under this category.

Liabilities and Net Position

Liabilities are obligations of the Federal Government resulting from prior actions that will require resources. The most significant liabilities reported on the Balance Sheet are Federal debt securities held by the public and accrued pension liabilities for current and retired Federal civilian and military personnel. However, the Government's responsibilities are much broader than these Balance Sheet liabilities.

The Government's responsibilities and policy commitments include the social insurance programs disclosed in Stewardship Information and certain future loss contingencies.

The magnitude and complexity of social insurance programs coupled with the extreme sensitivity of projections relating to the many assumptions of the program produce a large range of possible results. The Stewardship Responsibilities section explains factors that impact the various programs. Using this information, the readers can apply their own judgment to the sustainability of the individual programs. The Federal Accounting Standards Advisory Board continues to consider the appropriate accounting treatment for them.

The Balance Sheet includes social insurance benefits due and payable as of the reporting date.

Each of the social insurance programs has an associated trust fund to account for its activity. An explanation of the large trust funds for social insurance and many of the other large trust funds is included in Note 17–Dedicated Collections. That note also contains information about trust fund receipts, disbursements and assets.

A broad perspective on the Federal Government's responsibilities is provided by the Current Services Assessment, which also can be found under Stewardship Information. Presented in accordance with the President's budget, this information estimates Federal expenditures for fiscal years 1999 through 2004 if there are no changes to current law.

The Government also has unresolved contingencies where existing conditions, situations or circumstances create uncertainty about future losses. Contingent liabilities that do not meet the criteria for recognition on the Balance Sheet, but for which there is at least a reasonable possibility that a loss has been incurred, are disclosed in Note 15–Commitments and Contingencies.

"Net position" is presented as the sum of Balance Sheet assets less Balance Sheet liabilities.

United States Government
Statement of Operations and Changes in Net Position
for the Year Ended September 30, 1998

(In billions of dollars)

Revenue:	
Individual income tax and tax withholdings	1,374.2
Corporation income taxes	186.3
Unemployment taxes	26.4
Excise taxes	57.6
Estate and gift taxes	24.0
Customs duties	17.7
Other taxes and receipts	26.6
Miscellaneous earned revenues	7.4
Total revenue	1,720.2
Net Cost of Government Operations:	
National defense	321.6
Human resources	1,080.4
Physical resources	100.2
Net interest	243.1
Other functions	108.7
Total net cost of Government operations	1,854.0
Excess of Net Cost Over Revenue	(133.8)
Unreconciled transactions affecting the change in net position (Note 16)	23.9
Decrease in net position	(109.9)
Net position, beginning of period	(5,003.0)
Prior Period Adjustments (Note 14):	
Changes in accounting principles	(681.7)
Other adjustments	(339.8)
Net position, end of period	(6,134.4)

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

United States Government
Statement of Net Cost
for the Year Ended September 30, 1998

(In billions of dollars)	Gross Cost	Earned Revenue	Net Cost
National defense	343.6	22.0	321.6
Human Resources:			
Education, training, employment and social services	54.7	3.3	51.4
Health	125.3	1.1	124.2
Medicare	213.7	20.6	193.1
Income security	181.8	7.7	174.1
Social Security	378.7	-	378.7
Veterans benefits and services (Note 10)	160.2	1.3	158.9
Total human resources	1,114.4	34.0	1,080.4
Physical Resources:			
Energy	13.3	11.9	1.4
Natural resources and environment	27.0	4.2	22.8
Commerce and housing credit	96.5	70.7	25.8
Transportation	41.6	3.7	37.9
Community and regional development	14.7	2.4	12.3
Total physical resources	193.1	92.9	100.2
Net interest	243.1	-	243.1
Other Functions:			
International affairs	24.8	6.0	18.8
General science, space and technology	19.9	0.1	19.8
Agriculture	19.1	2.3	16.8
Administration of justice	28.3	1.4	26.9
General government	29.2	2.8	26.4
Total other functions	121.3	12.6	108.7
Total	2,015.5	161.5	1,854.0

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

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United States Government
Balance Sheet
as of September 30, 1998

(In billions of dollars)

Assets:	
Cash and other monetary assets (Note 2)	96.8
Accounts receivable	36.1
Loans receivable (Note 3)	166.8
Taxes receivable (Note 4)	27.1
Inventories and related property (Note 5)	166.8
Property, plant and equipment (Note 6)	299.3
Other assets (Note 7)	59.9
Total assets	852.8
Liabilities and Net Position:	
Accounts payable (Note 8)	90.0
Federal debt securities held by the public (Note 9)	3,717.7
Federal employee and veteran benefits payable (Note 10)	2,685.1
Environmental liabilities (Note 11)	224.5
Benefits due and payable (Note 12)	77.6
Loan guarantee liabilities (Note 3)	37.7
Other liabilities (Note 13)	154.6
Total liabilities	6,987.2
Commitments and Contingencies (Note 15)	
Net Position	(6,134.4)
Total liabilities and net position	852.8

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

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United States Government Stewardship Information for the Year Ended September 30, 1998 (Unaudited)

Stewardship Assets

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

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

National Defense Assets

The Department of Defense (DOD) owns and uses "National defense assets" to accomplish military missions, such as war, operations short of war, training, peacekeeping and supporting civilian authorities during civil emergencies.

These assets divide into two categories: weapons systems and support principal end items. Weapon systems refer to military equipment that launch, release, carry, or fire ordnance; and/or equipment that carries weapon systems related property, equipment, material or personnel. Support principal end items consist of items acquired to support weapon systems that ultimately may be incorporated into weapon systems. Examples of these items include aircraft engines, tank engines, aircraft radar, ship sonar, uninstalled missile motors, missile control panels, gun mounts, gun turrets and guidance systems.

"The Department of Defense (DOD) owns and uses 'National defense assets' to accomplish military missions, such as war, operations short of war, training, peacekeeping and supporting civilian authorities during civil emergencies."

National Defense Assets, cont.

The DOD's property systems information, listed in the National Defense Assets table, does not capture and/or retain addition and deletion data; therefore, DOD could not report separately such amounts. The report reflects the net amount between the opening and closing balances. As DOD's property systems are modified or upgraded, appropriate modifications will be made to report additions and deletions separately.

The quantities of national defense assets presented reflect the sum of the quantities reported by the Army, Navy, Air Force and the Marine Corps. National defense assets do not include Coast Guard ships and other assets. At times of war, Coast Guard assets are under the direction of DOD, but in times of peace, they are under the Department of Transportation (Transportation). Each of the military services' financial statements presents additional information on national defense assets.

National Defense Assets as of September 30

(In number of systems or items)	Balance as of October 1, 1997	Additions / (Deletions)	Balance as of September 30, 1998
Aircraft:			
Combat	9,047	(434)	8,613
Airlift	2,380	(62)	2,318
Other aircraft	8,916	(857)	8,059
Ships:			
Submarines	137	(14)	123
Aircraft carriers	16	2	18
Surface combatants	229	2	231
Amphibious warfare ships	78	5	83
Mine warfare ships	34	4	38
Support ships	238	(10)	228
Other ships	1,209	(62)	1,147
Small boats	3,237	(684)	2,553
Missiles:			
Ballistic missiles	3,905	(652)	3,253
Other missiles	*	*	725,346
Combat Vehicles:			
Tanks	10,889	(827)	10,062
Other combat vehicles	43,844	(6,360)	37,484
Space Systems:			
Satellites	69	9	78
Other Weapon Systems:			
Torpedoes	7,436	1,050	8,486
Other weapons	13,490	(1,696)	11,794

* The beginning of the year amount and additions and deletions were not available from all sources.

National Defense Assets, cont.

"Mission support assets" include various types of military equipment, such as ordnance support equipment, vehicular equipment, electronics equipment and communications equipment. Weapon systems support real property includes ammunition bunkers and missile silos in active use.

Recently, the requirements were modified for reporting acquisition costs of national defense assets to require the full cost in accordance with the Statement of Federal Financial Accounting Standards (SFFAS) Number 4. DOD currently does not have cost accounting systems that capture the full cost required by SFFAS Number 4 and will not for many years. Therefore, the amounts reported in this report represent the DOD's annual disbursements for each category of National Defense Assets.

The investment amounts in National Defense Assets presented in this report reflect the sum of invest-

Investments in National Defense Assets for the Period Ended September 30

(In millions of dollars)

Aircraft:	
Combat	$5,269
Airlift	3,727
Other aircraft	1,512
Aircraft support principal end items	3,340
Ships:	
Submarines	1,090
Aircraft carriers	1,301
Surface combatants	2,879
Amphibious warfare ships	753
Mine warfare ships	89
Other support ships	575
Ship support principal end items	851
Missiles:	
Ballistic missiles	587
Other missiles	1,271
Missile support principal end items	1,339
Combat Vehicles:[1]	
Tanks	38
Other combat vehicles	489
Combat vehicle support principal end items	842
Space Systems:	
Satellites	517
Satellite support principal end items	667
Other Weapon Systems:	
Torpedoes	125
Other weapons	132
Other weapons support principal end items	135
Mission support assets[2]	4,968
Weapons systems support real property	28
Total investments in national defense assets for fiscal year ended September 30	$32,524

[1] Air Force investments in combat vehicles are not included in amounts reported.
[2] The amount reported does not include Air Force investments.

Stewardship Land

"Stewardship land" refers to federally owned land that is not used, or held for use, in "General Government" operations. This category excludes lands administered by the Bureau of Indian Affairs and held in trust. Also, excluded from stewardship land are military bases, land used by the Tennessee Valley Authority and other lands used as part of "General Government" operations.

Most stewardship land is "public domain." Between 1781 and 1867, the Government acquired land equal to 79.4 percent of the current acreage of the United States, spending a total of $85.1 million.

United States Government Stewardship Land as of September 30

(In millions of acres)

Predominate Land Use	U.S. Forest Service	National Park Service	U.S. Fish and Wildlife Service	Bureau of Land Management	Totals: Total by Type of Use	Totals: Percent of Total
Bureau of Land Management land	-	-	-	263.6	263.6	42.4
National wildlife refuge	-	-	87.5	-	87.5	14.1
National parks	-	50.2	-	-	50.2	8.1
National forest	153.3	-	-	-	153.3	24.7
National grassland	3.8	-	-	-	3.8	0.6
Wilderness and other areas	34.8	27.2	0.9	-	62.9	10.1
Total acres.	191.9	77.4	88.4	263.6	621.3	100.0

Bureau of Land Management

The Bureau of Land Management (BLM) manages a variety of land types. BLM subdivides its management responsibility into five primary categories: rangeland, forestland, riparian and wetlands, aquatic areas, and other habitat and wastelands.

Rangeland consists of land where the native vegetation is predominately grasses, grass-like plants, forbs, or shrubs suitable for grazing or browsing. This includes lands that are revegetated naturally or artificially to provide forage cover and are managed like native vegetation. Rangeland includes natural grasslands, savannas, shrublands, most deserts, tundra, alpine communities, coastal marshes and wet meadows. Rangeland totals 165 million acres, including 5 million acres in the Alaska Reindeer Range.

Forestland encompasses approximately 11 million acres. Alaska forestland numbers about 7 million acres, while Western States boast another 4 million. Forested lands are of great variety. They include:

- The black and white spruce in Alaska.
- The aspen, lodgepole pine, ponderosa pine, interior Douglas fir, and associated species of the Inter-Mountain West.
- The pinyon-juniper woodlands of the Great Basin and Southwest.
- The Douglas fir, hemlock and cedar forests of western Oregon and northern California.

Wetlands are inundated or saturated by surface or ground water at a frequency and duration sufficient to support vegetation adapted for life in saturated soil. Wetlands include bogs, marshes, shallows, muskegs, wet meadows, estuaries and riparian areas. Wetlands total 16 million acres.

Riparian lands adjacent to creeks, streams, lakes and rivers total 18,300 miles in length and 7 million acres in area. These areas contain water and vegetation in the otherwise arid western United States. They are important to fish and wildlife species, as well as livestock. Since they filter water flowing through them, riparian-wetland areas can affect the health of the entire water-shed.

Aquatic areas have flowing or standing water. They include about 4 million acres of lakes, reservoirs and streams. These waters contain a wide variety of aquatic species ranging from rare resident species, such as the desert pupfish, to endangered and threatened anadromous species, such as steelhead and chinook salmon.

BLM designates wasteland areas as those that generally do not provide forage in sufficient amounts to sustain wildlife or grazing animals. This land category includes mountain tops, glaciers, barren mountains, sand dunes, playas, hot-dry deserts and other similar areas totaling 20 million acres.

U.S. Fish and Wildlife Service

The U.S. Fish and Wildlife Service manages 88.4 million acres of federally owned lands held primarily for wildlife conservation. It has five goals:

- Preserve, restore and enhance, in their natural ecosystems, all species of animals and plants endangered or threatened.
- Perpetuate the migratory bird resource.
- Preserve a natural diversity and abundance of flora and fauna.
- Provide an understanding and appreciation of fish and wildlife ecology.
- Provide refuge visitors a safe, wholesome and enjoyable recreational experience oriented toward wildlife.

The Fish and Wildlife Service subdivides its management responsibility into the following categories:

- "National wildlife refuges" (516 sites on 87.5 million acres).
- "Refuge coordination areas" (50 sites on 197,000 acres).
- "Waterfowl production areas" (199 sites on 704,000 acres).
- "Fisheries research centers" (83 sites on 14,000 acres).
- "Wild and scenic rivers" (six rivers totaling 1,416 miles in length).

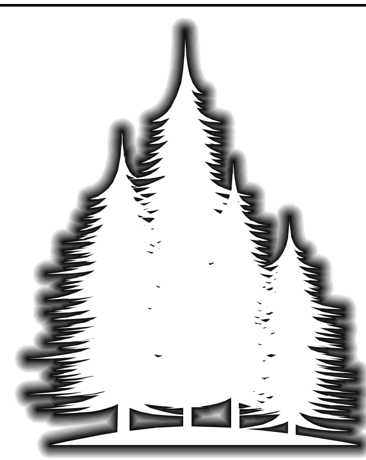
U.S. Forest Service

The Forest Service manages 191.9 million acres of federally owned lands for the sustained use of outdoor recreation, range, timber, watershed, wildlife and fish.

Forest land contains 155 named National Forests totaling 153.3 million acres. Within the National Forests, livestock grazing for cattle, horses, sheep and goats was permitted on over 92.4 million acres of rangeland. The Forest Service harvested 3.3 billion board feet of timber, sold 3.0 billion board feet, and reforested 287,905 acres, primarily with genetically improved seedlings in fiscal 1998.

Wilderness land contains 34.7 million acres in 38 States and is served by 33,000 miles of trails.

The Forest Service also manages 20 named grasslands on 3.8 million acres and about 4,348 miles of the wild and scenic river system.



National Park Service

The National Park Service manages 77.4 million acres of federally owned lands. These lands are set aside to conserve the scenery, nature, historic objects and wildlife so they can be enjoyed by current and future generations of Americans

Other types of park areas include: national rivers, parkways, national lakeshores, historic parks, scenic trails, wild and scenic rivers, military parks, reserves, battlefields and other parks.

Summary of Acreage

(In millions of acres)

Type of Park Area	Acreage
National parks	50.2
National preserves	21.4
National recreation areas	3.4
National monuments	1.9
National seashores	0.5
Total acres	77.4

Heritage Assets

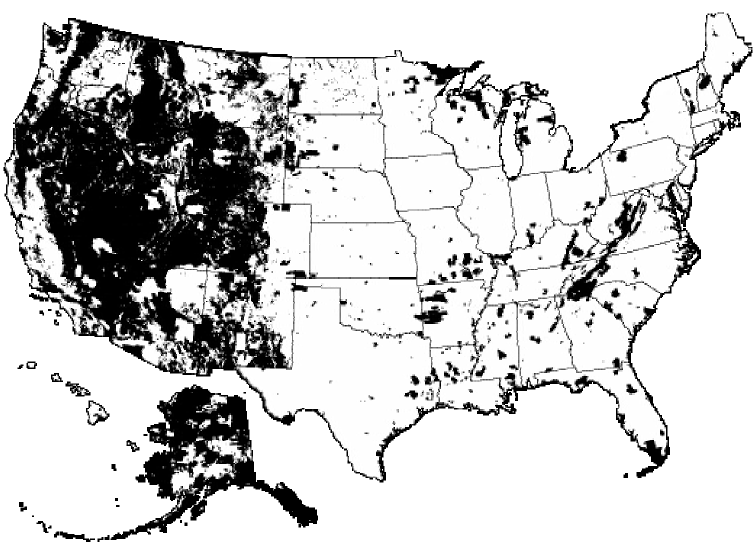
The Federal Government holds vast numbers of heritage assets. These assets encompass many of the Nation's most precious historic, natural and cultural resources. Heritage assets are unique property, plant and equipment with:

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

The Government has been entrusted with, and is accountable for, these assets which are held for the long-term benefit of the Nation. Examples of heritage assets are the Washington Monument, Declaration of Independence, Yosemite National Park and museum objects on display at the Smithsonian Institution.

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

Federal Stewardship Land



Source: National Atlas of the United States of America, U.S. Geological Survey

The Government's heritage assets can be classified into three broad categories: collection type, natural and cultural. Collection-type heritage assets include objects gathered and maintained for exhibition such as museum collections and library collections. Natural heritage assets include properties such as national wilderness areas, wild and scenic rivers, natural landmarks, forests and grasslands. The Stewardship Land section lists the total acres of land area for some natural heritage assets such as national forests. Cultural heritage assets include historic places and structures, memorials and monuments, national cemeteries, and archeological sites.

Collection-type Heritage Assets

Prominent among Federal museum collections are those of the Smithsonian Institution, numbering approximately 140 million individual objects. The Smithsonian acquires, protects and preserves these objects for public exhibition, education and research.

The Library of Congress holds the world's largest library collection. More than 115 million items comprise that collection which is held for use by the Congress and the public. The Library contains two copies of every book, pamphlet, map, print, photograph and piece of music registered for copyright in the United States.

Additionally, the National Archives holds over 2 million cubic feet of records. These records ensure ready access to essential evidence documenting the rights of citizens, the actions of Federal officials and the effects of those actions on the national experience. These records include: textual and legislative records; cartographic and architectural records; motion picture, sound, and video records, and still pictures and graphics. The Archives maintains such historically important documents as the U. S. Constitution and the Louisiana Purchase Treaty.

Natural Heritage Assets

A “Wilderness area” is an area designated by Congress that is protected and managed so as to preserve its natural conditions. The Department of the Interior manages 255 wilderness areas comprising 66.5 percent of the Nation’s 103.7 million acres of wilderness. One of those is the Cebolla Wilderness in New Mexico.

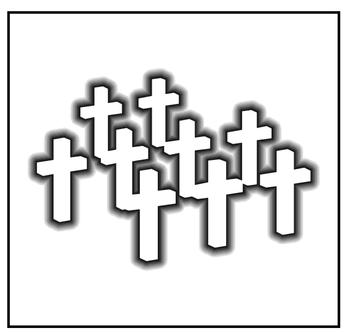
The “National wild and scenic rivers system” includes free-flowing rivers that are valued for their fish and wildlife or their scenic, recreational, geologic historic, cultural, or other value. The Department of the Interior manages 54 percent of the 10,831 river miles in the “National and wild scenic rivers system, including the Bluestone National Scenic River in West Virginia.

National natural landmarks have national significance because they exemplify a natural region’s characteristic features. The National Park Service has identified 578 national natural landmarks, such as the Garden of the Gods in Colorado.

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

Cultural Heritage Assets

The National Register of Historic Places lists historic places and structures. This is America's official listing of important historical sites. Properties listed include districts, sites, buildings, structures and objects significant to American history, architecture, archaeology, engineering and culture. Forest Service lands contain 887 such properties. The National Register estimates that another 109,000 properties are eligible for this designation.



The Nation's monuments and memorials include the Washington Monument, Vietnam Veteran's Memorial and Jefferson Memorial in Washington, DC. The National Park Service manages these sites. Also, the American Battle Monuments Commission manages 27 memorials, monuments and markers around the world, such as the Belleau Wood Marine Monument in France.

Archeological sites contain the remains of past human activity. The Department of the Interior manages over 290,000 archeological sites. The ancient earthen mounds at the Hopewell Culture National Historic Site in Ohio is a notable example.

National cemeteries include the Arlington National Cemetery in Virginia and the Fort Logan National Cemetery in Colorado. The VA manages those and 58 other cemeteries.

Stewardship Responsibilities

Social Security

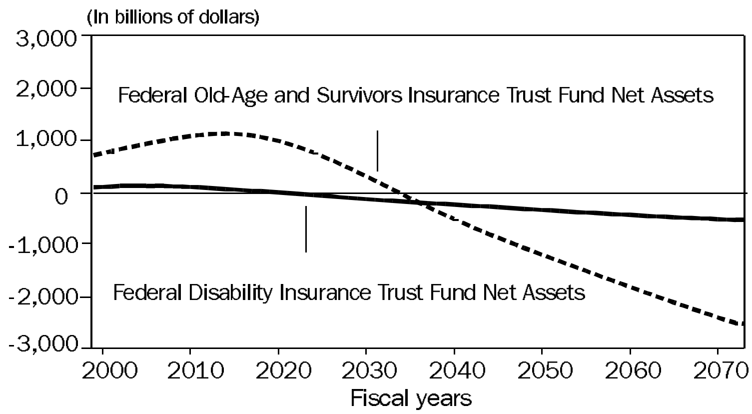
Congress passed the Social Security Act in 1935. The Act, as subsequently amended, includes programs providing retirement and disability benefits.

Congress established two trust funds for Social Security: The Federal Old-Age and Survivors Insurance (OASI) and the Federal Disability insurance (DI) Trust Funds (OASDI). OASI pays retirement and survivors benefits and DI pays benefits to disabled workers.

Revenue to OASDI consists of taxes on earnings paid by employees, their employers and the self-employed. OASDI also receives revenue from the income taxes on Social Security and from interest on its investments in Treasury securities. Social Security revenues not needed to pay current benefits or administrative expenses are invested in special-issue Government securities. Those securities are guaranteed as to both principal and interest and backed by the full faith and credit of the Government.

The Board of Trustees of the OASI and DI trust funds provides the President and Congress with short-range (10 years) and long-range (75 years) actuarial estimates of each trust fund in its annual report. Because of the inherent uncertainty in estimates for as long as 75 years into the future, the Board of Trustees uses three alternative sets of economic and demographic assumptions to show the range of possibilities. Assumptions are made about many economic, demographic and programmatic factors, including gross domestic product, earnings, the Consumer Price Index, unemployment, birth rate, immigration, mortality, and disability incidents and termination. The assumptions used in the table below, generally referred to as the "intermediate assumptions," reflects the best estimate of expected future experience.

Social Security Estimated Trust Fund Balances



The present values of actuarial estimates were computed as of the beginning of the valuation period, September 30, 1998. The expenditures consist of the sum of the present value of all estimated payments during the valuation period. The contributions consist of the sum of the present value of all estimated non-interest income during the period. The estimates were prepared on the basis of the financing method regarded as being the most appropriate by both Congress and the Board of Trustees. These estimates assume future workers will be covered by the program as they enter the labor force.

Under current legislation and using intermediate assumptions, the DI and OASI trust funds are projected to be exhausted in 2019 and 2034, respectively. Combined OASDI expenditures will exceed current tax income beginning in 2013, and will exceed total current income (including current interest income) for calendar years 2021 and later. Thus, current tax income plus a portion of annual interest income will be needed to meet expenditures for year 2013 through 2020. Thereafter, in addition to current tax income and current interest income, a portion of the principal (combined OASDI assets) will be needed each year until trust fund assets are totally exhausted in 2032. At that point, current tax income will be sufficient to pay approximately 75 percent of the benefits due.

Social Security Present Value Estimates for the Period of 75 Years into the Future, Beginning September 30, 1998

(In billions of dollars)	OASI	DI	OASDI
Present value of actuarial contributions to December 31, 2073	16,383.3	2,689.0	19,072.3
Present value of actuarial expenditures to December 31, 2073	19,567.3	3,307.2	22,874.5
Present value of future resources needed	3,184.0	618.2	3,802.2
Assets of Social Security as of September 30 (Note 17)	664.5	78.2	742.7

Medicare

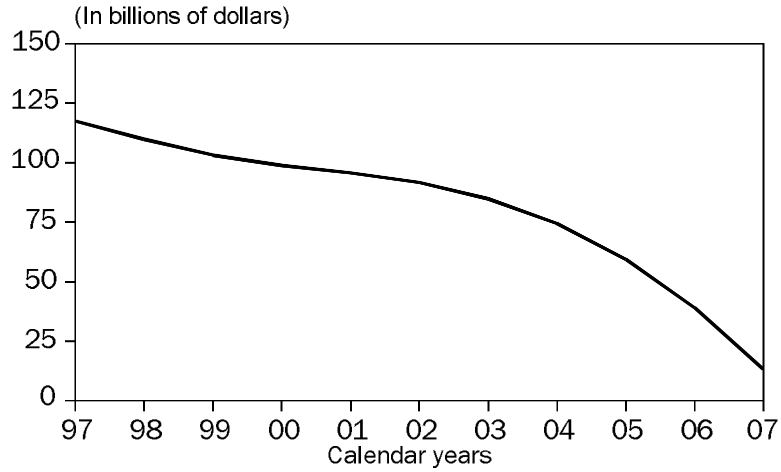
Federal Hospital Insurance Trust Fund revenue consists of taxes on earnings paid by employees, their employers and the self-employed. The fund also receives revenue from the taxation of Social Security benefits and from interest on its investments in Treasury securities. Revenues not needed to pay current benefits of the Federal Hospital Insurance Program (Medicare Part A) or administrative expenses are invested in special issue Treasury securities. These securities bear a market rate of interest, and are guaranteed both as to principal and interest. In addition, the securities are backed by the full faith and credit of the U.S. Government.

As computed 75 years into the future (to calendar year 2073), Medicare Part A has an actuarial deficit of $4,042.7 billion. This estimate includes the book value of assets as of September 30, 1998, and the present value of various program income items expected to be received through the year 2073. Subtracted from those amounts are: the present value of outlays through the year 2073, claims incurred through September 30, 1998, that were unpaid as of that date, and administrative expenses related to those claims. Under current legislation and using intermediate assumptions from the 1998 Trustees Report, which incorporated changes from the Balanced Budget Act, the fund is projected to be exhausted in 2008.

The benefits and administrative expenses of the Federal Supplementary Medical Insurance program (Medicare Part B)are financed by premiums paid by Medicare beneficiaries as well as Government contributions. The monthly premium in calendar year 1998 covered 25 percent of the Medicare Part B program's estimated 1998 cost.

Medicare Part B has a surplus of $29.1 billion, representing the amount of the estimated book value of the Federal Supplemental Medical Insurance Trust Fund assets as of September 30, 1998, less unpaid benefits and related administrative expenses.

Estimated Balances of Federal Hospital Insurance Trust Fund (Medicare Part A) Under Intermediate Assumptions



Medicare Part A (Hospital Insurance) Present Value Estimates for the Period of 75 Years into the Future, Beginning September 30, 1998

(In billions of dollars)

Present value of actuarial contributions to the year 2073	6,325.3
Present value of actuarial expenditures to the year 2073	10,368.0
Present value of future resources needed	4,042.7
Assets in Federal Hospital Insurance Trust Fund as of September 30 (Note 17)	120.5

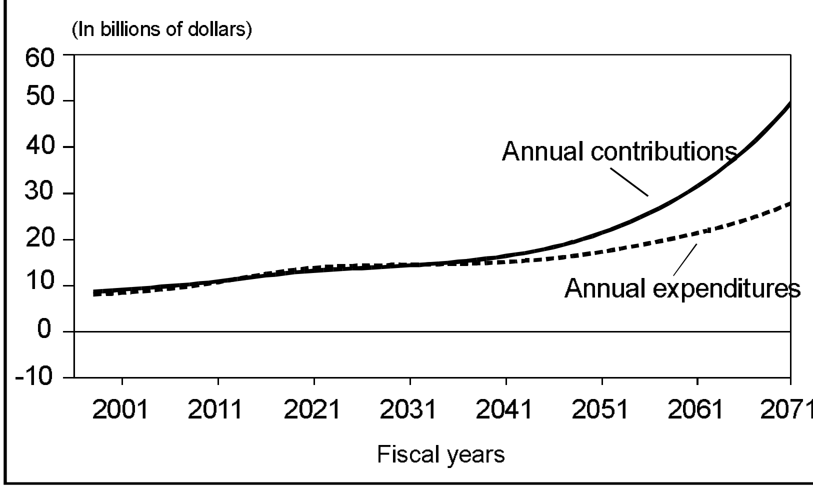
Note: the estimates for this program are significantly different than those of prior years due to a change in the valuation period from 25 to 75 years.

Medicare Part B (Supplementary Medical Insurance) Balances as of September 30, 1998

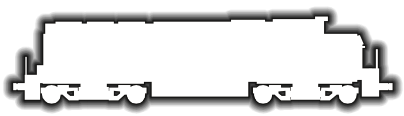
(In billions of dollars)

Total Federal Supplemental Medical Insurance Trust Fund assets (Note 17)	40.1
Total unpaid benefits	11.0
Excess of trust fund assets over unpaid benefits	29.1

Railroad Retirement



Railroad retirement pays full-age annuities when eligible persons reach age 65 (if they have 10 years of service) or age 62 (if they have 30 years of service). It pays reduced age annuities to eligible beneficiaries who are age 62 (with 10 to 29 years of service), or age 60 (with 30 years of service). The railroad retirement program pays disability annuities on the basis of total or occupational disability. It also pays annuities to divorced spouses, remarried widow(er)s, surviving divorced spouses, children and parents of deceased railroad workers. Qualified railroad retirement beneficiaries are covered by Medicare in the same way as Social Security beneficiaries.



The Railroad Retirement Board (RRB) and the Social Security Administration (SSA) share jurisdiction over the payment of retirement and survivors benefits. RRB has jurisdiction over the payment of retirement benefits if the employee had at least 10 years of railroad service. For survivor benefits, there is an additional requirement that the employee's last regular employment before retirement or death was in the railroad industry. If a railroad employee or his or her survivors do not qualify for railroad retirement benefits, the RRB transfers the employee's railroad retirement credits to SSA, where they are treated as Social Security credits.

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

Other sources of program income include the financial interchanges with the Social Security trust funds, interest on investments, revenue resulting from Federal income taxes and railroad retirement benefits, and appropriations from general Treasury revenues (provided after 1974 as part of a phaseout of certain vested dual benefits).

The net book value of assets in the Railroad Retirement Account at September 30, 1998, was $14.6 billion. The holdings within this account include notes and bonds that, if sold at market value, would equal $15.3 billion due to their higher yields.

Railroad Retirement Account Present Value Estimates for the Period of 75 Years into the Future, Beginning September 30, 1998*

(In billions of dollars)

Present value of actuarial contributions to December 31, 2073	61.9
Present value of actuarial expenditures to December 31, 2073	73.1
Present value of future resources needed	11.2
Assets in the Railroad Retirement Account as of September 30, 1998	14.6

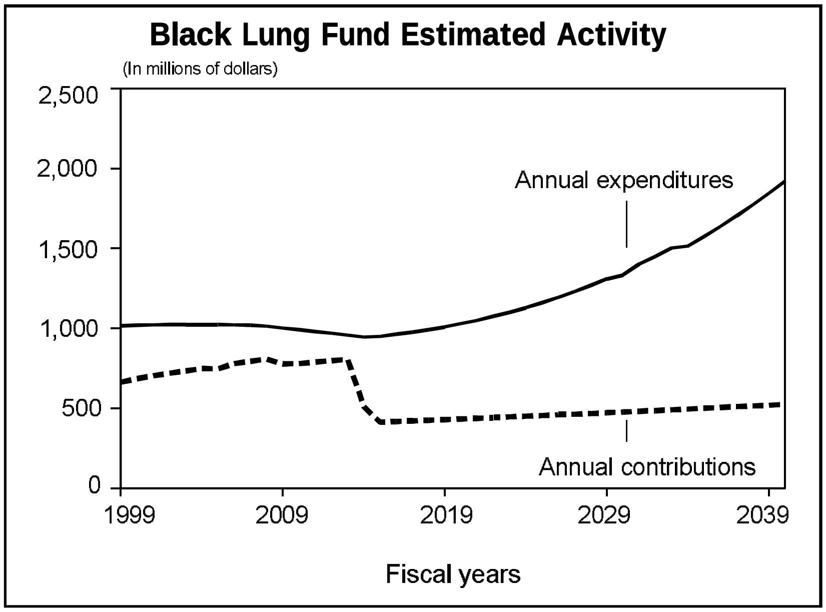
*These figures take into account future entrants as well as former and present employees.

Black Lung Benefits

The Black Lung Disability Benefits program provides for compensation as well as medical and survivor benefits for eligible coal miners disabled due to employment-related pneumoconiosis (black lung disease). The Department of Labor (Labor) operates Part C of the Black Lung Disability Benefits Program. Under Part

C, the Black Lung Disability Trust Fund provides benefit payments to eligible disabled miners when no responsible mine operator can be assigned the liability.

Excise taxes from coal mine operators, based on the sale of coal, fund black lung disability payments and related costs.



The projected decrease in cash inflows in the year 2014 and thereafter is the result of a scheduled reduction in the tax on the sale of coal. This rate reduction is projected to result in a 49-percent decrease in the amount of excise taxes collected between the years 2013 and 2015. The cumulative effect of this change is estimated to be in excess of $12.6 billion by the year 2040.

The total liabilities of the Black Lung Disability Trust Fund exceed assets by $5.9 billion. This deficit fund balance represents the accumulated shortfall of excise taxes that are necessary to meet benefit payments and interest expenses. This shortfall was funded by advances to the Black Lung Disability Trust Fund that must be repaid with interest.

Black Lung Disability Trust Fund Present Value Estimates for the Period of 42 Years into the Future, Beginning September 30, 1998

(In billions of dollars)

Present value of actuarial contributions to September 30, 2040	23.9
Present value of actuarial expenditures to September 30, 2040	50.4
Present value of future resources needed	26.5
Excess of liabilities over assets in the Black Lung Disability Trust Fund as of September 30, 1998	(5.9)

Unemployment Insurance

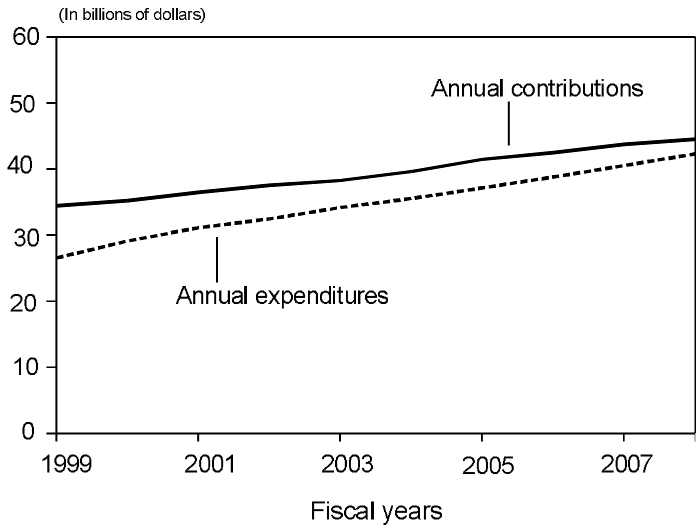
Congress created the Unemployment Trust Fund in 1935 to provide income assistance to unemployed workers who have lost their jobs through no fault of their own. A unique system of Federal and State partnerships administers the unemployment insurance program. Although established in Federal law, State officials execute the program through conforming State laws. The Federal Government provides broad policy guidance and program direction through the oversight of the Department of Labor. Meanwhile, State unemployment insurance statutes administered by State agencies establish program details.

"A unique system of Federal and State partnerships administers the unemployment insurance program."

Federal and State unemployment taxes levied on subject employers finance the Unemployment Trust Fund. Those funds are deposited in the Unemployment Trust Fund and reported as Federal tax revenue.

The total assets within the Unemployment Trust Fund exceeded liabilities by $72.1 billion. This fund balance approximates the accumulated surplus of tax revenues and earnings on these revenues over benefit payment expenses. It is available to finance benefit payments in the future when tax revenues may be insufficient. Treasury invests this accumulated surplus in Federal securities. The net value of these securities as of September 30, 1998, was $70.6 billion.

Unemployment Fund Estimated Activity



Unemployment Trust Fund Present Value Estimates in Nominal Dollars for the Period of 10 Years into the Future, Beginning September 30, 1998

(In billions of dollars)

Present value of actuarial contributions to September 30, 2008.	393.7
Present value of actuarial expenditures to September 30, 2008.	347.6
Excess of contributions over expenditures	46.1
Assets in the Unemployment Trust Fund as of September 30, 1998 (Note 17)	72.1

Current Services Assessment

The Current Services Assessment table shows the Office of Management and Budget's estimated receipts, outlays, and surplus or deficit in the budget if no changes are made to laws already enacted. Receipts and mandatory outlays, such as Social Security benefits and net interest, involve ongoing activities that generally operate under permanent legal authority authorized by legislation. The current services estimates of receipts and mandatory spending assume that receipts and mandatory spending continue in the future as specified by current laws. The current services estimates for discretionary spending assume discretionary funding for fiscal 1999 equals appropriations enacted by Congress. It also assumes that discretionary funding for subsequent years holds constant in real terms. Because laws already enacted provide the basis for the current services estimates, they do not constitute a proposed budget, nor do they predict the most likely budget outcomes.

The current services estimates may be used to assess the sustainability of

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

(In billions of dollars)

Fiscal Year	Base Year 1998	1999	2000	2001	2002	2003	2004
Receipts:							
Individual income taxes	828	869	902	918	948	975	1,023
Corporate income taxes	189	182	187	193	199	208	217
Social insurance and retirement receipts	572	609	636	660	686	712	739
Excise taxes	58	68	65	67	69	71	73
Other receipts	75	78	82	87	96	100	105
Total receipts	1,722	1,806	1,872	1,925	1,998	2,066	2,157
Outlays:							
National defense	269	277	278	289	296	305	313
Social Security	379	393	409	427	447	469	491
Medicare	193	205	218	232	237	255	269
Income security	233	243	257	268	278	287	299
Health	132	143	153	162	173	186	198
Veterans benefits and services	42	43	45	46	48	50	52
Education, training, employment and social services	55	60	65	66	66	69	71
Transportation	40	43	46	49	50	51	53
Other programmatic functions	114	129	130	136	140	143	149
Net interest	243	227	215	208	199	192	185
Undistributed offsetting receipts	(47)	(40)	(42)	(45)	(51)	(46)	(47)
Total outlays	1,653	1,723	1,774	1,838	1,883	1,961	2,033
Unified surplus	69	83	98	87	115	105	124

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

The preceding schedule presents the actual budget results for fiscal 1998 and the current services estimates for all Federal taxes and spending programs for the subsequent 6 years. It shows receipts by source and outlays by function. The estimates for these years are identical to the current services estimates in the President's budget for fiscal 2000. The following estimates use the same economic, programmatic and other technical assumptions as that document.

United States Government Notes to the Financial Statements for the Year Ended September 30, 1998

Note 1. Summary of Significant Accounting Policies

A. Reporting Entity

This Financial Report includes the financial status and activities of the executive branch and portions of the legislative and judicial branches of the Government. This includes those Government corporations that are part of the Federal Government. The Appendix lists Government entities included in these financial statements and also contains a partial list of entities excluded. For the purposes of this document, "Government" refers to the U.S. Government. The fiscal year of the Government ends September 30. The financial reporting period is the same used for the annual budget. Material intragovernmental transactions were eliminated in consolidation, except as described in Note 16.

B. Basis of Accounting

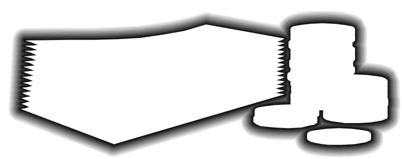
The Financial Report was prepared in accordance with Form and Content guidance specified by the Office of Management and Budget (OMB) and the Statements of Federal Financial Accounting Standards (SFFAS). This basis of accounting generally recognizes expenses when incurred. It recognizes non-exchange revenues on a modified cash basis of accounting. Remittances of non-exchange revenues are recognized when received; related receivables are recognized when measurable and legally collectible. This basis of accounting also recognizes refunds and related offsets of non-exchange revenues when measurable and legally payable. Exchange revenues are recognized when earned. This basis of accounting differs from that used for budgetary reporting. This fiscal year, four accounting standards became effective pertaining to property, plant and equipment; managerial cost accounting; revenue and other financing sources; and supplementary stewardship reporting.

C. Revenue Recognition

Government revenue comes from two sources: non-exchange transactions and exchange transactions. Non-exchange revenues arise primarily from exercise of the Government's power to tax and levy duties, fines and penalties. Exchange (earned) revenues arise when a Government entity provides goods and services to the public for a price.

Non-exchange revenue is recognized when received. Total revenue is reported net of the change in Federal taxes receivable. Refunds and other offsets are recognized when disbursed and netted against non-exchange revenue.

Earned revenue represents revenue earned from user charges such as admission fees to Federal parks, insurance premiums, and fees on Federal housing and loan programs. Earned revenue is recognized when the Government provides the goods or services.



D. Direct Loans and Loan Guarantees

Direct loans obligated and loan guarantees committed after September 30, 1991, are recorded based on the present value of net cash-flows estimated over the life of the loan or guarantee. Direct loans made prior to October 1, 1991, may be recorded under the present-value method or the allowance-for-loss method. The allowance-for-loss method reduces the outstanding principal by an allowance for uncollectible amounts when it is more likely than not that the loans will not be collected in full. Liabilities related to loan guarantees committed before October 1, 1991, may be recorded under the present-value method or the allowance-for-loss method by the amount the agency estimates will more likely than not require a future cash outflow to pay default claims.

E. Taxes Receivable

"Taxes receivable" primarily consist of uncollected tax assessments, penalties and interest when taxpayers have agreed the amounts are owed, or a court has determined the assessments are owed. This Financial Report does not include unpaid assessments when neither taxpayers nor a court has agreed that the amounts are owed (compliance assessments) and the Government does not expect further collections due to factors such as the taxpayer's death, bankruptcy or insolvency (write-offs). Taxes receivable are reported net of an allowance for the estimated portion deemed to be uncollectible.

F. Inventories and Related Property

"Inventories" are valued at historical cost. Historical cost methods include first-in-first-out, weighted average and moving average. Estimated repair costs reduce the value of inventory held for repair. Excess, obsolete and unserviceable inventories are valued at estimated net realizable values.

G. Property, Plant and Equipment

"Property,plant and equipment" used in Government operations is carried at cost. Depreciation and amortization expense applies to property, plant and equipment except land, limited duration land rights, heritage assets, national defense assets and construction in progress. It is recognized using the straight-line method over the assets' estimated useful lives.

The Government Management Reform Act does not require the legislative and judicial branches to report their financial information to Treasury. Therefore, this Financial Report does not include most property, plant

H. Retirement Programs

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

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

I. Environmental Liabilities

"Environmental liabilities" are recorded at the estimated current cost to remediate hazardous waste and environmental contamination, assuming the use of current technology. Remediation consists of removal, treatment and/or safe containment. Where technology does not exist to clean up hazardous waste, only the estimable portion of the liability, typically safe containment, is recorded.

J. Contingencies

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

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

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

Contingent liabilities that do not meet the above criteria for recognition, but for which there is at least a reasonable possibility that a loss has been incurred, are disclosed in Note 15–Commitments and Contingencies.

K. Social Insurance

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

L. Related Party Transactions

Federal Reserve Banks (FRBs), which are not part of the reporting entity, serve as the Government's depositary and fiscal agent. They process Federal payments and deposits to Treasury's account and service Federal debt securities. FRBs owned $477.9 billion of Federal debt securities held by the public as of September 30, 1998. FRB earnings that exceed statutory amounts of surplus established for Federal banks are paid to the Government and are recognized as non-exchange revenue. Those earnings totaled $24.6 billion for the year ended September 30, 1998. The primary source of these earnings is from interest earned on Federal debt securities held by FRBs.

FRBs issue Federal Reserve notes, the circulating currency of the United States. These notes are collateralized by specific assets owned by FRBs, typically Government securities. Federal Reserve notes are backed by the full faith and credit of the U.S. Government.

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

Note 2. Cash and Other Monetary Assets

Cash and Other Monetary Assets as of September 30

(In billions of dollars)

Cash	42.2
Gold	11.0
Domestic monetary assets	1.2
International monetary assets	42.4
Total cash and other monetary assets	96.8

Cash

"Cash," in the amount of $42.2 billion, consists of:

- Treasury balances held at the FRBs, net of outstanding checks.
- Treasury balances in special depositaries that hold the proceeds of certain tax payments known as the U. S. Treasury Tax and Loan Note accounts.
- Funds held outside of Treasury and the FRBs by authorized fiscal officers or agents.
- Monies held by Government collection and disbursing officers, agencies' undeposited collections, unconfirmed deposits, and cash transfers.
- Time deposits at financial institutions.

The Government maintains formal arrangements with numerous banks to maintain time deposits known as "compensating balances." These balances compensate the banks for services provided to the Government, such as maintaining zero-balance accounts for the collection of public monies.

Gold

"Gold" is valued at the statutory price of $42.2222 per fine troy ounce. As of September 30, 1998, the number of fine troy ounces was 260,928,196. The market value of gold on the London Fixing as of the reporting date was $293.85 per fine troy ounce. Gold was pledged as collateral for gold certificates issued to the FRBs totaling $11.0 billion. See Note 13–Other Liabilities.

Domestic Monetary Assets

"Domestic monetary assets" consist of liquid assets, other than cash, that are based on the U.S. dollar including coins, silver bullion and other coinage metals. These items totaled $1.2 billion.

International Monetary Assets

Assets valued on a basis other than the U.S. dollar comprise "International monetary assets."

The U.S. reserve position in the International Monetary Fund (IMF) represents an investment in the IMF. The IMF provides financial assistance to about 180 countries including the United States. It seeks to promote currency exchange stability. Only a portion of the required payment to the IMF was paid in cash, with the remainder treated as a subscription. The recorded balance is shown net of the subscription portion, which represents a letter of credit payable to the IMF. As of September 30, 1998, the remaining available balance under the letter of credit totaled $14.9 billion. The U.S. reserve position in the IMF has a U.S. dollar equivalent of $21.2 billion as of that date.

Special drawing rights (SDRs) are interest-bearing assets obtained through either IMF allocations, transactions with IMF member countries, or interest earnings on SDR holdings. Treasury's Exchange Stabilization Fund held SDRs totaling $10.1 billion at the end of fiscal 1998. Those holdings are similar to an investment in the IMF.

At September 30, 1998, "Other liabilities" included a $6.7 billion interest-bearing liability to the IMF. This liability consisted of SDRs obtained through IMF allocations.

The SDR Act of 1968 authorized the Secretary of the Treasury to issue SDR certificates to Federal Reserve Banks (FRBs) in exchange for cash. The value of these certificates cannot exceed the value of the SDR holdings. The Secretary of the Treasury determines when the SDR certificates can be redeemed by the FRBs. The liability for such redemptions, which totaled $9.2 billion at the end of the fiscal year, is included in Note 13–Other Liabilities.

International monetary assets also include foreign currency and other monetary assets denominated in foreign currency. These assets have a U.S. dollar equivalent of $42.4 billion.

Note 3. Loan Programs

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

The total estimated cost represents the allowance for loss and subsidy cost for direct loans and the loan guarantee liability for guaranteed loans.

Rural electrification and telecommunications loans are for the construction and operation of generating plants, electric transmissions, and distribution lines or systems. These loans carry an average maturity of greater than 20 years and are usually secured.

The major programs funded though the Rural Housing Insurance Fund program account are:

- Very low and low-to-moderate income home ownership loans and guarantees.
- Very low-income housing repair loans.

Federal Loan Programs as of September 30

(In billions of dollars)

Loan Program	Face Value of Loans Outstanding	Total Estimated Cost to the Federal Government	Net Loans Receivable (Includes related Interest)	Amount Guaranteed by the Federal Government	Percent of Face Value of Loans Guaranteed by the Federal Government
Direct Loans:					
Rural development	70.1	15.1	55.0		
Student loan programs	54.3	11.7	42.6		
Commodity Credit Corporation	18.0	11.1	6.9		
Agency for International Development	12.3	5.7	6.6		
Housing programs	11.9	0.5	11.4		
Farm Service Agency	9.7	0.8	8.9		
Export-Import Bank	9.3	3.0	6.3		
Small business loans	9.2	1.8	7.4		
All other direct loan programs	26.6	4.9	21.7		
Total loans receivable (see Balance Sheet)			**166.8**		
Guaranteed Loans:					
FHA	519.5	9.4		476.6	91.8
VA housing credits	203.5	4.7		70.0	34.4
Guaranteed student loans	112.5	11.6		110.3	98.0
Small Business Administration	37.5	1.5		30.6	81.6
Commodity Credit Corporation	22.8	6.1		22.8	100.0
All other guaranteed loan programs	39.7	4.4		34.0	85.6
Total loan guarantee liabilities (see Balance Sheet)		**37.7**			
Total for all loan programs	1,156.9	92.3			

- Domestic farm labor housing loans.
- Housing site loans.
- Credit sales of acquired property.

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

The Direct Student Loan program, established in 1994, offers four types of education loans: Stafford, Unsubsidized Stafford, PLUS for parents and consolidation loans. Evidence of financial need is required for a student to receive a subsidized Stafford loan. The other three loan programs are available to borrowers at all income levels. These loans usually mature 9 to 13 years after the student is no longer enrolled. They are unsecured.

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

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

- Assume commercial and political risk that exporters or private institutions are unwilling or are unable to undertake.
- Overcome maturity and other limitations in private sector financing.
- Assist U.S. exports to meet foreign officially sponsored export credit competition.
- Provide leadership and guidance in export financing to the U.S. exporting and banking communities and to foreign borrowers. Repayment terms for these loans are usually 1 to 7 years.

The Federal Housing Administration (FHA) provides mortgage insurance encouraging lenders to make credit available to expand homeownership. FHA predominately serves borrowers that the conventional market does not adequately serve such as first-time homebuyers, minorities, lower-income families and residents of underserved areas.

The Federal Family Education Loan program, formerly known as the Guaranteed Student Loan program, was established in 1965. Like the Direct Student Loan program, it offers four types of loans: Stafford, Unsubsidized Stafford, PLUS for parents and consolidation loans.

Veteran housing benefits provide partial guarantee of residential mortgage loans issued to eligible veterans and servicemen by private lenders. This guarantee allows veterans and servicemen to purchase a home without a substantial down payment.

Other loan guarantees include: Small Business Administration loans to minority businesses; and the Farm Service Agency for farm ownership, emergency and disaster loans.

The subsidy expense is the estimated cost of current-year loan disbursements and loans guaranteed.

The subsidy expense incurred in fiscal 1998 totaled $1.0 billion.

Note 4. Taxes Receivable

Taxes Receivable as of September 30

(In billions of dollars)

Gross taxes receivable	82.9
Allowance for doubtful accounts	55.8
Taxes receivable, net as of September 30, 1998	27.1

Note 5. Inventories and Related Property

"Inventories and related properties" consist of the categories listed below, net of allowance for obsolete and unserviceable inventory, as of September 30, 1998.

"Operating materials and supplies" are comprised of tangible personal property purchased for use in normal operations.

"Materials and supplies held for future use" includes tangible personal property not readily available in the market or held because there is more than a remote chance that they will eventually be needed.

"Inventory held for sale" is tangible personal property held for sale, net of allowances.

"Seized monetary instruments" comprise only monetary instruments. These monetary instruments are awaiting judgment to determine ownership. The related liability is included in "Other liabilities." Other property seized by the Government, such as real property and tangible personal property, is not included as a Government asset. It is accounted for in agency property-management records until the property is forfeited, returned or otherwise liquidated.

"Forfeited property" is comprised of monetary instruments, intangible property, real property and tangible personal property acquired through forfeiture proceedings; property acquired by the Government to satisfy a tax liability; and unclaimed and abandoned merchandise.

"Stockpile materials" are strategic and critical materials held for use in national defense, conservation or national emergencies due to statutory requirements.

"Commodities" are items of commerce or trade that have an exchange value used to stabilize or support market prices.

"Other related property" includes all other related property not included above (for example, property ac-

Inventories and Related Property as of September 30

(In billions of dollars)	Defense	All Others	Total
Inventory held for sale	69.4	0.5	69.9
Stockpile materials	4.3	37.7	42.0
Operating materials and supplies	31.1	2.6	33.7
Materials and supplies held for future use	20.3	0.1	20.4
Commodities	-	0.3	0.3
Seized monetary instruments	-	0.2	0.2
Forfeited property	-	0.2	0.2
Other related property	0.1	-	0.1
Total inventories and related property	125.2	41.6	166.8

Note 6. Property, Plant and Equipment

"Property, plant and equipment" consist of tangible assets including land, buildings, structures and other assets used to provide goods and services. Certain types of tangible assets, collectively referred to as "Stewardship assets," are not reported as property, plant and equipment or elsewhere on the Balance Sheet. This is based on accounting standards that became effective for fiscal 1998. "Stewardship assets" include "National defense assets," "Heritage assets" and "Stewardship land." These assets are presented in the Stewardship Information section. Accordingly, these financial statements reflect a prior period adjustment of $655.5 billion to remove the stewardship assets previously capitalized on the Balance Sheet. (See Note 14–Prior Period Adjustments.)

Property, Plant and Equipment as of September 30

(In billions of dollars)	Cost	Accumulated Depreciation / Amortization	Net
Buildings, structures and facilities	269.3	129.5	139.8
Furniture, fixtures and equipment	159.6	73.9	85.7
Construction in progress	51.5	-	51.5
Land and land improvements	18.3	1.3	17.0
Automated data processing software	2.8	1.6	1.2
Assets under capital lease	2.3	0.4	1.9
Leasehold improvements	1.9	0.7	1.2
Other property, plant and equipment	1.0	-	1.0
Total property, plant and equipment	506.7	207.4	299.3

Note 7. Other Assets

"Other assets" consist of advances and prepayments, securities and investments, and other assets of the Government not otherwise classified. Securities are shown at cost, net of unamortized premiums and discounts.

Other Assets as of September 30

(In billions of dollars)	
Advances and prepayments	13.2
Securities and investments	19.1
Other	27.6
Total other assets	59.9

Note 8. Accounts Payable

"Interest on Treasury securities held by the public" is the amount of interest accrued on Federal debt securities held by the public (see Note 9) and not paid as of September 30, 1998. Other accounts payable are for goods and other property ordered and received, and for services rendered by other than employees.

Accounts Payable as of September 30

(In billions of dollars)	
Agency:	
Interest on Treasury securities held by the public	45.5
DOD	13.7
U.S. Postal Service	4.1
Agriculture	3.2
VA	3.0
NASA	2.9
OPM	2.9
HHS	0.4
All other departments	14.3
Total accounts payable	90.0

Note 9. Federal Debt Securities Held by the Public

Definitions of Debt

- **Gross Federal Debt** - All Government debt, whether issued by Treasury (Treasury securities) or by other agencies (agency securities). "Gross Federal debt" is either held by the public or by Government entities.
- **Debt Held by the Public** - Federal debt held outside the Government by individuals, corporations, State or local governments, the Federal Reserve System, foreign governments, and central banks.
- **Intragovernmental holdings** - Federal debt held by Government trust funds, revolving funds and special funds.

"Federal debt held by the public" totaled $3,717.7 billion at the end of fiscal 1998. The table on Federal Debt Securities Held by the Public reflects information on borrowing to finance Government operations. Debt is shown at face value, with unamortized premiums added and unamortized discounts subtracted.

"Intragovernmental holdings" represent that portion of the gross Federal debt held as investments by Government entities, including major trust funds. For more information on trust funds, see Note 17–Dedicated Collections. Intragovernmental holdings were eliminated in consolidation.

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

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

As of September 30, 1998, $5,439 billion of Federal debt was subject to a statutory limit (31 United States Code 3101). That limit was $5,950 billion. The debt subject to the limit includes:

- Debt held by the public and intragovernmental holdings, less most agency securities, Federal Financing Bank debt, miscellaneous debt and unrealized discount on Government account series securities.
- Unamortized net discounts on public issues of Treasury notes and bonds (other than zero-coupon bonds).

Federal Debt Securities Held by the Public as of September 30

(In billions of dollars)	Beginning Balance Oct. 1, 1997	Net Change During Fiscal 1998	Ending Balance Sept. 30, 1998	Average Interest Rate During Fiscal 1998
Treasury Securities:				
Marketable securities	3,439.8	(108.8)	3,331.0	6.556%
Non-marketable securities	1,967.7	220.0	2,187.7	6.903%
Non-interest bearing debt	5.6	1.9	7.5	
Total Treasury securities	5,413.1	113.1	5,526.2	
Plus: Unamortized premium on Treasury securities	20.2	(3.3)	16.9	
Less: Unamortized discount on Treasury securities	78.2	0.7	78.9	
Total Treasury securities, net of unamortized premiums and discounts	5,355.1	109.1	5,464.2	
Agency Securities:				
Tennessee Valley Authority	27.4	(0.7)	26.7	
All other agencies	5.8	(3.1)	2.7	
Less: Unamortized net discounts	0.5	(0.1)	0.4	
Total agency securities, net of unamortized premiums and discounts	32.7	(3.7)	29.0	
Total Federal debt	5,387.8	105.4	5,493.2	
Less: Intragovernmental holdings, net of unamortized premiums and discounts	1,619.6	155.9	1,775.5	
Total Federal debt securities held by the public	3,768.2	(50.5)	3,717.7	

Types of marketable securities:

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

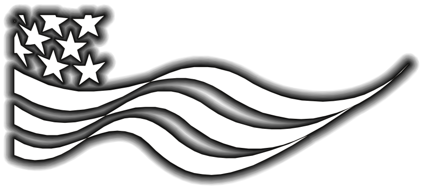
Notes—Medium-term obligations issued with a term of at least 1 year, but not more than 10 years.

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

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

(In billions of dollars)	Beginning Balance Oct. 1, 1997	Net Change During Fiscal 1998	Ending Balance Sept. 30, 1998
Holdings Greater than or Equal to $100 Billion:			
SSA, Old-Age and Survivors Insurance	567.5	85.8	653.3
OPM, civil service retirement and disability	422.1	29.2	451.3
DOD, military retirement	126.0	7.8	133.8
HHS, Hospital Insurance Fund	116.6	1.7	118.3
Subtotal	1,232.2	124.5	1,356.7
Holdings Less than $100 Billion and Greater than $15 Billion:			
SSA, disability insurance	63.6	13.4	77.0
Labor, unemployment	61.9	8.7	70.6
HHS, supplementary medical insurance	34.5	5.0	39.5
FDIC funds	37.4	1.7	39.1
Railroad Retirement Board	19.2	2.6	21.8
OPM, Employees Life Insurance	18.0	1.4	19.4
Transportation, Highway Trust Fund	22.3	(4.4)	17.9
Treasury, Exchange Stabilization Fund	15.5	0.5	16.0
Subtotal	272.4	28.9	301.3
Other programs and funds	102.8	10.0	112.8
Subtotal	1,607.4	163.4	1,770.8
Plus: Unamortized net premiums	12.2	(7.5)	4.7
Total intragovernmental holdings	1,619.6	155.9	1,775.5

Note 10. Federal Employee and Veteran Benefits Payable



The Government offers its employees, both civilian and military, retirement benefits, life and health insurance, and other benefits.

The Federal Government administers more than 40 pension plans. The largest are administered by the Office of Personnel Management (OPM), for civilian employees, and by DOD, for military personnel. The Government has both defined benefit and defined contribution pension plans. The largest are defined benefit plans.

Federal Employee and Veteran Benefits Payable as of September 30

(In billions of dollars)	Civilian	Military	Total
Pension liability	996.4	650.5	1,646.9
Health benefits payable	181.8	223.4	405.2
Veterans compensation and burial benefits	-	578.1	578.1
Liability for other benefits	34.1	20.8	54.9
Total Federal employee and veteran benefits payable	1,212.3	1,472.8	2,685.1

Change in Actuarial Accrued Pension Liability and Components of Related Expense

(In billions of dollars)	Civilian [1]	Military	Total
Actuarial accrued pension liability, as of September 30, 1997	965.0	641.7	1,606.7
Pension Expense:			
Normal costs	23.7	16.6	40.3
Interest on liability	65.9	41.0	106.9
Actuarial (gains)/losses	(20.8)	(17.6)	(38.4)
Total pension expense	68.8	40.0	108.8
Benefits paid	(43.5)	(31.2)	(74.7)
Actuarial accrued pension liability, as of September 30, 1998	990.3	650.5	1,640.8

[1] Does not include U.S. Tax Court, judicial branch, or the DC government.

Significant Assumptions Used in Determining Pension Liability and the Related Expense

(In percentages)	Civilian	Military
Rate of interest	7.0%	6.5%
Rate of inflation	4.0%	2.1%
Projected salary increases	4.3%	2.8%

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

(In billions of dollars)	Civilian	Military	Total
Actuarial accrued post-retirement health benefits, as of September 30, 1997	164.3	218.0	382.3
Post-Retirement Health Benefits Expense:			
Normal costs	6.1	6.0	12.1
Interest on liability	11.9	14.7	26.6
Actuarial (gains)/losses	6.0	(8.5)	(2.5)
Total post-retirement health benefits expense	24.0	12.2	36.2
Claims paid	(6.5)	(6.8)	(13.3)
Actuarial accrued post-retirement health benefits liability, as of September 30, 1998	181.8	223.4	405.2

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

(In percentages)	Civilian	Military
Rate of interest	7.0%	6.5%
Rate of health care inflation	7.0%	2.5% - 8.0%

Civilian Employees

Pensions

The largest civilian pension plan is administered by OPM and covers approximately 90 percent of all Federal civilian employees. It includes two components of defined benefits: the Civil Service Retirement System (CSRS) and the Federal Employees' Retirement System (FERS). The basic benefit components of the CSRS and the FERS are financed and operated through the Civil Service Retirement and Disability Fund (CSRDF). CSRDF monies are generated primarily from employees, agency contributions, payments from the general fund and interest on investments in Federal debt securities. For further discussion, see Note 17–Dedicated Collections, Civil Service Retirement and Disability Fund.

The Federal Retirement Thrift Investment Board, an independent Government agency, operates the Thrift Savings Plan. Federal employees and retirees covered by CSRS and FERS own the fund's assets. For this reason, the fund is excluded from the Financial Report and the fund's holdings of Federal debt are considered part of the Federal debt held by the public, rather than Federal debt held by the Government. FERS employees may contribute up to 10 percent of base pay to the plan, which the Government matches up to 5 percent. CSRS employees may contribute up to 5 percent of base pay with no Government match.

The Thrift Savings Plan held $26.5 billion of nonmarketable Treasury securities as of September 30, 1998 and is included in "Total Federal debt securities held by the public" in the Balance Sheet.

Health Benefits

Civilian retirees pay the same insurance premiums as active employees under the Federal Employee Health Benefits Program (FEHBP). These premiums cover only a portion of the costs.

Other Benefits

Employee and annuitant contributions, and interest on investments fund a portion of the Federal Employees Group Life Insurance program. This insurance program finances payments to private insurance companies for Federal employees' group life insurance. It is administered by OPM.

Military Employees (Including Veterans)

Pensions

The DOD Military Retirement Trust Fund accumulates funds to finance liabilities of the Department under military retirement and survivor benefit programs. The Fund provides retirement benefits for military personnel and their survivors.

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

Health Benefits

Military retirees and their dependents are entitled to health care in military medical facilities if the facility can provide the needed care. Until they reach age 65, military retirees and their dependents also are entitled to health care financed by TRICARE (formerly CHAMPUS). No premium is charged for TRICARE financed care, but there are deductible and copayment requirements. After they reach 65 years of age, military retirees are entitled to Medicare.

Military retiree health care includes the cost of buildings, equipment, education and training, staffing, operations, and maintenance of military medical treatment facilities. They also consist of claims paid by TRICARE and the cost of administering the program.

Compensation and Burial Benefits

Veterans compensation is payable as a disability benefit or a survivor's benefit. Entitlement to compensation depends on: the veteran's disabilities incurred in, or aggravated during, active military service; death while on duty; or death resulting from service-connected disabilities, if not in active duty.

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

The liability for veterans compensation and burial benefits payable increased in fiscal 1998 by $381 billion. The primary factors contributing to this increase were changes in the actuarial methodology and the interest rate assumptions.

Due to these changes, the Statement of Net Cost line item titled "Veterans benefits and services" increased by $109.4 billion.

Other Benefits

Veterans insurance includes the following programs: United States Government Life Insurance, National Service Life Insurance, Veterans Insurance and Indemnities, Veterans Special Life Insurance, Veterans Reopened Insurance, Service Disabled Veterans Insurance, and Servicemen's Group Life Insurance.

The National Service Life Insurance was established in 1940 for World War II servicemen and veterans. It remained open until 1951. Of the original 22 million policies issued, approximately 1.9 million remain. This program limits coverage to $10,000.

Veterans Special Life Insurance was established in 1951 for servicemen who served in the Korean War and in the post-Korean period through 1957. Approximately 800,000 policies were issued, of which 240,000 remain.

Veterans Compensation and Burial Benefits Payable as of September 30

(In billions of dollars)

Veterans	462.3
Survivors	112.1
Burial benefits	3.7
Total compensation and burial benefits payable	578.1

Note 11. Environmental Liabilities

During World War II and the Cold War, the United States developed a massive industrial complex to research, produce and test nuclear weapons. The nuclear weapons complex included nuclear reactors, chemical processing buildings, metal machining plants, laboratories and maintenance facilities. The costs associated with removing, containing and/or disposing of hazardous waste from the properties comprise the resulting environmental liabilities. "Environmental liabilities," in this report, apply only to required cleanup costs from Federal operations known to result in hazardous waste resulting from approved Federal, State, or local statutes and/or regulations.

Environmental Liabilities as of September 30

(In billions of dollars)

Energy:		
Environmental management and legacy waste	145.1	
Active facilities	19.6	
High-level waste and spent nuclear fuel	10.7	
Pipeline facilities	7.8	
Other	3.2	
Total Energy		186.4
DOD		34.0
All other agencies		4.1
Total environmental liabilities		224.5

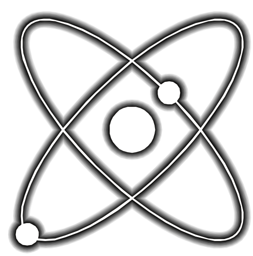
Energy incurred operating and capital expenditures totaling $6.3 billion in fiscal 1998 to remediate legacy waste. This includes nuclear materials and facilities stabilization as well as waste treatment, storage and disposal activities at each installation.

"Environmental management and legacy wastes" include costs for environmental restoration, nuclear material and facility stabilization, and waste treatment, storage and disposal activities at each installation. They also include costs for related activities such as landlord responsibilities, program management, and legally prescribed grants for participation and oversight by Native American tribes and regulatory agencies. "Active facilities" represent anticipated remediation costs for those facilities conducting ongoing operations that ultimately will require stabilization, deactivation and decommissioning.

DOD is responsible for cleaning up and disposing of hazardous materials in facilities it operates or has operated. The Department has recorded a $34.0 billion liability for these costs. DOD has not currently recorded any liability for national defense assets (primarily weapon systems like aircraft, ships and submarines) and ammunitions (primarily hazardous materials).

Projects with no current feasibility remediation approach are excluded from the estimate. Significant projects not included are:

- Nuclear explosion test areas (for example, Nevada test sites).
- Large surface water bodies (for example, the Clinch and Columbia rivers).
- Most ground water (even with treatment, future use will be restricted).
- Some special nuclear material (for example, uranium hexafluoride).



Note 12. Benefits Due and Payable

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

Benefits Due and Payable as of September 30

(In billions of dollars)

Federal Old-Age and Survivors Insurance	28.9
Federal Hospital Insurance (Medicare Part A)	17.8
Federal Supplemental Medical Insurance (Medicare Part B)	11.0
Grants to States for Medicaid	10.8
Federal Disability Insurance	6.7
Supplemental security income	0.9
Railroad retirement	0.7
Unemployment insurance	0.5
Black lung	0.1
Other benefits	0.2
Total benefits due and payable	77.6

Note 13. Other Liabilities

Other Liabilities as of September 30

(In billions of dollars)

Insurance programs	23.8
Deferred revenue	19.7
Exchange Stabilization Fund	15.9
Other debt	11.7
Accrued wages and benefits	11.1
Gold certificates	11.0
Advances from others	1.7
Other miscellaneous liabilities	59.7
Total other liabilities	154.6

"Insurance liabilities" include bank deposit insurance, guarantees of pension benefits, life insurance and medical insurance against damage to property (home, crops and airplanes) caused by perils such as flooding and other natural disasters, risk of war, and insolvency. "Deferred revenue" refers to revenue received but not yet earned. "Exchange Stabilization Fund" includes Special Drawing Right certificates issued to the FRBs and allocations from the International Monetary Fund. "Other debt" includes Government obligations, whether secured or unsecured, not included in public debt. "Accrued wages and benefits" consist of the estimated liability for civilian and commissioned officers' salaries and wages earned but unpaid. It also includes funded annual leave and other employee benefits that have been earned but are unpaid. "Gold certificates" are monetarized portion of gold and the certificates are deposited in the Federal Reserve Bank. Amounts received for goods and services to be furnished comprise "Advances from others." "Other miscelleanous liabilities" consist of deposit funds and suspense accounts.

Note 14. Prior Period Adjustments

Prior Period Adjustments to the Fiscal Year Beginning October 1, 1997

(In billions of dollars)	Increases to Net Position	Decreases to Net Position
Changes in Accounting Principles:		
National defense assets		655.2
NASA	17.1	23.2
All other agencies		20.4
Total net changes in accounting principles		681.7
Other Adjustments:		
VA pension		271.3
DOD		69.9
Transportation		14.2
Railroad retirement liability	11.4	
Liability for loan guarantees	2.0	
Other corrections of errors	2.2	
Total net other adjustments		339.8

"Prior period adjustments" consist of all adjustments to the opening net position. They correct errors in a prior period, or adjust figures that have changed due to the implementation of changes in accounting principles. If military service has resulted in any veterans' disability or death, VA provides compensation payments to the veterans and their dependents. Changes in actuarial methodologies and interest assumptions resulted in an increase in the VA liability of $271.3 billion.

In addition, DOD has adjusted its accumulated depreciation in fiscal 1997, by $32.2 billion. Defense assets (war reserves such as missiles, aircraft and vehicles) had to be corrected by $35.9 billion to reflect the proper amount. Overstated DOD inventories required an adjustment of $0.8 billion.

Transportation changed the value of its property and adjusted "Accumulated depreciation" by $8.4 billion. Also, actuarial assumptions for pensions and health benefits accounted for a further Transportation adjustment of $5.1 billion.

Railroad retirement adjusted its prior year actuarial retirement liability of $11.4 billion. To be consistent with this Financial Report, this liability was reclassified to stewardship responsibilities from the Balance Sheet.

National defense assets, as explained in the introduction to the Balance sheet, were moved to Stewardship Information. The total amount of $655.2 billion represents a change in accounting principles for the 1998 *Financial Report of the United States Government* and is included in prior period adjustments.

Not previously capitalized, "Assets in space" in the amount of $17.1 billion were recorded and represent a change in accounting principles. NASA also adjusted accumulated depreciation by $20.0 billion. Further, a change in the capitalization threshold resulted in a $3.0 billion decrease in NASA's fixed assets.

Note 15. Commitments and Contingencies

Commitments and Contingencies as of September 30

(In billions of dollars)

	Capital Leases	Operating Leases
Commitments		
Long-term Leases:		
General Services Administration	1.0	14.8
U.S. Postal Service	0.4	7.7
Other long-term leases	0.9	3.1
Total long-term leases	2.3	25.6
Undelivered Orders:		
HUD	111.2	
DOD	86.2	
HHS	40.4	
Education	36.9	
Agriculture	15.6	
Transportation	14.8	
EPA	10.9	
Treasury	6.9	
AID	6.3	
Energy	6.3	
Justice	5.6	
Export-Import Bank	5.0	
NSF	3.4	
Other undelivered orders	27.2	
Total undelivered orders	376.7	
Contingencies		
Insurance:		
Pension Benefit Guaranty Corporation	17.0	
Other insurance contingencies	0.3	
Total insurance	17.3	
Government Loan and Credit Guarantees:		
VA	78.9	
Education	110.3	
Other Government loan and credit guarantees	0.3	
Total Government loan and credit guarantees	189.5	
Unadjudicated Claims:		
DOD	0.7	
Transportation	0.5	
Treasury	0.2	
Other unadjudicated claims	0.8	
Total unadjudicated claims	2.2	
Other Contingencies:		
Treasury	56.3	
Agriculture	7.5	
DOD	5.7	
Transportation	3.0	
NASA	1.5	
Other contingencies	2.2	
Total other contingencies	76.2	
Total contingencies	**285.2**	

The Government engages in contractual commitments requiring future financial obligations. Disclosure of some of these commitments is required in private sector accounting due to their nature or amounts. Adaptations of these disclosures for the Government's commitments are still evolving. The Government has significant amounts of long-term lease obligations, shown in the table on the previous page. "Undelivered orders" represent the value of goods and services ordered and obligated that have not yet been received.

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

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

Numerous cases are pending involving supervisory goodwill at savings and loan institutions, Medicare cost report settlements, harbor maintenance fees and certain other matters. While it is likely that the United States will have to pay some amount of damages on the claims, the ultimate costs cannot be reasonably estimated at this time.

Financial Treatment of Loss Contingencies

Probability of Loss	Probable	Reasonably Possible, more than remote but less than probable	Remote, chance of occurrence slight
Financial Treatment	Balance Sheet	Note 15 – Commitments and Contingencies	No disclosure

Note 16. Unreconciled Transactions Affecting the Change in Net Position

The reconciliation of the "Change in net position" requires that the difference between ending and beginning net position equals the excess of revenues over cost, plus or minus prior period adjustments. The unreconciled transactions needed to bring the change in net position into balance net to $23.9 billion.

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

- Misclassification of intragovernmental transactions by agencies.
- Changes in valuation of Balance Sheet assets and liabilities, which were not identified by agencies as prior period adjustments.
- Timing differences and errors in the reporting of transactions.

The identification and reporting of these unreconciled transactions are a priority project of the financial community within the Government.

Note 17. Dedicated Collections

The term "trust fund," as used in this report and in Federal budget accounting, is frequently misunderstood. In the private sector, "trust" refers to funds of one party held by a second party (the trustee) in a fiduciary capacity. In the Federal budget, the term "trust fund" means only that the law requires the funds be accounted for separately, used only for specified purposes and designated as a "trust fund." A change in law may change the future receipts and the terms under which the fund's resources are spent.

"Trust fund assets" represent the unexpended balance from all sources of receipts and amounts due the trust fund, regardless of source. This includes related governmental transactions. These are transactions between two different entities within the Federal Government (for example, monies received by one entity of the Government from another entity of the Government).

"Intragovernmental assets" are comprised of investments in Federal debt securities, related accrued interest and fund balance with Treasury. These amounts were eliminated in preparing this Financial Report.

"Net assets" represent only the amounts due from individuals and other entities outside the Government. This means that all related governmental transactions are removed to present the Government's position as a whole.

The majority of trust fund assets are invested in intragovernmental Federal debt securities. These securities require redemption if a fund's disbursements exceed its receipts. Redeeming these securities will increase the Government's financing needs and require increased borrow-

Federal Disability Insurance Trust Fund

The Federal Disability Insurance Trust Fund provides assistance and protection against the loss of earnings due to a wage earner's disability. The assistance is in the form of money payments or medical care. The Federal Disability Insurance Trust Fund is administered by SSA.

Like the Federal Old-Age and Survivors Insurance Trust Fund, payroll taxes primarily fund the Federal Disability Insurance Trust Fund. The Fund also receives income from interest earnings on Federal debt securities, Federal agencies' payments for the Social Security benefits earned by military and Federal civilian employees, and a portion of income taxes paid on Social Security benefits.

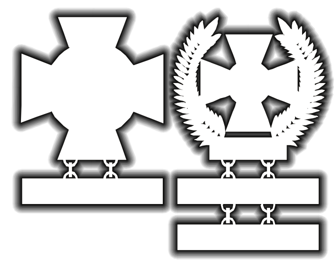
Federal Supplementary Medical Insurance Trust Fund

The Federal Supplementary Medical Insurance Trust Fund finances the Supplemental Medical Insurance program (Medicare Part B), which provides supplementary medical insurance for enrolled participants to cover medical expenses not covered by Medicare Part A. The program is administered by HHS.

Appropriations, premiums charged to enrollees and interest earned on investments in Federal debt securities fund the Federal Supplementary Medical Insurance Trust Fund.

Military Retirement Trust Fund

The Military Retirement Trust Fund provides retirement benefits for Army, Navy, Marine Corps, and Air Force personnel and their survivors. The fund is financed by DOD contributions, appropriations and interest earned on investments in Federal debt securities.



Federal Old-Age and Survivors Insurance Trust Fund

This trust fund provides assistance and protection against the loss of earnings due to retirement or death. The assistance is in the form of money payments and/or medical care. The Federal Old-Age and Survivors Insurance Trust Fund is administered by SSA.

Payroll taxes primarily fund the Federal Old-Age and Survivors Insurance Trust Fund. Earnings on Federal debt securities, Federal agencies' payments for the Social Security benefits earned by military and civilian employees, and Treasury payments for a portion of income taxes paid on Social Security benefits provide the fund with additional income.

Civil Service Retirement and Disability Fund

The Civil Service Retirement and Disability Fund covers two Federal civilian retirement systems: the Civil Service Retirement System (CSRS) for employees hired before 1984 and the Federal Employee Retirement System (FERS), for employees hired after 1983.

The CSRS is financed by Federal civilian employees' contributions, agencies' contributions on behalf of the employees, appropriations and interest earned on investments in Federal debt.

Federal Hospital Insurance Trust Fund

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

The Federal Hospital Insurance Trust Fund is financed primarily by payroll taxes. It also receives income from interest earnings on Federal debt securities, Federal agencies' payments for the Social Security benefits earned by military and Federal civilian employees, and a portion of income taxes paid on Social Security benefits.

Hazardous Substance Superfund

The Hazardous Substance Superfund was authorized to address public health and environmental threats from spills of hazardous materials and from sites contaminated with hazardous substances. The Environmental Protection Agency (EPA) administers the fund.

Excise taxes collected on petroleum and chemicals, environmental taxes from all corporations with income in excess of $2 million, and interest earned on investments in Federal debt securities finance the Hazardous Substance Superfund.

Unemployment Trust Fund

The Unemployment Trust Fund protects workers who lose their jobs through no fault of their own. The unemployment insurance program is a unique Federal and State partnership based on Federal law, executed through State law by State officials. Labor administers the program.

Taxes on employers primarily fund the Unemployment Trust Fund. However, interest earned on investments in Federal debt securities also provides income to the fund. Appropriations have supplemented its income during periods of high and extended unemployment.

Airport and Airway Trust Fund

The Airport and Airway Trust Fund provides for airport improvement, maintenance of airport facilities and equipment, research and a portion of operations. Transportation administers the Airport and Airway Trust Fund.

Taxes received from transportation of persons and property in the air, fuel used in non-commercial aircraft, international departure taxes and interest earned on investments in Federal debt securities provide funding for the Airport and Airway Trust Fund.

Highway Trust Fund

The Highway Trust Fund was established to promote domestic interstate transportation, moving people and the transportation of goods. The fund provides Federal grants to States for highway construction and related transportation purposes. Transportation administers the Highway Trust Fund.

Earmarked taxes on gasoline and other fuel, certain tires, vehicle and truck use, and interest earned on investments in Federal debt securities provide all financing for the Highway Trust Fund.

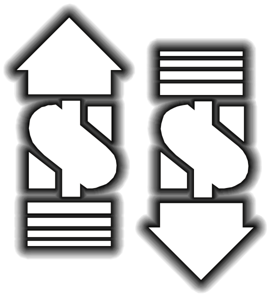
Dedicated Collections as of September 30*

(In billions of dollars)

			Assets		
Fund Name	**Receipts**	**Disbursements**	**Trust Fund Assets**	**Less Intragovernmental Assets**	**Consolidated Assets**
Federal Old-Age and Survivors Insurance Trust Fund	416.9	329.8	664.5	664.5	-
Federal Disability Insurance Trust Fund	63.2	49.5	78.2	78.2	-
Medicare Part A	138.2	136.6	120.5	120.5	-
Medicare Part B	82.0	76.9	40.1	40.1	-
Unemployment Trust Fund	32.5	23.5	72.1	72.1	-
Hazardous Substance Superfund	0.9	1.5	5.1	5.1	-
Highway Trust Fund	28.3	32.7	26.1	26.1	-
Airport and Airway Trust Fund	8.7	5.9	9.3	9.3	-
Civil Service Retirement and Disability Fund	50.8	59.0	460.0	459.7	0.3
Military Retirement Trust Fund	37.8	33.8	149.9	149.9	-

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

Note 18. Indian Trust Funds



The Indian Trust Funds differ from other dedicated collections reported in Note 17.

The Department of the Interior (Interior) has responsibility for the assets held in trust on behalf of American Indian Tribes and individuals. Trust funds are held in accounts for approximately 315 tribes, 317,000 individual Indian accounts and other funds, including the Alaska Native Escrow Fund. The assets held in trust for Native Americans are owned by the trust beneficiaries and are not Federal assets. Therefore, these amounts are not reflected in the Balance Sheet or Statement of Net Cost.

Indian Trust Fund balances presented below do not include trust land managed by the Government.

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

(In millions of dollars)	
Receipts	521.7
Disbursements	(465.4)
Receipts in excess of disbursements	56.3
Trust fund balances, beginning of year	2,403.7
Trust fund balances, end of year	2,460.0

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

(In millions of dollars)	
Receipts	313.6
Disbursements	(354.1)
Disbursements in excess of receipts	(40.5)
Trust fund balances, beginning of year	519.7
Trust fund balances, end of year	479.2

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United States Government Supplemental Information for the Year Ended September 30, 1998 (Unaudited)

Net Cost Detail

The Statement of Net Cost presents the cost of the Government's major functions. The objectives of each of the functions are described below. Also, the statement contains the definitions of "Gross cost," "Earned revenue" and "Net cost."

National Defense

Amounts listed under this function include the costs to provide military forces to deter war; to be prepared to engage in war; and to preserve the peace and security of the United States, the Territories, Commonwealth, its possessions and any area occupied by the United States. National defense also includes the cost to train, equip and compensate the armed forces; develop, acquire, utilize and dispose of weapons systems; conduct research and development to maintain technological superiority, cut costs and improve performance of weapon systems; and carry out other defense related activities.

Human Resources

Education, Training, Employment and Social Services

The "Education, training, employment and social services" function serves to extend knowledge and skills, enhance employment and employment opportunities, protect workplace standards and provide services to the needy.

Education, Training, Employment and Social Services

(In billions of dollars)

Subfunctions	Gross Cost	Earned Revenue	Net Cost
Elementary, secondary and vocational education	16.2	-	16.2
Higher education	13.6	3.3	10.3
Research and general education aids	2.5	-	2.5
Training and employment	5.4	-	5.4
Other labor services	0.8	-	0.8
Social services	16.2	-	16.2
Total education, training, employment and social services	54.7	3.3	51.4

Human Resources, cont.

Health

Listed under the "Health" function are the costs to promote physical and mental health, including the prevention of illness and accidents, and the Medicaid program. Although the Medicare program is the largest Federal health program, by law it is in a separate function for budget purposes. Also excluded from the "Health" subfunction is Federal health care for military personnel and veterans.

Health

(In billions of dollars)

Subfunctions	Gross Cost	Earned Revenue	Net Cost
Health care services	109.0	0.6	108.4
Health research and training	13.5	0.3	13.2
Consumer and occupational health and safety	1.9	0.2	1.7
Cost not allocated to subfunctions	0.9	-	0.9
Total health	125.3	1.1	124.2

Medicare

Federal hospital insurance and Federal supplementary medical programs make up Medicare. This function is not further subdivided. For more information on Medicare, see the note in the Stewardship Responsibilities section of Stewardship Information, and Note 17–Dedicated Collections.

Social Security

"Social Security" costs include payments to eligible beneficiaries of the old-age and survivors insurance and disability insurance programs. These are collectively referred to as "Social Security." The Social Security program is the single largest Federal program and is funded primarily by payroll taxes. For more information on Social Security, refer to the Stewardship Information section on Stewardship Responsibilities and Note 17–Dedicated Collections.

Income Security

The cost of providing payments to persons for whom no current service is rendered comprises the "Income security" function. Included are disability, unemployment, welfare and similar programs, except Social Security and income security for veterans. Also included are food stamps; special milk and child nutrition programs; unemployment compensation and workers' compensation; public assistance cash payments; benefits paid to the elderly and coal miners; and low- and moderate-income housing assistance. The cost of Federal pensions and retiree health benefits are allocated to other functions.

Income Security

(In billions of dollars)

Subfunctions	Gross Cost	Earned Revenue	Net Cost
Unemployment compensation	24.0	1.0	23.0
Housing assistance	27.1	-	27.1
Food and nutritional assistance	35.5	0.2	35.3
Other income security	81.4	4.4	77.0
Cost not allocated to subfunctions	13.8	2.1	11.7
Total income security	181.8	7.7	174.1

Human Resources, cont.

Veterans Benefits and Services

The amounts listed under this function include specific benefits and services paid to those with prior military service. Included are veterans compensation, life insurance, pensions, burial benefits, education, training, medical care, veterans housing and VA administrative expenses. The net cost for the subfunction titled "Income security for veterans" increased this fiscal year by $109.4 billion. This increase resulted from a change in actuarial methodology and interest rate assumptions.

Veterans Benefits and Services

(In billions of dollars)

Subfunctions	Gross Cost	Earned Revenue	Net Cost
Income security for veterans	137.6	-	137.6
Veterans education, training and rehabilitation	2.0	-	2.0
Hospital and medical care for veterans	18.5	0.6	17.9
Veterans housing	0.6	0.5	0.1
Other veterans benefits and services	1.5	0.2	1.3
Total veterans benefits and services	160.2	1.3	158.9

Physical Resources

Energy

The "Energy" subfunction includes the cost of promoting an adequate supply and appropriate use of energy to serve the needs of the economy.

Natural Resources and Environment

This function is comprised of cost incurred to develop, manage and maintain the Nation's natural resources and environment. Excluded are funding for community water supply programs, basic sewer systems and waste treatment plants that are part of community or regional development programs.

Energy

(In billions of dollars)

Subfunctions	Gross Cost	Earned Revenue	Net Cost
Energy supply	11.7	11.3	0.4
Energy conservation	0.7	-	0.7
Emergency energy preparedness	0.2	-	0.2
Energy information, policy and regulation	0.7	0.6	0.1
Total energy	13.3	11.9	1.4

Natural Resources and Environment

(In billions of dollars)

Subfunctions	Gross Cost	Earned Revenue	Net Cost
Water resources	7.9	1.6	6.3
Conservation and land management	5.3	1.0	4.3
Recreational resources	1.7	0.3	1.4
Pollution control and abatement	8.4	0.8	7.6
Other natural resources	3.7	0.5	3.2
Total natural resources and environment	27.0	4.2	22.8

Physical Resources, cont.

Commerce and Housing Credit

This function encompasses the promotion and regulation of the commerce, housing and deposit insurance industries. Included under "Commerce and housing credit" are costs to collect and disseminate social and economic data; provide general purpose subsidies to business and individuals, including credit subsidies to housing; and support the Postal Service fund.

Transportation

Grants to States and others for local or national transportation of passengers and property make up the bulk of the costs associated with this function. Included are costs to construct facilities; purchase equipment; do research, testing and evaluation; and provide operating subsidies to transportation facilities (such as airports and railroads).

Commerce and Housing Credit

(In billions of dollars)

Subfunctions	Gross Cost	Earned Revenue	Net Cost
Mortgage credit	2.9	4.8	(1.9)
Postal Service	78.1	60.0	18.1
Deposit insurance	3.3	1.0	2.3
Other advancement of commerce	12.2	4.9	7.3
Total commerce and housing credit	96.5	70.7	25.8

Transportation

(In billions of dollars)

Subfunctions	Gross Cost	Earned Revenue	Net Cost
Ground transportation	27.4	2.3	25.1
Air transportation	8.6	0.6	8.0
Water transportation	5.3	0.8	4.5
Other transportation	0.3	-	0.3
Total transportation	41.6	3.7	37.9

Community and Regional Development

The costs of promoting viable community economies by developing physical facilities or financial infrastructures comprise this function. Also included are the costs of developing transportation facilities that are integral parts of community development programs. Aid to businesses is usually excluded from this function unless it promotes the economic development of depressed areas and is not designed to promote particular lines of business for their own sake.

Community and Regional Development

(In billions of dollars)

Subfunctions	Gross Cost	Earned Revenue	Net Cost
Community development	7.1	0.2	6.9
Area and regional development	3.9	0.6	3.3
Disaster relief and insurance	3.7	1.6	2.1
Total community and regional development	14.7	2.4	12.3

Net Interest

Interest costs are primarily amounts on Federal securities held by the public. Interest payments on these securities are made by Treasury's Bureau of the Public Debt.

Other Functions

International Affairs

This function includes the cost of maintaining peaceful relations, supporting commerce and travel between the United States and the rest of the world, and promoting international security and economic development abroad.

General Science, Space and Technology

This function covers the costs of National Science Foundation research, NASA space programs and Energy general science research.

Agriculture

Costs associated with promoting agricultural economic stability and maintaining and increasing agricultural production are found under the "Agriculture" function.

International Affairs

(In billions of dollars)

Subfunctions	Gross Cost	Earned Revenue	Net Cost
International development and humanitarian assistance	10.5	1.1	9.4
International security assistance	2.4	1.0	1.4
Conduct of foreign affairs	4.9	0.6	4.3
Foreign information and exchange activities	1.3	-	1.3
International financial programs	5.7	3.3	2.4
Total international affairs	24.8	6.0	18.8

General Science, Space and Technology

(In billions of dollars)

Subfunctions	Gross Cost	Earned Revenue	Net Cost
General science and basic research	5.1	-	5.1
Space flight, research and supporting activities	14.8	0.1	14.7
Total general science, space and technology	19.9	0.1	19.8

Agriculture

(In billions of dollars)

Subfunctions	Gross Cost	Earned Revenue	Net Cost
Farm income stabilization	16.0	1.9	14.1
Agriculture research and service	3.1	0.4	2.7
Total agriculture	19.1	2.3	16.8

Other Functions, cont.

Administration of Justice

The costs of judicial services includes police protection, law enforcement (including civil rights), rehabilitation and incarceration of criminals, and the general maintenance of domestic order. It also includes the cost of providing court-appointed counsel or other legal services for individuals. Not found under "Administration of justice" are the costs of the legislative branch and police and guard activities that protect Federal property. Also, the cost of National Guard personnel and military personnel who are called upon occasionally to maintain public safety and the cost of military police are included under the national defense function.

General Government

"General Government" covers general overhead costs of the Federal Government. This includes legislative and executive activities as well as central fiscal, personnel and property activities. All activities reasonably or closely associated with other functions are included in those functions rather than "General Government."

Administration of Justice

(In billions of dollars)

Subfunctions	Gross Cost	Earned Revenue	Net Cost
Federal law enforcement activities	13.2	0.4	12.8
Federal litigative and judicial activities	6.6	0.5	6.1
Federal correctional activities	4.0	0.2	3.8
Criminal justice activities	4.5	0.3	4.2
Total administration of justice	28.3	1.4	26.9

General Government

(In billions of dollars)

Subfunctions	Gross Cost	Earned Revenue	Net Cost
Legislative functions	1.6	-	1.6
Executive direction and management	0.4	-	0.4
Central fiscal operations	11.0	2.0	9.0
General property and records management	12.1	0.4	11.7
Central personnel management	0.2	-	0.2
General purpose fiscal assistance	1.6	0.1	1.5
Other general Government	2.3	0.3	2.0
Total general Government	29.2	2.8	26.4

Reconciliation of the Excess of Net Cost Over Revenue to the Unified Budget Surplus

For fiscal 1998, the unified budget reported a surplus of $69.2 billion. For the same period, the Financial Report reports an excess of net cost over revenue of $133.8 billion. The difference between these two amounts occurs because they are prepared on different measurement basis to carry out their different objectives. The Financial Report is prepared on the accrual basis, according to standards recommended by the Federal Accounting Standards Advisory Board as issued by OMB and GAO. Under accrual accounting, transactions are reported when the events giving rise to the transactions occur rather when the cash is received or paid. By contrast, the unified budget is computed primarily on the cash basis, according to accepted budget concepts and policies. The most significant differences between these two bases involve the timing of recognition and measurement of revenue and costs.

The differences between these two basis of accounting can be divided into four primary categories.

1. Receipts recognized in the budget that are not recognized as revenue in the Financial Report, such as:

- Collections of pre-credit reform loans.
- Collections of taxes receivable.
- Collections of accounts receivable.
- Proceeds from the sale of capital assets representing "book value."

2. Revenues recognized in the Financial Report that are not recognized as receipts in the budget, such as:

- Increases in taxes receivable.
- Increases in accounts receivable.

3. Outlays recognized in the budget that are not recognized as costs in the Financial Report, such as:

- Purchases of inventory and property, plant and equipment.
- Reductions in accounts payable.

4. Costs recognized in the Financial Report that are not recognized as outlays in the budget, such as:

- Depreciation on property, plant and equipment.
- Increases in estimated liabilities for employee pensions.
- Increases in estimated liabilities for employee benefits.
- Increases in estimated environmental liabilities.
- Defaults on pre-credit reform loans.

In fiscal 1998, some of the the primary differences between the unified budget surplus and the excess of net cost over revenue were as follows:

1. VA compensation–An interest rate change was made in the actuarial assumptions for Veterans compensation that significantly increased the liability. This increase in the liability is recognized as a current period expense in the Financial Report. The related liability is disclosed in Note 10–Federal Employee and Veteran Benefits Payable.

2. Military and Federal employees–The increase in actuarial health and pension liabilities for military and Federal employees is recognized as a current period expense in the Financial Report. For a detailed disclosure, see Note 10–Federal Employee and Veteran Benefits Payable.

3. Environmental Expenses–The increase in estimated liabilities associated with removing, containing and/or disposing of hazardous waste is recognized as a current period expense in the Financial Report. For a detailed disclosure, see Note 11–Environmental Liabilities.

4. District of Columbia (DC) pension fund–In fiscal 1998, the Federal Government assumed management responsibility of the DC pension fund. The Financial Report recognized the transfer of this fund as a $8.5 billion liability for future payments to retirees, and as a $3 billion

Reconciliation of the Excess of Net Cost over Revenue to the Unified Budget Surplus for the Year Ended September 30 (Unaudited)

(In billions of dollars)

Unified budget surplus	69.2
Veterans compensation	(109.4)
Military and Federal employees	(39.8)
Environmental liabilities	(12.8)
District of Columbia pension fund	(5.5)
Net amount of all other differences	(35.5)
Financial Report's excess of net cost over revenue	(133.8)

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Appendix: List of Significant Government Entities Included and Excluded

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

Significant Entities Included in these Statements and their Website Addresses:

Executive Office of the President
Office of Management and Budget (OMB)
    www.whitehouse.gov/wh/eop/omb
Department of Agriculture (Agriculture)
    www.usda.gov
Department of Commerce (Commerce)
    www.doc.gov
Department of Defense (DOD)
    www.defenselink.mil
Department of Education (Education)
    www.ed.gov
Department of Energy (Energy)
    www.doe.gov
Department of Health and Human Services (HHS)
    www.hhs.gov
Department of Housing and Urban Development (HUD)
    www.hud.gov
Department of Interior (Interior)
    www.doi.gov
Department of Justice (Justice)
    www.usdoj.gov
Department of Labor (Labor)
    www.dol.gov
Department of State (State)
    www.state.gov
Department of the Air Force (Air Force)
    www.af.mil
Department of the Army (Army)
    www.army.mil
Department of the Navy (Navy)
    www.navy.mil
Department of the Treasury (Treasury)
    www.ustreas.gov
Department of Transportation (Transportation)
    www.dot.gov
Department of Veterans Affairs (VA)
    Www.va.gov
U. S. Postal Service
    www.usps.gov

Agency for International Development (AID)
    www.info.usaid.gov
Central Intelligence Agency (CIA)
    www.odci.gov
Commodity Credit Corporation
Commodity Futures Trading Commission
Corporation for Public Broadcasting
Environmental Protection Agency (EPA)
    www.epa.gov
Export-Import Bank of the United States
    www.exim.gov
Farm Credit Administration
    www.fca.gov
Federal Communications Commission (FCC)
    www.fcc.gov
Federal Deposit Insurance Corporation (FDIC)
    www.fdic.gov
Federal Emergency Management Agency (FEMA)
    www.fema.gov
Federal Trade Commission (FTC)
    www.ftc.gov
General Services Administration (GSA)
    www.gsa.gov
National Aeronautics and Space Administration (NASA)
    www.nasa.gov
National Archives and Records Administration
    www.nara.gov
National Credit Union Administration
    www.ncua.gov
National Science Foundation (NSF)
    www.nsf.gov
National Transportation Safety Board (NTSB)
    www.ntsb.gov
Office of Personnel Management (OPM)
    www.opm.gov
Pension Benefit Guaranty Corporation
    www.pbgc.gov

Entities Included, cont.

Securities and Exchange Commission (SEC)
www.sec.gov
Small Business Administration (SBA)
www.sba.gov
Smithsonian Institution
www.si.edu
Social Security Administration (SSA)
www.ssa.gov
Tennessee Valley Authority (TVA)
www.tva.gov
Nuclear Regulatory Commission
www.nrc.gov
Army Corps of Engineers
www.usace.army.mil
U.S. Information Agency
www.usia.gov
Enrichment Corporation-(until 7/28/98)

Other Boards and Commissions
Library of Congress (LOC)
www.loc.gov
Government Printing Office (GPO)
www.gpo.gov
General Accounting Office (GAO)
www.gao.gov
Congressional Budget Office (CBO)
www.cbo.gov
Other legislative and judicial-(cash transactions only)

Significant entities excluded from these statements:

Federal Reserve Banks (FRBs)
Board of Governors of the Federal Reserve System
Federal Retirement Thrift Investment Board
Thrift Savings Plan (TSP)
Farm Credit System
Federal Home Loan Banks
Financing Corporation
Freddie Mac
Fannie Mae
Sallie Mae
Resolution Funding Corporation
Army and Air Force Exchange Service
Navy Exchange Service Command
Marine Corps Exchange